

Quanex Building Products CORP  
Form 10-Q  
March 03, 2015

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended January 31, 2015

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-33913

QUANEX BUILDING PRODUCTS CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE

26-1561397

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification No.)

1800 West Loop South, Suite 1500, Houston, Texas 77027

(Address of principal executive offices and zip code)

Registrant's telephone number, including area code: (713) 961-4600

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

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

Class

Outstanding at February 25, 2015

Common Stock, par value \$0.01 per share

33,869,560



QUANEX BUILDING PRODUCTS CORPORATION

INDEX

|          |  |           |
|----------|--|-----------|
| PART I.  | <u>FINANCIAL INFORMATION</u>   | <u>1</u>  |
| Item 1:  | Financial Statements (Unaudited)   | <u>1</u>  |
|          | <u>Condensed Consolidated Balance Sheets – January 31, 2015 and October 31, 2014</u>                                   | <u>1</u>  |
|          | <u>Condensed Consolidated Statements of Income (Loss) – Three Months Ended January 31, 2015 and 2014</u>               | <u>2</u>  |
|          | <u>Condensed Consolidated Statements of Comprehensive Income (Loss) – Three Months Ended January 31, 2015 and 2014</u> | <u>3</u>  |
|          | <u>Condensed Consolidated Statements of Cash Flow – Three Months Ended January 31, 2015 and 2014</u>                   | <u>4</u>  |
|          | <u>Condensed Consolidated Statement of Stockholders’ Equity – Three Months Ended January 31, 2015</u>                  | <u>5</u>  |
|          | <u>Notes to Unaudited Condensed Consolidated Financial Statements</u>  | <u>6</u>  |
| Item 2:  | <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>                           | <u>22</u> |
| Item 3:  | <u>Quantitative and Qualitative Disclosures About Market Risk</u>  | <u>27</u> |
| Item 4:  | <u>Controls and Procedures</u>   | <u>28</u> |
| PART II. | <u>OTHER INFORMATION</u>   | <u>29</u> |
| Item 2:  | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>   | <u>29</u> |
| Item 6:  | <u>Exhibits</u>  | <u>29</u> |

---

Table of Contents

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

QUANEX BUILDING PRODUCTS CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Unaudited)

|  | January 31,<br>2015                  | October 31,<br>2014 |
|--|--------------------------------------|---------------------|
|  | (In thousands, except share amounts) |                     |
| <b>ASSETS</b>  |                                      |                     |
| Current assets:  |                                      |                     |
| Cash and cash equivalents  | \$63,924                             | \$120,384           |
| Accounts receivable, net of allowance for doubtful accounts of \$718 and \$698   | 39,334                               | 55,193              |
| Inventories, net (Note 3)  | 59,831                               | 57,358              |
| Deferred income taxes (Note 8)   | 24,662                               | 21,442              |
| Prepaid and other current assets   | 5,715                                | 6,052               |
| Total current assets   | 193,466                              | 260,429             |
| Property, plant and equipment, net of accumulated depreciation of \$205,872 and \$200,414  | 110,033                              | 109,487             |
| Deferred income taxes (Note 8)   | 7,295                                | 1,545               |
| Goodwill (Note 4)  | 68,802                               | 70,546              |
| Intangible assets, net (Note 4)  | 67,889                               | 70,150              |
| Other assets   | 5,524                                | 4,956               |
| Total assets   | \$453,009                            | \$517,113           |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                                      |                     |
| Current liabilities:   |                                      |                     |
| Accounts payable   | \$31,016                             | \$41,488            |
| Accrued liabilities  | 22,920                               | 32,482              |
| Income taxes payable (Note 8)  | —                                    | 107                 |
| Current maturities of long-term debt (Note 5)  | 190                                  | 199                 |
| Total current liabilities  | 54,126                               | 74,276              |
| Long-term debt (Note 5)  | 568                                  | 586                 |
| Deferred pension and postretirement benefits (Note 6)  | 5,309                                | 4,818               |
| Liability for uncertain tax positions (Note 8)   | 548                                  | 4,626               |
| Other liabilities  | 11,152                               | 11,887              |
| Total liabilities  | 71,703                               | 96,193              |
| Commitments and contingencies (Note 9)   |                                      |                     |
| Stockholders' equity:  |                                      |                     |
| Preferred stock, no par value, shares authorized 1,000,000; issued and outstanding - none  | —                                    | —                   |
| Common stock, \$0.01 par value, shares authorized 125,000,000; issued 37,622,163 and 37,632,032, respectively; outstanding 33,976,102 and 36,214,332, respectively | 376                                  | 376                 |
| Additional paid-in-capital   | 249,497                              | 249,600             |
| Retained earnings  | 207,760                              | 202,319             |
| Accumulated other comprehensive loss   | (8,528                               | ) (5,708            |
| Less: Treasury stock at cost, 3,646,061 and 1,417,700 shares, respectively   | ) (67,799                            | ) (25,667           |
| Total stockholders' equity   | 381,306                              | 420,920             |
| Total liabilities and stockholders' equity   | \$453,009                            | \$517,113           |

The accompanying notes are an integral part of the financial statements.



Table of Contents

QUANEX BUILDING PRODUCTS CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (LOSS)  
(Unaudited)

|  | Three Months Ended<br>January 31,        |             |
|--|--|-------------|
|  | 2015                                     | 2014        |
|  | (In thousands, except per share amounts) |             |
| Net sales  | \$ 127,893                               | \$ 126,379  |
| Cost and expenses:   |  |             |
| Cost of sales (excluding depreciation and amortization)                                    | 105,804                                  | 96,189      |
| Selling, general and administrative  | 19,496                                   | 22,503      |
| Depreciation and amortization  | 8,208                                    | 8,544       |
| Asset impairment charges   | —  | 5           |
| Operating loss   | (5,615 )                                 | (862 )      |
| Non-operating income (expense):  |  |             |
| Interest expense   | (141 )                                   | (141 )      |
| Other, net   | (151 )                                   | 96          |
| Loss from continuing operations before income taxes  | (5,907 )                                 | (907 )      |
| Income tax benefit (expense)   | 2,813                                    | (304 )      |
| Loss from continuing operations  | (3,094 )                                 | (1,211 )    |
| Income (loss) from discontinued operations, net of tax of \$15 and \$(1,579), respectively | 23                                       | (2,689 )    |
| Net loss   | \$ (3,071 )                              | \$ (3,900 ) |
| Basic loss per common share:   |  |             |
| From continuing operations   | \$ (0.09 )                               | \$ (0.03 )  |
| From discontinued operations   | —  | (0.08 )     |
| Loss per share, basic  | \$ (0.09 )                               | \$ (0.11 )  |
| Diluted loss per common share:   |  |             |
| From continuing operations   | \$ (0.09 )                               | \$ (0.03 )  |
| From discontinued operations   | —  | (0.08 )     |
| Loss per share, diluted  | \$ (0.09 )                               | \$ (0.11 )  |
| Weighted-average common shares outstanding:  |  |             |
| Basic  | 35,079                                   | 37,003      |
| Diluted  | 35,079                                   | 37,003      |
| Cash dividends per share   | \$ 0.04                                  | \$ 0.04     |

The accompanying notes are an integral part of the financial statements.

Table of Contents

QUANEX BUILDING PRODUCTS CORPORATION  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
 (Unaudited)

|   | Three Months Ended<br>January 31, |            |
|---|-----------------------------------|------------|
|   | 2015                              | 2014       |
|   | (In thousands)                    |            |
| Net loss  | \$(3,071 )                        | \$(3,900 ) |
| Other comprehensive (loss) income:                              |                                   |            |
| Foreign currency translation adjustments (loss) gain (pretax)   | (2,849 )                          | 55         |
| Foreign currency translation adjustments tax benefit            | —                                 | 14         |
| Change in pension from net unamortized gain adjustment (pretax) | —                                 | 122        |
| Change in pension from net unamortized gain tax benefit         | 29                                | —          |
| Other comprehensive (loss) income, net of tax                   | (2,820 )                          | 191        |
| Comprehensive loss  | \$(5,891 )                        | \$(3,709 ) |

The accompanying notes are an integral part of the financial statements.

Table of Contents

QUANEX BUILDING PRODUCTS CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW  
(Unaudited)

|  | Three Months Ended<br>January 31, |            |
|--|-----------------------------------|------------|
|  | 2015                              | 2014       |
|  | (In thousands)                    |            |
| Operating activities:  |                                   |            |
| Net loss   | \$(3,071 )                        | \$(3,900 ) |
| Adjustments to reconcile net loss to cash used for operating activities: |                                   |            |
| Depreciation and amortization  | 8,208                             | 10,294     |
| Stock-based compensation   | 1,264                             | 1,090      |
| Deferred income tax benefit  | (3,239 )                          | (1,885 )   |
| Excess tax benefit from share-based compensation                         | (60 )                             | (1 )       |
| Asset impairment charges   | —                                 | 510        |
| Other, net   | (478 )                            | 728        |
| Changes in assets and liabilities, net of effects from acquisitions:     |                                   |            |
| Decrease in accounts receivable  | 15,323                            | 26,654     |
| Increase in inventory  | (2,920 )                          | (15,998 )  |
| Increase in other current assets   | (12 )                             | (594 )     |
| Decrease in accounts payable   | (10,298 )                         | (10,894 )  |
| Decrease in accrued liabilities  | (10,934 )                         | (15,027 )  |
| (Decrease) increase in income taxes payable                              | (58 )                             | 26         |
| Increase in deferred pension and postretirement benefits                 | 520                               | 915        |
| Increase (decrease) in other long-term liabilities                       | 13                                | (1,087 )   |
| Other, net   | (5 )                              | (2,315 )   |
| Cash used for operating activities                                       | (5,747 )                          | (11,484 )  |
| Investing activities:  |                                   |            |
| Acquisitions, net of cash acquired                                       | —                                 | (5,161 )   |
| Capital expenditures   | (7,321 )                          | (6,748 )   |
| Proceeds from property insurance claim                                   | 513                               | 400        |
| Proceeds from disposition of capital assets                              | —                                 | 303        |
| Cash used for investing activities                                       | (6,808 )                          | (11,206 )  |
| Financing activities:  |                                   |            |
| Repayments of other long-term debt                                       | (23 )                             | (26 )      |
| Common stock dividends paid  | (1,448 )                          | (1,490 )   |
| Issuance of common stock   | —                                 | 331        |
| Excess tax benefit from share-based compensation                         | 60                                | 1          |
| Purchase of treasury stock   | (42,748 )                         | —          |
| Cash used for financing activities                                       | (44,159 )                         | (1,184 )   |
| Effect of exchange rate changes on cash and cash equivalents             | 254                               | (55 )      |
| Decrease in cash and cash equivalents                                    | (56,460 )                         | (23,929 )  |
| Cash and cash equivalents at beginning of period                         | 120,384                           | 49,736     |
| Cash and cash equivalents at end of period                               | \$63,924                          | \$25,807   |
| The accompanying notes are an integral part of the financial statements. |                                   |            |



Table of Contents

QUANEX BUILDING PRODUCTS CORPORATION  
 CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
 (Unaudited)

| Three Months Ended January 31, 2015                           | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Treasury<br>Stock | Total<br>Stockholders'<br>Equity |
|---|-----------------|----------------------------------|----------------------|---|-------------------|----------------------------------|
| (In thousands, no per share amounts shown except in verbiage) |                 |                                  |                      |   |                   |                                  |
| Balance at October 31, 2014                                   | \$376           | \$249,600                        | \$202,319            | \$ (5,708 )                                   | \$(25,667 )       | \$ 420,920                       |
| Net loss  | —               | —                                | (3,071 )             | —   | —                 | (3,071 )                         |
| Foreign currency translation adjustment                       | —               | —                                | —                    | (2,849 )                                      | —                 | (2,849 )                         |
| Common dividends (\$0.04 per share)                           | —               | —                                | (1,448 )             | —   | —                 | (1,448 )                         |
| Purchase of treasury stock                                    | —               | —                                | —                    | —   | (43,404 )         | (43,404 )                        |
| Stock-based compensation activity:                            |                 |                                  |                      |   |                   |                                  |
| Expense related to stock-based compensation                   | —               | 1,264                            | —                    | —   | —                 | 1,264                            |
| Tax benefit from share-based compensation                     | —               | 60                               | —                    | —   | —                 | 60                               |
| Restricted stock awards granted                               | —               | (1,273 )                         | —                    | —   | 1,273             | —                                |
| Recognition of unrecognized tax benefit (Note 8)              | —               | —                                | 10,003               | —   | —                 | 10,003                           |
| Other   | —               | (154 )                           | (43 )                | 29  | (1 )              | (169 )                           |
| Balance at January 31, 2015                                   | \$376           | \$249,497                        | \$207,760            | \$ (8,528 )                                   | \$(67,799 )       | \$ 381,306                       |

The accompanying notes are an integral part of the financial statements.

Table of Contents

QUANEX BUILDING PRODUCTS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Nature of Operations and Basis of Presentation

Quanex Building Products Corporation manufactures components primarily for the window and door (fenestration) industry, which include (1) energy-efficient flexible insulating glass spacers, (2) extruded vinyl profiles, (3) window and door screens, and (4) precision-formed metal and wood products for original equipment manufacturers (OEMs), as well as certain non-fenestration components, which include solar panel sealants, wood flooring and furniture moldings. Quanex Building Products Corporation serves a primary customer base in North America and also serves customers in international markets through operating plants in the United Kingdom and Germany, as well as through sales and marketing efforts in other countries.

Unless the context indicates otherwise, references to "Quanex", the "Company", "we", "us" and "our" refer to the consolidated business operations of Quanex Building Products Corporation and its subsidiaries.

The accompanying interim condensed consolidated financial statements include the accounts of Quanex Building Products Corporation. All intercompany accounts and transactions have been eliminated in consolidation. These financial statements have been prepared by us, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) have been condensed or omitted pursuant to such rules and regulations. The consolidated balance sheet as of October 31, 2014 was derived from audited financial information, but does not include all disclosures required by U.S. GAAP. The accompanying financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto, included in our Annual Report on Form 10-K for the fiscal year ended October 31, 2014. In our opinion, the accompanying financial statements contain all adjustments (which consist of normal recurring adjustments, except as disclosed herein) necessary to fairly present our financial position, results of operations and cash flows for the interim periods. The results of operations for the periods presented are not necessarily indicative of the results to be expected for the full year or for any future periods.

In preparing financial statements, we make informed judgments and estimates that affect the reported amounts of assets and liabilities as of the date of the financial statements and affect the reported amounts of revenues and expenses during the reporting period. We review our estimates on an on-going basis, including those related to impairment of long lived assets and goodwill, contingencies and income taxes. Changes in facts and circumstances may result in revised estimates and actual results may differ from these estimates.

Discontinued Operations

Prior to April 1, 2014, we had two reportable business segments: (1) Engineered Products and (2) Aluminum Sheet Products. On April 1, 2014, we sold our interest in a limited liability company which held the assets of the Nichols Aluminum business (Nichols), the sole operating segment included in our Aluminum Sheet Products reportable segment, to Aleris International, Inc.

(Aleris), a privately held Delaware corporation which provides aluminum rolled products and extrusions, aluminum recycling and specification aluminum alloy production. We received net proceeds of \$107.4 million, which is net of a working capital adjustment of \$2.6 million which we paid in June 2014, resulting in a gain on the transaction of \$24.1 million, net of related taxes of \$15.1 million.

Nichols represented a significant portion of our assets and operations. We accounted for this sale as a discontinued operation. We revised our financial statements and removed the results of operations of Nichols from net income (loss) from continuing operations, and presented separately as income (loss) from discontinued operations, net of taxes, for each of the accompanying condensed consolidated statements of income (loss). Unless noted otherwise, the notes to the consolidated financial statements pertain to our continuing operations.

For cash flow statement presentation, the sources and uses of cash for Nichols are presented as operating, investing and financing cash flows, as applicable, combined with such cash flows for continuing operations for the three months ended January 31, 2014, as permitted by U.S. GAAP.

We have historically purchased rolled aluminum product from Nichols. We expect to continue to purchase aluminum from Nichols in the normal course of business. We considered whether these aluminum purchases and the services provided under a transition services agreement for the period from April 1, 2014 to May 31, 2014 constituted significant continuing involvement with Nichols. Since these purchases are in the normal course of business and the services provided were for a relatively short period and are customary for similar transactions, we determined that this involvement was not deemed significant and did not preclude accounting for the transaction as a discontinued operation. Our purchases of aluminum product from Nichols for the three-month periods ended January 31, 2015 and 2014 were \$4.5 million and \$3.5 million, respectively.

Table of Contents

## QUANEX BUILDING PRODUCTS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

In November 2013, Nichols experienced a fire at its Decatur, Alabama facility, which damaged a cold mill used to roll aluminum sheet to a desired thickness. The loss was insured, subject to a \$0.5 million deductible. We capitalized \$6.5 million to rebuild the asset, which was returned to service as of March 31, 2014. We incurred costs of \$2.3 million associated with this loss, including an impairment of \$0.5 million related to retirement of the asset, moving costs, outside service costs, clean-up and the deductible. To date, we have received insurance proceeds of \$5.3 million. We have revised our estimate of total insurance proceeds expected related to this loss to approximately \$6.8 million, resulting in an expected gain on involuntary conversion of \$4.4 million of which we have recognized \$2.9 million. We estimate the remaining gain on involuntary conversion at \$1.5 million and that this gain will be recognized during fiscal 2015, when and to the extent that insurance proceeds are received, which will result in an increase in income from discontinued operations, net of tax.

Income from discontinued operations for the three months ended January 31, 2015 was reduced by \$0.3 million, net of tax, associated with a health insurance claim amount reimbursable to the stop-loss insurance provider.

The following table summarizes the operating results for Nichols for the three-month period ended January 31, 2014:

|                               | Three Months Ended<br>January 31,<br>(In thousands, except per<br>share amounts) |   |
|-------------------------------|--|---|
| Net sales                     | \$ 79,491  |   |
| Operating loss                | (4,251   | ) |
| Loss before income taxes      | (4,268   | ) |
| Income tax benefit            | 1,579  |   |
| Net loss                      | \$ (2,689  | ) |
| Basic loss per common share   | \$ (0.08   | ) |
| Diluted loss per common share | \$ (0.08   | ) |

**Product Sales**

We produce a wide variety of products that are used in the fenestration industry, including: window and door systems design, engineering and fabrication; accessory trim profiles with real wood veneers and wood grain laminate finishes; window spacer systems; extruded vinyl products; metal fabrication; and astragals, thresholds and screens. In addition, we produce certain non-fenestration products, including: wood and aluminum grilles, flooring and furniture moldings, solar edge tape and other products. Historically, we have presented product sales information at the reportable segment level, and we attribute our net sales based on the location of the customer. We currently have one reportable operating segment, which includes this breadth of product offerings across the fenestration and non-fenestration spectrum, but for which there are common economic and other characteristics that meet the criteria for aggregation, as discussed in Note 14, "Segment Information".

The following table summarizes our product sales for the three-month periods ended January 31, 2015 and 2014 into general groupings to provide additional information to our shareholders.

|                              | Three Months Ended<br>January 31, |          |
|------------------------------|-----------------------------------|----------|
|                              | 2015                              | 2014     |
|                              | (In thousands)                    |          |
| Product Group:               |                                   |          |
| United States - fenestration | \$96,191                          | \$97,424 |
| International - fenestration | 17,776                            | 18,623   |

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|                                  |           |           |
|----------------------------------|-----------|-----------|
| United States - non-fenestration | 9,474     | 7,191     |
| International - non-fenestration | 4,452     | 3,141     |
| Total sales                      | \$127,893 | \$126,379 |

7

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Table of Contents

## QUANEX BUILDING PRODUCTS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

## 2. Acquisitions

On December 31, 2013, we acquired certain vinyl extrusion assets of Atrium Windows and Doors, Inc. (Atrium) at a facility in Greenville, Texas, for \$5.2 million in cash (Greenville). We accounted for this transaction as a business combination resulting in an insignificant gain on the purchase. We entered into a supply agreement with Atrium related to the products produced at Greenville. We believe this acquisition expanded our vinyl extrusion capacity and positioned us with a platform from which to better serve our customers in the southern United States.

The purchase price has been allocated to the fair value of the assets acquired and liabilities assumed, as indicated in the table below.

|   | As of Date of<br>Opening Balance Sheet<br>(In thousands) |
|---|--|
| Net assets acquired:                            |  |
| Inventories                                     | \$ 161   |
| Prepaid and other current assets                | 145  |
| Property, plant and equipment                   | 4,695  |
| Intangible assets                               | 290  |
| Deferred income tax liability                   | (50 )  |
| Net assets acquired                             | \$5,241  |
| Consideration:                                  |  |
| Cash, net of cash and cash equivalents acquired | \$5,161  |
| Gain recognized on bargain purchase             | \$80   |

We used recognized valuation techniques to determine the fair value of the assets and liabilities, including the income approach for customer relationships, with a discount rate that reflects the risk of the expected future cash flows. The gain on bargain purchase of approximately \$0.1 million is included in "Other, net" on our condensed consolidated statement of income (loss) for the three months ended January 31, 2014.

Pro forma results of operations were omitted because this acquisition was not deemed to be material to our results of operations for the three months ended January 31, 2014.

## 3. Inventories

Inventories consisted of the following at January 31, 2015 and October 31, 2014:

|                                    | January 31,<br>2015 | October 31,<br>2014 |
|------------------------------------|---------------------|---------------------|
|                                    | (In thousands)      |                     |
| Raw materials                      | \$38,133            | \$36,751            |
| Finished goods and work in process | 26,614              | 25,558              |
| Supplies and other                 | 1,063               | 806                 |
| Total                              | 65,810              | 63,115              |
| Less: Inventory reserves           | 5,979               | 5,757               |
| Inventories, net                   | \$59,831            | \$57,358            |

Fixed costs related to excess manufacturing capacity, if any, have been expensed in the period they were incurred and, therefore, are not capitalized into inventory.

Our inventories at January 31, 2015 and October 31, 2014 were valued using the following costing methods:



Table of Contents

## QUANEX BUILDING PRODUCTS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

|       | January 31,<br>2015 | October 31,<br>2014 |
|-------|---------------------|---------------------|
|       | (In thousands)      |                     |
| LIFO  | \$6,908             | \$5,122             |
| FIFO  | 52,923              | 52,236              |
| Total | \$59,831            | \$57,358            |

During interim periods, we estimate a LIFO reserve based on our expectations of year-end inventory levels and costs. If our calculations indicate that an adjustment at year-end will be required, we record a proportionate share of this amount during the period. At year-end, we calculate the actual LIFO reserve and record an adjustment for the difference between the annual calculation and any estimates recognized during the interim periods. Because the interim projections are subject to many factors beyond our control, the results could differ significantly from the year-end LIFO calculation. We recorded no interim LIFO allocation for the three-month periods ended January 31, 2015 and 2014.

For inventories valued under the LIFO method, replacement cost exceeded the LIFO value by approximately \$1.4 million at January 31, 2015 and October 31, 2014.

## 4. Goodwill and Intangible Assets

## Goodwill

The change in the carrying amount of goodwill for the three months ended January 31, 2015 was as follows:

|  | Three Months Ended<br>January 31, 2015<br>(In thousands) |
|--|--|
| Beginning balance as of November 1, 2014 | 70,546   |
| Foreign currency translation adjustment  | (1,744)  |
| Balance as of the end of the period      | \$68,802   |

During the fourth quarter of 2014, we evaluated our goodwill balances for indicators of impairment and performed an annual goodwill impairment test to determine the recoverability of these assets. Three of our reporting units had goodwill at October 31, 2014 which totaled \$55.2 million, \$12.6 million and \$2.8 million. We determined that our goodwill was not impaired and there have been no triggering events to indicate impairment during the three months ended January 31, 2015, so no additional testing was deemed necessary.

## Identifiable Intangible Assets

Amortizable intangible assets consisted of the following as of January 31, 2015 and October 31, 2014:

|                              | January 31, 2015         |                             | October 31, 2014         |                             |
|------------------------------|--------------------------|-----------------------------|--------------------------|-----------------------------|
|                              | Gross Carrying<br>Amount | Accumulated<br>Amortization | Gross Carrying<br>Amount | Accumulated<br>Amortization |
|                              | (In thousands)           |                             |                          |                             |
| Customer relationships       | \$53,083                 | \$20,722                    | \$53,083                 | \$19,700                    |
| Trademarks and trade names   | 44,722                   | 21,036                      | 44,722                   | 20,343                      |
| Patents and other technology | 25,244                   | 13,702                      | 25,244                   | 13,228                      |
| Other                        | 1,392                    | 1,092                       | 1,392                    | 1,020                       |
| Total                        | \$124,441                | \$56,552                    | \$124,441                | \$54,291                    |



We do not estimate a residual value associated with these intangible assets. Included in intangible assets as of January 31, 2015 were customer relationships of \$0.2 million associated with the Greenville acquisition. These assets have estimated remaining useful lives of four years. See Note 2, "Acquisitions", included herewith.

We had aggregate amortization expense of \$2.3 million for each of the three-month periods ended January 31, 2015 and 2014.

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Table of Contents

## QUANEX BUILDING PRODUCTS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Estimated remaining amortization expense, assuming current intangible balances and no new acquisitions, for each of the fiscal years ending October 31, was as follows (in thousands):

|                              | Estimated<br>Amortization Expense |
|------------------------------|-----------------------------------|
| 2015 (remaining nine months) | \$6,916                           |
| 2016                         | 8,713                             |
| 2017                         | 8,607                             |
| 2018                         | 8,360                             |
| 2019                         | 7,571                             |
| Thereafter                   | 27,722                            |
| Total                        | \$67,889                          |

## 5. Debt and Capital Lease Obligations

Debt consisted of the following at January 31, 2015 and October 31, 2014:

|  | January 31,<br>2015 | October 31,<br>2014 |
|--|---------------------|---------------------|
|  | (In thousands)      |                     |
| Revolving Credit Facility                                    | \$—                 | \$—                 |
| City of Richmond, Kentucky Industrial Building Revenue Bonds | 600                 | 600                 |
| Capital lease obligations                                    | 158                 | 185                 |
| Total debt   | 758                 | 785                 |
| Less: Current maturities of long-term debt                   | 190                 | 199                 |
| Long-term debt   | \$568               | \$586               |

On January 28, 2013, we entered into a Senior Unsecured Revolving Credit Facility (the Credit Facility) that has a five-year term and permits aggregate borrowings at any time of up to \$150.0 million, with a letter of credit sub-facility, a swing line sub-facility and a multi-currency sub-facility. Borrowings denominated in United States dollars bear interest at a spread above the London Interbank Borrowing Rate (LIBOR) or a base rate derived from the prime rate. Foreign denominated borrowings bear interest at a spread above the LIBOR applicable to such currencies. Subject to customary conditions, we may request that the aggregate commitments under the Credit Facility be increased by up to \$100.0 million, with total commitments not to exceed \$250.0 million.

The Credit Facility requires us to comply with certain financial covenants, the terms of which are defined therein. Specifically, we must not permit, on a quarterly basis, our ratio of consolidated EBITDA to consolidated interest expense as defined (Minimum Interest Coverage Ratio), to fall below 3.00:1 or our ratio of consolidated funded debt to consolidated EBITDA, as defined (Maximum Consolidated Leverage Ratio), to exceed 3.25:1. The Maximum Consolidated Leverage Ratio is the ratio of consolidated EBITDA to consolidated interest expense, in each case for the previous four consecutive fiscal quarters. EBITDA is defined by the indenture to include pro forma EBITDA of acquisitions and to exclude certain items such as goodwill and intangible asset impairments and certain other non-cash charges and non-recurring items. Subject to our compliance with the covenant requirements, the amount available under the Credit Facility is a function of: (1) our trailing twelve-month EBITDA; (2) the Minimum Interest Coverage Ratio and Maximum Consolidated Leverage Ratio allowed under the Credit Facility; and (3) the aggregate amount of our outstanding debt and letters of credit. As of January 31, 2015, we were in compliance with the financial covenants set forth in the Credit Facility.

As of January 31, 2015, the amount available to us for use under the Credit Facility was \$124.7 million and we had outstanding letters of credit of \$6.0 million. For the three-month period ended January 31, 2015, we did not borrow any amounts under the Credit Facility, and thus had no outstanding borrowings at January 31, 2015. Our current borrowing rate under the Credit Facility was 3.25% and 1.20% for the swing-line sub facility and the revolver, respectively, at January 31, 2015. As of October 31, 2014, the amount available to us for use under the Credit Facility was \$140.7 million and we had outstanding letters of credit of \$6.1 million. Our borrowing rate under the Credit Facility was 3.25% and 1.20% for the swing-line sub facility and the revolver, respectively, at October 31, 2014.

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Table of Contents

## QUANEX BUILDING PRODUCTS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

## 6. Retirement Plans

## Pension Plan

Our non-contributory, single employer defined benefit pension plan covers a majority of our employees. Employees of acquired companies are covered after a transitional period. The net periodic pension cost for this plan for the three-month periods ended January 31, 2015 and 2014 was as follows:

|                                | Three Months Ended  |        |
|--------------------------------|---------------------|--------|
|                                | January 31,<br>2015 | 2014   |
|                                | (In thousands)      |        |
| Service cost                   | \$881               | \$920  |
| Interest cost                  | 253                 | 263    |
| Expected return on plan assets | (461                | ) (423 |
| Amortization of net loss       | —                   | —      |
| Net periodic benefit cost      | \$673               | \$760  |

During 2014, we contributed approximately \$4.1 million to fund our plan, and we expect to make a contribution to our plan in September 2015.

## Other Plans

We also have a supplemental benefit plan covering certain executive officers and a non-qualified deferred compensation plan covering members of the Board of Directors and certain key employees. As of January 31, 2015 and October 31, 2014, our liability under the supplemental benefit plan was approximately \$1.8 million and \$1.9 million, respectively, and under the deferred compensation plan was approximately \$3.4 million for both periods. In January 2014, we paid \$3.3 million related to the deferred compensation plan as a result of the separation of our former chief executive officer in July 2013. We record the current portion of liabilities under these plans under the caption "Accrued Liabilities," and the long-term portion was included under the caption "Other Liabilities" in the accompanying balance sheets.

## 7. Warranty Obligations

We accrue warranty obligations as we recognize revenue associated with certain products. We make provisions for our warranty obligations based upon historical experience of costs incurred for such obligations adjusted, as necessary, for current conditions and factors. During January 2014, we reduced our warranty accrual by \$2.8 million for certain products associated with our insulating glass business that were discontinued in a prior year and for which claim activity for a particular customer had ceased. There are significant uncertainties and judgments involved in estimating our warranty obligations, including changing product designs, differences in customer installation processes and future claims experience which may vary from historical claims experience. Therefore, the ultimate amount we incur as warranty costs in the near and long-term may not be consistent with our current estimate.

Table of Contents

## QUANEX BUILDING PRODUCTS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

A reconciliation of the activity related to our accrued warranty, including both the current and long-term portions (reported in accrued liabilities and other liabilities, respectively, on the accompanying condensed consolidated balance sheet) follows:

|  | Three Months Ended<br>January 31, 2015<br>(In thousands) |
|--|--|
| Beginning balance as of November 1, 2014           | \$671  |
| Provision for warranty expense                     | 226  |
| Change in accrual for preexisting warranties       | 317  |
| Warranty costs paid                                | (76)   |
| Total accrued warranty as of the end of the period | \$1,138  |
| Less: Current portion of accrued warranty          | 757  |
| Long-term portion of accrued warranty              | \$381  |

The increase in the warranty accrual during the three months ended January 31, 2015 was primarily attributable to a specific claim related to our vinyl extrusion products stemming from a change in formulation.

## 8. Income Taxes

To determine our income tax expense for interim periods, consistent with accounting standards, we apply the estimated annual effective income tax rate to year-to-date results. Our estimated annual effective tax rates from continuing operations for the three months ended January 31, 2015 and 2014, were a benefit of 47.6% and expense of 33.5%, respectively. The increase in the 2015 effective tax rate is attributable to a discrete benefit item resulting from the reassessment of our uncertain tax position related to the liability associated with the tax benefit recorded in conjunction with the 2008 spin-off of Quanex from a predecessor company. Excluding this item, the effective tax rate was 34.1%. The decrease in the 2014 effective rate is attributable to the change in the tax status of our facility in the United Kingdom (UK). On November 1, 2013, the assets of our UK branch were contributed to a newly formed wholly-owned UK subsidiary. This change resulted in a U.S. taxable charge and was booked as a discrete item in the first quarter. Without the discrete item, the 2014 effective tax rate was a benefit of 38.7%.

As of January 31, 2015, our unrecognized tax benefit (UTB) relates to certain state tax items regarding the interpretation of tax laws and regulations. The total UTB at October 31, 2014 included the UTB associated with the 2008 spin-off and totaled \$11.4 million. Of this amount, \$4.6 million was recorded as a liability for uncertain tax positions and \$6.8 million was recorded as deferred income taxes (non-current assets) on the accompanying condensed consolidated balance sheet. During the three months ended January 31, 2015, we reassessed our unrecognized tax benefit related to the 2008 spin-off of Quanex from a predecessor company and recognized the full benefit of the tax positions taken. This reduced the liability for uncertain tax positions by \$4.0 million and increased deferred income taxes (non-current assets) by \$6.8 million and resulted in a non-cash increase in retained earnings of \$10.0 million and an increase in income tax benefit of \$0.8 million. At January 31, 2015, \$0.5 million is recorded as a liability for uncertain tax positions. The disallowance of the UTB would not materially affect the annual effective tax rate.

We evaluate the likelihood of realization of our deferred tax assets by considering both positive and negative evidence. We believe there is no need for a valuation allowance of the federal net operating losses. We will continue to evaluate our position throughout the year. We maintain a valuation allowance for certain state net operating losses which totaled \$1.4 million at January 31, 2015.

Judgment is required in assessing the future tax consequences of events that have been recognized in our financial statements or tax returns. The final outcome of the future tax consequences of legal proceedings, if any, as well as the outcome of competent authority proceedings, changes in regulatory tax laws, or interpretation of those tax laws could impact our financial statements. We are subject to the effect of these matters occurring in various jurisdictions. We do not believe any of the UTB will be recognized within the next twelve months.

Our federal income tax returns for the tax years ended October 31, 2011 and 2012 were examined by the Internal Revenue Service and no adjustments were made.

Table of Contents

QUANEX BUILDING PRODUCTS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

9. Contingencies

Environmental

We are subject to extensive laws and regulations concerning the discharge of materials into the environment and the remediation of chemical contamination. We accrue our best estimates of our remediation obligations and adjust these accruals when further information becomes available or circumstances change.

We are currently not subject to any remediation activities. Prior to April 1, 2014, we had remediation activities associated with one of our subsidiaries, Nichols Aluminum-Alabama, LLC, a component business unit of Nichols. As discussed in Note 1, "Nature of Operations and Basis of Presentation - Discontinued Operations", on April 1, 2014, we sold Nichols and the liabilities associated with this on-going remediation effort were assumed by Aleris International, Inc.

Spacer Migration

We were notified by certain customers through our German operation that the vapor barrier employed on certain spacer products manufactured prior to March 2014 may fail and permit spacer migration in certain extreme circumstances. This product does not have a specific customer warranty, but we have received claims from customers related to this issue, which we continue to investigate. We incurred expense of \$1.8 million during 2014 associated with this issue, including an accrual of \$1.2 million at October 31, 2014 for any asserted claim that we deem to be reasonably possible and estimable. The balance of this accrual at January 31, 2015 was \$0.9 million, reflecting net claim payments of \$0.2 million and a translation adjustment of approximately \$0.1 million. We cannot estimate any future liability with regard to unasserted claims. We will investigate any future claims, but we are not obligated to honor any future claims.

Litigation

From time to time, we, along with our subsidiaries, are involved in various litigation matters arising in the ordinary course of our business. Although the ultimate resolution and impact of such litigation is not presently determinable, we believe that the eventual outcome of such litigation will not have a material adverse effect on our overall financial condition, results of operations or cash flows.

10. Derivative Instruments

Our derivative activities are subject to the management, direction, and control of the Chief Financial Officer and Chief Executive Officer. Certain transactions in excess of specified levels require further approval from the Board of Directors.

The nature of our business activities requires the management of various financial and market risks, including those related to changes in foreign currency exchange rates. We have historically used foreign currency forwards and options to mitigate or eliminate certain of those risks at our subsidiaries. We use foreign currency contracts to offset fluctuations in the value of accounts receivable and accounts payable balances that are denominated in currencies other than the United States dollar, including the Euro, British Pound and Canadian Dollar. Currently, we do not enter into derivative transactions for speculative or trading purposes. We are exposed to credit loss in the event of nonperformance by the counterparties to our derivative transactions. We attempt to mitigate this risk by monitoring the creditworthiness of our counterparties and limiting our exposure to individual counterparties. In addition, we have established master netting agreements in certain cases to facilitate the settlement of gains and losses on specific derivative contracts.

We have not designated any of our derivative contracts as hedges for accounting purposes in accordance with the provisions under the Accounting Standards Codification topic 815 "Derivatives and Hedging" (ASC 815). Therefore, changes in the fair value of these contracts and the realized gains and losses are recorded in the condensed

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consolidated statements of income (loss) for the three-month periods ended January 31, 2015 and 2014 as follows (in thousands):

| Location of Gain or<br>(Loss):                               | Three Months Ended<br>January 31, |       |
|--|-----------------------------------|-------|
|  | 2015                              | 2014  |
| Other, net                      Foreign currency derivatives | \$652                             | \$114 |

We have chosen not to offset any of our derivative instruments in accordance with the provisions of ASC 815. Therefore, the assets and liabilities are presented on a gross basis on our accompanying condensed consolidated balance sheets.



Table of Contents

## QUANEX BUILDING PRODUCTS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

The fair values of our outstanding derivative contracts as of January 31, 2015 and October 31, 2014 were as follows (in thousands):

|                                   | January 31, 2015 | October 31, 2014 |
|-----------------------------------|------------------|------------------|
| Prepaid and other current assets: |                  |                  |
| Foreign currency derivatives      | \$34             | \$69             |
| Accrued liabilities:              |                  |                  |
| Foreign currency derivatives      | \$(7 )           | \$—              |

The following table summarizes the notional amounts and fair value of outstanding derivative contracts at January 31, 2015 and October 31, 2014 (in thousands):

|                               | Notional as indicated |                     | Fair Value in \$    |                     |
|-------------------------------|-----------------------|---------------------|---------------------|---------------------|
|                               | January 31,<br>2015   | October 31,<br>2014 | January 31,<br>2015 | October 31,<br>2014 |
| Foreign currency derivatives: |                       |                     |                     |                     |
| Sell EUR, buy USD             | EUR 6,227             | \$4,907             | \$32                | \$68                |
| Sell CAD, buy USD             | USD 259               | 331                 | (6 )                | 1                   |
| Sell GBP, buy USD             | GBP 911               | —                   | 2                   | —                   |
| Buy EUR, sell GBP             | EUR 263               | —                   | (1 )                | —                   |

For the classification in the fair value hierarchy, see Note 11, "Fair Value Measurement of Assets and Liabilities", included herewith.

#### 11. Fair Value Measurement of Assets and Liabilities

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value hierarchy distinguishes between (1) market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (2) an entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The fair value hierarchy consists of three broad levels, which gives the highest priority to Level 1 and the lowest priority to Level 3. The three levels of the fair value hierarchy are described below:

Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly or indirectly including quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability (e.g., interest rates) and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 - Inputs that are both significant to the fair value measurement and unobservable.

Table of Contents

## QUANEX BUILDING PRODUCTS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

The following table summarizes the assets and liabilities measured on a recurring basis based on the fair value hierarchy (in thousands):

|                              | January 31, 2015 |         |         |           | October 31, 2014 |         |         |           |
|------------------------------|------------------|---------|---------|-----------|------------------|---------|---------|-----------|
|                              | Level 1          | Level 2 | Level 3 | Total     | Level 1          | Level 2 | Level 3 | Total     |
| <b>Assets</b>                |                  |         |         |           |                  |         |         |           |
| Short-term investments       | \$ 10,000        | \$—     | \$—     | \$ 10,000 | \$ 69,975        | \$—     | \$—     | \$ 69,975 |
| Foreign currency derivatives | —                | 34      | —       | 34        | —                | 69      | —       | 69        |
| Total assets                 | \$ 10,000        | \$ 34   | \$—     | \$ 10,034 | \$ 69,975        | \$ 69   | \$—     | \$ 70,044 |
| <b>Liabilities</b>           |                  |         |         |           |                  |         |         |           |
| Foreign currency derivatives | \$—              | \$ 7    | \$—     | \$ 7      | \$—              | \$—     | \$—     | \$—       |
| Total liabilities            | \$—              | \$ 7    | \$—     | \$ 7      | \$—              | \$—     | \$—     | \$—       |

We held short-term investments (with an original maturity of three months or less) in commercial paper at January 31, 2015 and October 31, 2014. We have included these investments as cash and cash equivalents in the accompanying condensed consolidated balance sheets. These investments are measured at fair value based on active market quotations and are therefore classified as Level 1. All of our derivative contracts are valued using quoted market prices from brokers or exchanges and are classified within Level 2 of the fair value hierarchy.

We had approximately \$2.4 million of certain property, plant and equipment that was recorded at fair value on a non-recurring basis and classified as Level 3 as of January 31, 2015 and October 31, 2014. The fair value was based on broker opinions.

Carrying amounts reported on the balance sheet for cash, cash equivalents, accounts receivable and accounts payable approximate fair value due to the short-term maturity of these instruments. Our outstanding debt was variable rate debt that re-prices frequently, thereby limiting our exposure to significant change in interest rate risk. As a result, the fair value of our debt instruments approximates carrying value at January 31, 2015 and October 31, 2014 (Level 3 measurement).

## 12. Stock-Based Compensation

We have established and maintain an Omnibus Incentive Plan (2008 Plan) that provides for the granting of restricted stock awards, stock options, restricted stock units, performance share awards and other stock-based and cash-based awards. The 2008 Plan is administered by the Compensation and Management Development Committee of the Board of Directors.

The aggregate number of shares of common stock originally authorized for grant under the 2008 Plan was 2,900,000. At our annual shareholder meeting held in February 2011, the shareholders approved an amendment which increased the aggregate number of shares available for grant by 2,400,000 shares; and at our annual shareholder meeting held in February 2014, the shareholders approved an amendment which increased the aggregate number of shares available for grant under the 2008 Plan by an additional 2,350,000 shares. Any officer, key employee and/or non-employee director or any of our affiliates is eligible for awards under the 2008 Plan. Our initial grant of awards under the 2008 Plan was on April 23, 2008. Our practice is to grant stock options and restricted stock units to non-employee directors on the last business day of each fiscal year, with an additional grant of options to each director on the date of his or her first anniversary of service. Once we receive approval from the Board of Directors in December, we grant stock options, restricted stock awards, restricted stock units and/or performance shares to officers, management and key employees. Occasionally, we may make additional grants to key employees at other times during the year.

### Restricted Stock Awards

Restricted stock awards are granted to key employees and officers annually, and typically cliff vest over a three-year period with service and continued employment as the only vesting criteria. The recipient of the restricted stock awards is entitled to all of the rights of a shareholder, except that the awards are nontransferable during the vesting period. The fair value of the restricted stock award is established on the grant date and then expensed over the vesting period resulting in an increase in additional paid-in-capital. Shares are generally issued from treasury stock at the time of grant.

Table of Contents

## QUANEX BUILDING PRODUCTS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

A summary of non-vested restricted stock awards activity during the three months ended January 31, 2015 is presented below:

|                                | Restricted Stock Awards | Weighted Average Grant Date Fair Value per Share |
|--------------------------------|-------------------------|--|
| Non-vested at October 31, 2014 | 220,800                 | \$17.42  |
| Granted                        | 68,800                  | 20.28  |
| Cancelled                      | —                       | —  |
| Vested                         | (33,500)                | 15.08  |
| Non-vested at January 31, 2015 | 256,100                 | \$18.49  |

The total weighted average grant-date fair value of restricted stock awards that vested during the three-month periods ended January 31, 2015 and 2014 was \$0.5 million and \$0.4 million, respectively. As of January 31, 2015, total unrecognized compensation cost related to unamortized restricted stock awards was \$2.7 million. We expect to recognize this expense over the remaining weighted average vesting period of 1.8 years.

**Stock Options**

Stock options are awarded to key employees, officers and non-employee directors. Director stock options vest immediately while employee and officer stock options typically vest ratably over a three-year period with service and continued employment as the vesting conditions. Our stock options may be exercised up to a maximum of ten years from the date of grant. The fair value of the stock options is determined on the grant date and expensed over the vesting period resulting in an increase in additional paid-in-capital.

We use a Black-Scholes pricing model to estimate the fair value of stock options. A description of the methodology for the valuation assumptions was disclosed in our Annual Report on Form 10-K for the fiscal year ended October 31, 2014.

The following table provides a summary of assumptions used to estimate the fair value of our stock options issued during the three-month periods ended January 31, 2015 and 2014.

|  | Three Months Ended<br>January 31, |        |
|--|-----------------------------------|--------|
|  | 2015                              | 2014   |
| Weighted-average expected volatility       | 47.7%                             | 55.7%  |
| Weighted-average expected term (in years)  | 5.8                               | 5.9    |
| Risk-free interest rate                    | 1.6%                              | 1.8%   |
| Expected dividend yield over expected term | 1.0%                              | 1.0%   |
| Weighted average grant date fair value     | \$8.40                            | \$8.52 |

The following table summarizes our stock option activity for the three months ended January 31, 2015:

|                                 | Stock Options | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value (000s) |
|---------------------------------|---------------|---------------------------------|--|----------------------------------|
| Outstanding at October 31, 2014 | 2,588,389     | \$16.21                         |  |                                  |
| Granted                         | 123,900       | 20.28                           |  |                                  |
| Exercised                       | —             | —                               |  |                                  |

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|  |           |   |         |     |         |
|--|-----------|---|---------|-----|---------|
| Forfeited/Expired                              | (167      | ) | 15.08   |     |         |
| Outstanding at January 31, 2015                | 2,712,122 |   | \$16.40 | 6.1 | \$7,698 |
| Vested or expected to vest at January 31, 2015 | 2,685,313 |   | \$16.36 | 6.1 | \$7,688 |
| Exercisable at January 31, 2015                | 2,244,900 |   | \$15.87 | 5.6 | \$7,320 |

Intrinsic value is the amount by which the market price of the common stock on the date of exercise exceeds the exercise price of the stock option. There were no stock options exercised during the three months ended January 31, 2015. The total intrinsic

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Table of Contents

## QUANEX BUILDING PRODUCTS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

value of stock options exercised during the three months ended January 31, 2014, was \$0.1 million. The weighted-average grant date fair value of stock options that vested during the three months ended January 31, 2015 and 2014, was \$2.2 million and \$2.8 million, respectively. As of January 31, 2015, total unrecognized compensation cost related to stock options was \$2.7 million. We expect to recognize this expense over the remaining weighted average vesting period of 1.7 years.

**Restricted Stock Units**

Restricted stock units may be awarded to key employees and officers from time to time, and annually to non-employee directors. The director restricted stock units vest immediately but are payable only upon the director's cessation of service, whereas restricted stock units awarded to employees and officers typically cliff vest after a three-year period with service and continued employment as the vesting conditions. Restricted stock units are not considered outstanding shares and do not have voting rights, although the holder does receive a cash payment equivalent to the dividend paid, on a one-for-one basis, on our outstanding common shares. Once the criteria is met, each restricted stock unit is payable to the holder in cash based on the market value of one share of our common stock. Accordingly, we record a liability for the restricted stock units on our balance sheet and recognize any changes in the market value during each reporting period as compensation expense.

The following table summarizes non-vested restricted stock unit activity during the three months ended January 31, 2015:

|                                | Restricted Stock<br>Units | Weighted Average<br>Grant Date Fair<br>Value per Share |
|--------------------------------|---------------------------|--|
| Non-vested at October 31, 2014 | 83,500                    | \$15.08  |
| Vested                         | (83,500)                  | ) 15.08  |
| Non-vested at January 31, 2015 | —                         | \$—  |

During the three-month period ended January 31, 2015, we paid \$1.7 million to settle certain restricted stock units. No restricted stock units were settled during the three-month period ended January 31, 2014.

**Performance Share Awards**

Historically, we have granted performance units to key employees and officers annually. These awards cliff vest after a three-year period with service and performance measures such as relative total shareholder return and earnings per share growth as vesting conditions. These awards were treated as a liability and marked to market based upon our assessment of the achievement of the performance measures, with the assistance of third-party compensation consultants.

For the annual grants which occurred in December 2014 and 2013, we granted performance shares rather than performance units. These performance share awards have the same performance measures (relative total shareholder return and earnings per share growth). However, the number of shares earned is variable depending on the metrics achieved, and the settlement method is 50% in cash and 50% in our common stock.

To account for these awards, we have bifurcated the portion subject to a market condition (relative total shareholder return) and the portion subject to an internal performance measure (earnings per share growth). We have further bifurcated these awards based on the settlement method, as the portion expected to settle in stock (equity component) and the portion expected to settle in cash (liability component).

To value the shares subject to the market condition, we utilized a Monte Carlo simulation model to arrive at a grant-date fair value. This amount will be expensed over the three-year term of the award with a credit to additional paid-in-capital. To value the shares subject to the internal performance measure, we used the value of our common

stock on the date of grant as the grant-date fair value per share. This amount is being expensed over the three-year term of the award, with a credit to additional paid-in-capital, and could fluctuate depending on the number of shares ultimately expected to vest based on our assessment of the probability that the performance conditions will be achieved. For both performance conditions, the portion of the award expected to settle in cash is recorded as a liability and is being marked to market over the three-year term of the award, and can fluctuate depending on the number of shares ultimately expected to vest.

In conjunction with the annual grants in December 2014 and 2013, we awarded 137,400 and 148,800 performance shares, respectively, of which 0% to 200% of these shares may ultimately vest, depending on the achievement of the performance conditions. During 2014, 7,000 of the performance shares issued in December 2013 were forfeited. For the three-month periods ended January 31, 2015 and 2014, we have recorded \$0.4 million and \$0.2 million of compensation expense, respectively, related to these performance share awards.

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Table of Contents

## QUANEX BUILDING PRODUCTS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Performance share awards are not considered outstanding shares and do not have voting rights, although dividends are accrued over the performance period and will be payable in cash based upon the number of performance shares ultimately earned.

The performance shares are excluded from the diluted weighted-average shares used to calculate earnings per share until the performance criteria is probable to result in the issuance of contingent shares.

## Treasury Shares

On September 5, 2014, our Board cancelled our existing stock repurchase program and approved a new stock repurchase program authorizing us to use up to \$75.0 million to repurchase shares of our common stock. For the period from September 5, 2014 through October 31, 2014, we purchased 1,316,326 shares at a cost of \$24.2 million under the new program. During the three months ended January 31, 2015, we purchased an additional 2,297,161 shares at a cost of \$43.4 million.

We record treasury stock purchases under the cost method whereby the entire cost of the acquired stock is recorded as treasury stock. Shares are generally issued from treasury stock at the time of grant of restricted stock awards, and upon the exercise of stock options and upon the issuance of performance shares. On the subsequent issuance of treasury shares, we record proceeds in excess of cost as an increase in additional paid in capital.

The following table summarizes the treasury stock activity during the three months ended January 31, 2015:

|  | Three Months Ended<br>January 31, 2015 |
|--|--|
| Beginning balance as of November 1, 2014 | 1,417,700                              |
| Restricted stock awards granted          | (68,800 )                              |
| Shares purchased                         | 2,297,161                              |
| Balance at end of period                 | 3,646,061                              |

During February 2015, we completed our stock repurchase program. We purchased an additional 378,742 shares at a cost of \$7.4 million. From inception of the program, we purchased 3,992,229 shares at a cost of \$75.0 million.

## 13. Other Income (Expense)

Other income (expense) included under the caption "Other, net" on the accompanying condensed consolidated statements of income (loss), consisted of the following for the three-month periods ended January 31, 2015 and 2014:

|   | Three Months Ended<br>January 31, |          |
|---|-----------------------------------|----------|
|   | 2015                              | 2014     |
|   | (In thousands)                    |          |
| Foreign currency transaction gains (losses) | \$(834 )                          | \$(104 ) |
| Foreign currency derivative gains (losses)  | 652                               | 114      |
| Interest income                             | 31                                | 6        |
| Other                                       | —                                 | 80       |
| Other (expense) income                      | \$(151 )                          | \$96     |

## 14. Segment Information

We have four operating segments which we aggregate into one reportable segment, in accordance with ASC Topic 280-10-50, "Segment Reporting" (ASC 280). This aggregation is based on factors including, but not limited to: (1) similar nature of products serving the building products industry, primarily the fenestration business; (2) similar production processes, although there are some differences in the amount of automation amongst operating plants; (3) similar types or classes of customers, namely the primary original equipment manufacturers (OEMs) in the window



and door industry; (4) similar distribution methods for product delivery, although the extent of the use of third-party distributors will vary amongst the businesses; (5) similar regulatory environment; and (6) converging long-term economic similarities. The primary market drivers of our business are residential remodeling and replacement activity (R&R) and new home construction.

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Table of Contents

## QUANEX BUILDING PRODUCTS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Prior to April 1, 2014, we presented two reportable operating segments: (1) Engineered Products and (2) Aluminum Sheet Products. In addition, we recorded LIFO inventory adjustments, corporate office charges and inter-segment eliminations as Corporate & Other. On April 1, 2014, we sold Nichols, the sole operating segment included in our Aluminum Sheet Products reportable segment. To account for Nichols as a discontinued operation, we reclassified certain costs from Corporate & Other to Nichols, including a portion of the LIFO reserve, as well as insurance accruals related to incurred but not reported workers compensation claims, to properly reflect these direct expenses as a component of the disposal group.

The following table reconciles our segment presentation as previously reported in our Quarterly Report on Form 10-Q for the three months ended January 31, 2014, to the current presentation (in thousands).

| Three Months Ended January 31, 2014 | As Previously Reported | Discontinued Operations | Reclassification | Current Presentation |
|-------------------------------------|------------------------|-------------------------|------------------|----------------------|
| <b>Engineered Products</b>          |                        |                         |                  |                      |
| Net sales                           | \$126,379              | \$—                     | \$—              | \$126,379            |
| Inter-segment sales                 | —                      | —                       | —                | —                    |
| Depreciation and amortization       | 7,644                  | —                       | 900              | 8,544                |
| Operating loss                      | 7,491                  | —                       | (8,353           | ) (862 )             |
| Capital expenditures                | \$4,578                | \$—                     | \$420            | \$4,998              |
| <b>Aluminum Sheet Products</b>      |                        |                         |                  |                      |
| Net sales                           | \$75,983               | \$(75,983               | ) \$—            | \$—                  |
| Inter-segment sales                 | 3,508                  | (3,508                  | ) —              | —                    |
| Depreciation and amortization       | 1,750                  | (1,750                  | ) —              | —                    |
| Operating loss                      | (4,251                 | ) 4,251                 | —                | —                    |
| Capital expenditures                | \$1,750                | \$(1,750                | ) \$—            | \$—                  |
| <b>Corporate &amp; Other</b>        |                        |                         |                  |                      |
| Net sales                           | \$—                    | \$—                     | \$—              | \$—                  |
| Inter-segment sales                 | (3,508                 | ) 3,508                 | —                | —                    |
| Depreciation and amortization       | 900                    | —                       | (900             | ) —                  |
| Operating loss                      | (8,353                 | ) —                     | 8,353            | —                    |
| Capital expenditures                | \$420                  | \$—                     | \$(420           | ) \$—                |

**15. Earnings Per Share**

We compute basic earnings per share by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per common and potential common shares include the weighted average of additional shares associated with the incremental effect of dilutive employee stock options, non-vested restricted stock as determined using the treasury stock method prescribed by U.S. GAAP and contingent shares associated with performance share awards, if dilutive.

Basic and diluted loss per share was \$(0.09) and \$(0.11) for the three months ended January 31, 2015 and 2014, respectively. The computation of diluted earnings per share excludes outstanding stock options and other common stock equivalents when their inclusion would be anti-dilutive. This is always the case when an entity incurs a net loss. During the three-month periods ended January 31, 2015 and 2014, 472,497 and 528,397 of common stock equivalents, respectively, and 101,579 and 83,594 shares of restricted stock, respectively, were excluded from the computation of

diluted earnings per share. There were no potentially dilutive contingent shares related to performance share awards for these periods.

For the three-month periods ended January 31, 2015 and 2014, we had 762,572 and 1,083,988 securities, respectively, that were potentially dilutive in future earnings per share calculations. Such dilution will be dependent on the excess of the market price of our stock over the exercise price and other components of the treasury stock method.

#### 16. New Accounting Pronouncements

In June 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-12, Compensation - Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide

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Table of Contents

QUANEX BUILDING PRODUCTS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

That a Performance Target Could be Achieved after the Requisite Service Period. This amendment requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition that affects vesting or as a nonvesting condition that affects the grant-date fair value of an award, and provides explicit guidance for those awards. This guidance becomes effective for fiscal years beginning on or after December 15, 2015. We expect to adopt this guidance during fiscal 2017, and we are currently evaluating the impact on our consolidated financial statements.

In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, "Revenue from Contracts with Customers." This guidance prescribes a methodology to determine when revenue is recognizable and constitutes a principles-based approach to revenue recognition based on the consideration to which the entity expects to be entitled in exchange for goods or services. In addition, this guidance requires additional disclosure in the notes to the financial statements with regard to the methodology applied. This pronouncement becomes effective for annual reporting periods beginning after December 15, 2016, and will essentially supersede and replace existing revenue recognition rules in U.S. GAAP, including industry-specific guidance. We expect to adopt this pronouncement in fiscal 2018, and we are currently evaluating the impact on our consolidated financial statements.

In April 2014, the FASB issued ASU No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. This new guidance clarifies the definition of a discontinued operation as a disposal of a component of any entity, or a group of such components, which represent a strategic shift that has or will have a major effect on an entity's operations and financial results. This guidance should result in fewer applications of discontinued operations accounting treatment. However, if such accounting treatment is required, the guidance requires additional footnote disclosures with regard to the major classes of line items constituting pretax profit or loss of the discontinued operation, a reconciliation of the major classes of assets and liabilities of the discontinued operation, and additional disclosure with regard to cash flows of the discontinued operation. This guidance becomes effective for fiscal years beginning on or after December 15, 2014. We expect to adopt this guidance during fiscal 2016, and we are currently evaluating the impact on our consolidated financial statements.

In July 2013, the FASB issued ASU No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists, which provides guidance related to the presentation of current and deferred income taxes on the balance sheet. In general, an entity must present an unrecognized tax benefit related to a net operating loss carryforward, similar tax loss or tax credit carryforward, as a reduction of a deferred tax asset, except in prescribed circumstances through which liability presentation would be appropriate. This guidance became effective for fiscal years beginning after December 15, 2013. We adopted this guidance on November 1, 2014 with no material impact on our consolidated financial statements.

Table of Contents

Unless the context indicates otherwise, references to "Quanex", the "Company", "we", "us" and "our" refer to the consolidated business operations of Quanex Building Products Corporation and its subsidiaries.

Cautionary Note Regarding Forward-Looking Statements

Certain of the statements contained in this document and in documents incorporated by reference herein, including those made under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" are "forward-looking" statements as defined under the Private Securities Litigation Reform Act of 1995. Generally, the words "expect," "believe," "intend," "estimate," "anticipate," "project," "will" and similar expressions identify forward-looking statements, which generally are not historical in nature. Forward looking statements are (1) all statements which address future operating performance, (2) events or developments that we expect or anticipate will occur in the future, including statements relating to volume, sales, operating income and earnings per share, and (3) statements expressing general outlook about future operating results. Forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from our historical experience and our current projections or expectations. As and when made, we believe that these forward-looking statements are reasonable. However, caution should be taken not to place undue reliance on any such forward-looking statements since such statements speak only as of the date when made and there can be no assurance that such forward-looking statements will occur. We are not obligated to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Factors that could cause actual results to differ materially from those expressed or implied by the forward-looking statements include, but are not limited to the following:

- changes in market conditions, particularly in the new home construction, and residential remodeling and replacement (R&R) activity markets;
- changes in prevailing prices of resin and other raw material costs;
- changes in domestic and international economic conditions;
- changes in purchases by our principal customers;
- fluctuations in foreign currency exchange rates;
- our ability to maintain an effective system of internal controls;
- our ability to successfully implement our internal operating plans and acquisition strategies;
- our ability to successfully implement our plans with respect to information technology (IT) systems and processes;
- our ability to control costs and increase profitability;
- changes in environmental laws and regulations;
- changes in warranty obligations;
- changes in energy costs;
- changes in tax laws, and interpretations thereof;
- changes in interest rates;
- our ability to maintain a good relationship with our suppliers, subcontractors, and key customers; and
- the resolution of litigation and other legal proceedings.

For information on additional factors that could cause actual results to differ materially, please refer to the section entitled "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended October 31, 2014.

About Third-Party Information

In this report, we rely on and refer to information regarding industry data obtained from market research, publicly available information, industry publications, U.S. government sources and other third parties. Although we believe this information is reliable, we cannot guarantee the accuracy or completeness of the information and have not independently verified it.

Table of Contents

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

The following discussion and analysis should be read in conjunction with the accompanying unaudited condensed consolidated financial statements and related notes as of January 31, 2015, and for the three-month periods ended January 31, 2015 and 2014, included elsewhere herein. For additional information pertaining to our business, including risk factors which should be considered before investing in our common stock, refer to our Annual Report on Form 10-K for the fiscal year ended October 31, 2014.

Our Business

Quanex Building Products Corporation manufactures components primarily for the window and door (fenestration) industry, which include (1) energy-efficient flexible insulating glass spacers, (2) extruded vinyl profiles, (3) window and door screens, and (4) precision-formed metal and wood products for original equipment manufacturers (OEMs), as well as certain non-fenestration components, which include solar panel sealants, wood flooring and furniture moldings. Quanex Building Products Corporation serves a primary customer base in North America and also serves customers in international markets through operating plants in the United Kingdom and Germany, as well as through sales and marketing efforts in other countries.

We continue to invest in organic growth initiatives and to pursue targeted business acquisitions, which may include vertically integrated vinyl extrusion businesses or screen manufacturers that allow us to expand our existing fenestration footprint, enhance our existing product offerings, acquire complementary technology, enhance our leadership position within the markets we serve, and expand into new markets or service lines.

We have four operating segments which we aggregate into one reportable business segment.

Recent Transactions and Events

Prior to April 1, 2014, we had two reportable business segments: (1) Engineered Products and (2) Aluminum Sheet Products. On April 1, 2014, we sold our interest in a limited liability company which held the assets of the Nichols Aluminum business (Nichols), the sole operating segment included in our Aluminum Sheet Products reportable segment, to Aleris International, Inc.

(Aleris), a privately held Delaware corporation which provides aluminum rolled products and extrusions, aluminum recycling and specification aluminum alloy production. We received net proceeds of \$107.4 million, which was net of a working capital adjustment of \$2.6 million which we paid in June 2014, resulting in a gain on the transaction of \$24.1 million, net of related taxes of \$15.1 million. We expect to continue to purchase aluminum product from Nichols, which has historically totaled approximately \$12.0 million annually. Our purchases of aluminum product from Nichols for the three-month periods ended January 31, 2015 and 2014 were \$4.5 million and \$3.5 million, respectively.

In November 2013, Nichols experienced a fire at its Decatur, Alabama facility, which damaged a cold mill used to roll aluminum sheet to a desired thickness. The loss was insured, subject to a \$0.5 million deductible. We capitalized \$6.5 million to rebuild the asset, which was returned to service as of March 31, 2014. We incurred costs of \$2.3 million associated with this loss, including an impairment of \$0.5 million related to retirement of the asset, moving costs, outside service costs, clean-up and the deductible. To date, we have received insurance proceeds of \$5.3 million. We revised our estimate of total insurance proceeds expected related to this loss to approximately \$6.8 million, resulting in an expected gain on involuntary conversion of \$4.4 million, of which we have recognized \$2.9 million. We estimate the remaining gain on involuntary conversion at \$1.5 million and we expect this gain will be recognized during fiscal 2015, when and to the extent that insurance proceeds are received, which will result in an increase in income from discontinued operations, net of tax.

In December 2013, we acquired certain vinyl extrusion assets of Atrium Windows and Doors, Inc. (Atrium) at a facility in Greenville, Texas, for \$5.2 million in cash (Greenville). We accounted for this transaction as a business combination resulting in an insignificant gain on the purchase. We entered into a supply agreement with Atrium related to the products manufactured at Greenville. We believe this acquisition expanded our vinyl extrusion capacity and positioned us with a platform from which to better serve our customers in the southern United States.

Market Overview and Outlook

We believe the primary drivers of our operating results continue to be new home construction and residential remodeling and replacement (R&R) activity. We believe that housing starts and window shipments are indicators of activity levels in the home building industry, and we use this data, as published by or derived from third-party sources, to evaluate the market.

Activity levels in the building products industry in the United States have increased annually since the recovery began in 2010, as evidenced by an increase in housing starts and window shipments. The National Association of Homebuilders (NAHB) has forecasted calendar-year housing starts to increase from 1.0 million units in 2014 to 1.2 million units in 2015 and 1.5 million units in 2016, reflecting increasing consumer confidence and a healthier economy. Ducker Worldwide, LLC (Ducker), a consulting

Table of Contents

and research firm, indicated that window shipments in the R&R market are expected to increase from 27.7 million units in 2014 to 28.5 million units in 2015 and 29.9 units in 2016, with new construction window shipments forecasted to increase at a higher pace. Derived from reports published by Ducker, the overall growth in window shipments for the trailing twelve-month period ended December 31, 2014 was 6.1%. During this period, growth in new construction increased 7.3%, while growth in R&R activity increased 5.3%. In recent years, growth in new construction has outpaced the growth in R&R, with a greater portion of the new construction associated with multi-family housing, although the growth rates for R&R, as published by Ducker, appear to be improving. According to the July 31, 2014 publication, "Multifamily Mid-Year Outlook 2014" by the Federal Home Loan Mortgage Corporation, a public government-sponsored enterprise, the economic recession has resulted in an estimated 3.9 million delayed household formations. With supply of single-family homes tight and rising home prices, we believe this delay in household formation has contributed to the growth in multi-family housing.

Higher energy efficiency standards in Europe are impacting the industry. We continue to be optimistic about our growth prospects in Europe, particularly in the United Kingdom, Germany and Scandinavian countries, where the push for higher energy efficiency standards has been the greatest. Older technology cold-edge spacers are still a dominant force in these regions and garner a larger portion of the total market share in Europe relative to the United States. We operate warm-edge spacer plants in the United Kingdom and Germany. We have encountered some spacer migration issues under extreme conditions for some spacer products sold by our German subsidiary. This issue was related to a vapor barrier that was discontinued in early 2014. We remain confident that we can become the provider of choice in Europe and the other markets we serve as demand for more energy-efficient warm edge spacers grows and eventually displaces cold edge spacers.

There are various internal and external factors that impact our operating results and challenge our growth prospects in the markets that we serve. Our business is subject to seasonality, as activity levels generally decline during the first half of the fiscal year and increase for the second half of the fiscal year. In addition, we utilize several commodities in our business for which pricing can fluctuate, including polyvinyl resin (PVC) and petroleum products. We typically include surcharges in our customer contracts which allow us to pass a portion of these price fluctuations onto our customers. However, during 2014 we were limited in our ability to recoup some of the increase in resin costs for certain customers of our vinyl extrusion products through surcharges due to contractual constraints. We renegotiated these customer contracts for the calendar year 2015. In addition, the price of crude oil per barrel has changed dramatically in recent months from a high of more than \$100 per barrel to approximately \$50 per barrel. Although we benefit from lower commodity prices associated with these petroleum products used in our business, our customer contracts may require concessions if oil prices per barrel decline below a designated threshold. Our profitability depends upon our ability to negotiate price, meet our customer's product and delivery demands, manage our cost structure and efficiently operate our facilities.



Table of Contents

## Results of Operations

Three Months Ended January 31, 2015 Compared to Three Months Ended January 31, 2014

|   | Three Months Ended January 31, |         |           |          |    |
|---|--------------------------------|---------|-----------|----------|----|
|   | 2015                           | 2014    | Change \$ | Change % |    |
|   | (Dollars in millions)          |         |           |          |    |
| Net sales   | \$127.9                        | \$126.3 | \$1.6     | 1        | %  |
| Cost of sales (excluding depreciation and amortization) | 105.8                          | 96.2    | 9.6       | 10       | %  |
| Selling, general and administrative                     | 19.5                           | 22.5    | (3.0)     | (13)     | )% |
| Depreciation and amortization                           | 8.2                            | 8.5     | (0.3)     | (4)      | )% |
| Operating loss  | \$(5.6)                        | \$(0.9) | \$(4.7)   | 522      | %  |
| Interest expense  | (0.1)                          | (0.1)   | —         | —        | %  |
| Other, net  | (0.2)                          | 0.1     | (0.3)     | (300)    | )% |
| Income tax benefit (expense)                            | 2.8                            | (0.3)   | 3.1       | (1,033)  | )% |
| Loss from continuing operations                         | \$(3.1)                        | \$(1.2) | \$(1.9)   | 158      | %  |
| Loss from discontinued operations, net of tax           | —                              | (2.7)   | \$2.7     | (100)    | )% |
| Net loss  | \$(3.1)                        | \$(3.9) | \$0.8     | (21)     | )% |

**Net Sales.** Net sales increased \$1.6 million, or 1%, for the three months ended January 31, 2015 compared to the same period in 2014. The fenestration market grew throughout 2014 and continued to grow in 2015. The year-over-year growth in window shipments as derived from preliminary data provided by Ducker for the calendar quarters ended December 31, 2014 and 2013 was 10%, and, for the trailing twelve months then ended, 6%. By comparison, our sales growth was 1% and 3%, respectively, as adjusted for certain foreign and other results to be more comparable to Ducker. To some extent, the disparity between our growth rate and that of the broader market reflects timing of the recovery in the building products industry, as Quanex benefited from a 12% growth rate for the first quarter of 2014 compared to Ducker's reported 6% growth for the same period. For the first quarter of 2015, net sales increased \$0.4 million as a result of an increase in volume. Volume lost at one of our large customers was more than offset by the Greenville acquisition volume and growth with other customers. In addition, we benefited from favorable pricing, which contributed incremental sales of \$0.8 million, with the remainder of the overall sales increase associated with product mix. We expect our growth rates to continue to converge with the Ducker growth rates throughout 2015.

**Cost of Sales.** The increase in cost of sales of \$9.6 million, or 10%, for the three months ended January 31, 2015 compared to the same period in 2014 exceeded a 1% increase in net sales as discussed above. Of the increase in cost of goods sold, \$2.8 million relates to the reversal of a warranty reserve during the first quarter of 2014 with regard to certain spacer product for which claim activity had ceased. In addition, our 2015 results were impacted by higher medical and worker's compensation claims, for which several large claims contributed incremental expense of \$1.2 million, as well as higher freight expense and an increase in the cost of resin used in our vinyl products. Our labor and overhead efficiency decreased in 2015, as we absorbed more cost in 2014 associated with the inventory build. By comparison, the seasonal build in 2015 has been at a slower pace, due to sufficient inventory on hand.

**Selling, General and Administrative.** Our selling, general and administrative expenses decreased by \$3.0 million, or 13%, for the three months ended January 31, 2015 compared to the same period in 2014. This decrease reflects severance and other expense incurred to reduce the size of our information technology group and sales and marketing organization during the first quarter of 2014 as we realigned our cost structure associated with the cessation of an ERP project in August 2013. In addition, we incurred transaction costs during 2014 associated with the Greenville acquisition in December 2013 and the sale of Nichols (finalized in April 2014). Compared to the first quarter of 2014, we experienced a decrease in expense in 2015 associated with long-term incentive plans tied to the performance of our common stock and a decrease in professional service fees. These cost reductions were partially offset by higher medical insurance costs and higher incentive accruals based on earnings.

**Depreciation and Amortization.** Depreciation and amortization expense decreased \$0.3 million, or 4%, for the three months ended January 31, 2015 compared to the same period in 2014. The results for the first quarter of 2014 included \$0.3 million associated with the run-off of depreciation associated with an ERP project that was ceased in August 2013 as well as the impact of other asset retirements. These decreases in expense year-over-year were partially

offset by incremental depreciation and amortization expense associated with fixed and intangible assets placed into service during the trailing twelve months ended January 31, 2015, including the assets purchased in conjunction with the Greenville acquisition.

Table of Contents

Interest Expense. Interest expense was consistent at \$0.1 million for the three-month periods ended January 31, 2015 and 2014.

Other, net. The increase in other net expense of \$0.3 million for the three months ended January 31, 2015 compared to the same period in 2014 was due primarily to net foreign exchange transaction losses.

Income Taxes. We recorded an income tax benefit of \$2.8 million for the three months ended January 31, 2015, an effective rate of 47.6%, which included a discrete benefit of \$0.8 million associated with the reversal of a liability for tax benefit associated with an uncertain tax position which stems from the 2008 spin-off of Quanex from a predecessor company. Excluding this discrete item, the effective tax rate would have been a benefit of 34.1%. For the three months ended January 31, 2014, we recorded income tax expense of \$0.3 million, an effective rate of 33.5%, which included a discrete expense item of \$0.7 million associated with the incorporation of the U.K. subsidiary. Excluding this discrete item, the effective tax rate would have been a benefit of 38.7%. The remaining difference in the effective rates between these periods relates to the impact of the foreign tax rate differential and permanent items. Income (Loss) from Discontinued Operations, Net of Tax. Discontinued operations represents the operating results of Nichols which was sold effective April 1, 2014. For the three-months ended January 31, 2014, we recorded a loss of \$2.7 million associated with Nichols which is due to seasonality, largely due to the fact that maintenance costs are incurred early in the fiscal year, as well as the impact of higher aluminum commodity prices and lower throughput. The result for the three-months ended January 31, 2015 was income of less than \$0.1 million reflecting a gain of \$0.5 million, pretax, from the involuntary conversion associated with a fire at the Nichols cold mill in November 2013, offset by a loss of \$0.5 million, pretax, associated with an amount payable to our health insurance stop-loss provider related to a trailing claim.

Liquidity and Capital Resources

Overview

Our principal sources of funds are cash on hand, cash flow from operations, and borrowings under our \$150 million Senior Unsecured Revolving Credit Facility (the Credit Facility). As of January 31, 2015, we had \$63.9 million of cash and cash equivalents, \$124.7 million of availability under the Credit Facility and outstanding debt of \$0.8 million, of which no amounts were outstanding under our Credit Facility.

Cash and cash equivalents decreased by \$56.5 million during the three months ended January 31, 2015 due primarily to the purchase of treasury shares, capital investments into our manufacturing facilities, dividends paid and on-going operational activities.

Analysis of Cash Flow

The following table summarizes our cash flow results for the three months ended January 31, 2015 and 2014:

Three Months Ended