

Quanex Building Products CORP
Form 10-K
December 31, 2012

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

FORM 10-K
(Mark One)

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

For the fiscal year ended October 31, 2012

or

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

Commission file number 1-33913

QUANEX BUILDING PRODUCTS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

26-1561397

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

1900 West Loop South, Suite 1500, Houston, Texas

(Address of principal executive offices)

77027

(Zip code)

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

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

Title of each class

Common Stock, \$0.01 par value

Name of each exchange on which registered

New York Stock Exchange, Inc.

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

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

Yes No

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

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

Indicate by check mark 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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definition 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 Smaller reporting company

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates as of April 30, 2012, computed by reference to the closing price for the Common Stock on the New York Stock Exchange, Inc. on that date, was \$672,023,844. Such calculation assumes only the registrant's current officers and directors were affiliates of the registrant.

At December 14, 2012, there were outstanding 37,037,341 shares of the registrant's Common Stock, \$0.01 par value.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive Proxy Statement for its 2013 Annual Meeting of Stockholders to be filed with the Commission within 120 days of October 31, 2012 are incorporated herein by reference in Part III of this Annual Report.

Table of Contents

TABLE OF CONTENTS

	Page
<u>PART I</u>	
Item 1.	<u>3</u>
	<u>3</u>
	<u>3</u>
	<u>4</u>
	<u>5</u>
	<u>5</u>
	<u>5</u>
	<u>6</u>
	<u>6</u>
	<u>6</u>
	<u>6</u>
	<u>6</u>
	<u>6</u>
	<u>7</u>
	<u>8</u>
	<u>8</u>
	<u>8</u>
Item 1A.	<u>10</u>
Item 1B.	<u>17</u>
Item 2.	<u>18</u>
Item 3.	<u>19</u>
<u>PART II</u>	
Item 5.	<u>20</u>
Item 6.	<u>23</u>
Item 7.	<u>26</u>
Item 7A.	<u>42</u>
Item 8.	<u>45</u>
Item 9.	<u>88</u>
Item 9A.	<u>88</u>
<u>PART III</u>	
Item 10.	<u>90</u>

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Item 11.	<u>Executive Compensation</u>	<u>90</u>
Item 12.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>90</u>
Item 13.	<u>Certain Relationships and Related Transactions, and Director Independence</u>	<u>90</u>
Item 14.	<u>Principal Accountant Fees and Services</u>	<u>90</u>
<u>PART IV</u>		
Item 15.	<u>Exhibits and Financial Statement Schedules</u>	<u>91</u>

Table of Contents

PART I

Item 1. Business

General

Quanex was organized in 1927 as a Michigan corporation under the name Michigan Seamless Tube Company. It reincorporated in Delaware in 1968 under the same name and then changed its name to Quanex Corporation in 1977. On December 12, 2007, Quanex Building Products Corporation was incorporated in the state of Delaware as a subsidiary of Quanex Corporation to facilitate the separation of Quanex Corporation's vehicular products and building products businesses. The separation occurred on April 23, 2008, through the spin-off of Quanex Corporation's building products business to its shareholders, immediately followed by the merger of Quanex Corporation (consisting principally of the Vehicular Products business and all non-building products related corporate accounts) with a wholly-owned subsidiary of Gerdau S.A. (Gerdau). This transaction is hereafter referred to as the "Separation". The Company's executive offices are located at 1900 West Loop South, Suite 1500, Houston, Texas 77027. For purposes of describing the events related to the Separation as well as other events, transactions and financial results of Quanex Building Products Corporation and its subsidiaries related to periods prior to April 23, 2008, the terms "Quanex" or the "Company" also refer to Quanex Building Products Corporation's accounting predecessor, Quanex Corporation.

The Company's manufacturing businesses are managed on a decentralized basis and operate in two reportable business segments: Engineered Products and Aluminum Sheet Products. Each business has administrative, operating and marketing functions. The Company measures each business' earnings, cash flow and return on investment and seeks to reward superior performance with incentive compensation, which is a significant portion of total compensation for salaried employees. Intercompany sales are conducted on an arms-length basis and appropriate eliminating entries are performed. The Engineered Products segment has a unified sales and marketing group, which is tasked with selling and marketing Engineered Products' complete range of components, products and systems. Operational activities and policies are managed by corporate officers and key division executives. Also, a small corporate staff provides corporate accounting, financial and treasury management, tax, legal, internal audit, information technology, payroll and human resource services to the operating divisions.

Quanex is a technological leader in the production of extruded vinyl profiles, flexible insulating glass (IG) spacer systems, solar panel sealants, aluminum flat-rolled sheet and metal and wood products that primarily serve the North American residential new construction and remodeling markets. The Company uses low-cost production processes, and engineering and metallurgical expertise, to provide customers with specialized products for their specific window and door applications. Quanex believes these capabilities also provide the Company with unique competitive advantages. The Company's growth strategy is focused on developing its Engineered Products businesses, introducing innovative products and components, and pursuing expansion through organic growth and the acquisition of companies that produce complementary products and serve similar building products markets.

Business Developments

The Company has grown primarily through the strategic acquisition of residential-related building products businesses that complement its fenestration (door and window) product base. The following business developments occurred in the past five years.

On March 31, 2011, the Company acquired Edgetech, I.G. Inc. and its German subsidiary, adding three manufacturing facilities (U.S., U.K. and Germany) that produce and market a full line of flexible insulating glass spacer systems for window and door customers in North America and abroad. In March 2011, the Company also acquired JELD-WEN's vinyl extrusion assets in Yakima, Washington. In January 2011, management closed its finished window screen

facility located in The Dalles, Oregon. In November 2011, management committed to a plan to consolidate its Truseal and U.S. Edgetech facilities. The consolidation plan, in part, called for the permanent closing of the Company's Barbourville, Kentucky facility, and relocation of the equipment used to manufacture the single seal, warm edge spacer system to the Company's Cambridge, Ohio facility. The Company believes this consolidation will allow it to better serve customers through streamlined operations. The consolidation of operations and the subsequent closure of the Barbourville facility were completed in August 2012 with residual cash payments and minor program costs expected to continue into fiscal 2013. All equipment to be retained has been relocated with the main outstanding activities only related to selling remaining equipment and the Barbourville facility itself.

In February 2010, the Company bought production assets in Shawano, Wisconsin for manufacturing engineered wood flooring. In 2010, management closed its start-up facility in China due to the contraction of demand and the Company's ability to serve the overseas thin film solar panel market from its North American operations. Accordingly, the China assets and liabilities, results of operations and cash flows are reported as discontinued operations for all periods presented.

Table of Contents

Manufacturing Processes, Markets, and Product Sales by Business Segment

The Company has 19 manufacturing facilities in 9 states in the United States, the United Kingdom, and Germany.

These facilities feature efficient plant design and flexible manufacturing processes, enabling the Company to produce a wide variety of custom engineered products and components primarily focused on the residential building products markets. The Company is able to maintain minimal levels of finished goods inventories at most locations because it typically manufactures products upon order to customer specifications. Payments for purchases and collections from customers are generally consistent with industry practices which are based on average 30 day terms for Engineered Products and 30 to 60 day terms for Aluminum Sheet Products. The majority of the Company's products are sold into the residential building products markets. Residential remodeling activity and housing starts are its primary market drivers.

For financial information regarding each of the Company's reportable business segments, see "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein and Note 12 to the Consolidated Financial Statements. For net sales of the Company by major product lines see Note 12 to the Consolidated Financial Statements. For the years ended October 31, 2012, 2011 and 2010, no single customer represented 10% or more of the consolidated net sales of the Company, respectively.

Quanex operates in two reportable business segments: Engineered Products and Aluminum Sheet Products.

Engineered Products

The Engineered Products segment is comprised of four polyvinyl chloride (vinyl) extrusion facilities, four fabricated metal components operations, two facilities producing wood fenestration (door and window) components, one facility producing engineered wood flooring and three flexible IG (insulating glass) spacer facilities. The segment's operations produce window and door components for Original Equipment Manufacturers (OEMs) that primarily serve the residential new construction, commercial construction, and residential remodeling markets. Products include vinyl window and door profiles, IG spacer systems, window and patio door screens, aluminum cladding and other roll formed metal window components, door components such as thresholds and astragals, patio doors and custom window grilles, trim and architectural moldings in a variety of woods, thin film solar panel sealants, and engineered wood flooring.

Engineered Products' extrusion operations use highly automated production facilities to manufacture vinyl and composite profiles, the framing material used by fenestration OEMs in the assembly of vinyl windows and patio doors. Value-added capabilities include compound blending, window system design, tooling design and fabrication, in-line weatherstrip installation and miter cutting, and the application of painted and co-extruded integrated weather-resistant coatings. Metal fabrication operations include roll forming, stamping, and end-product assembly to produce a variety of fenestration products. The IG systems business uses compound-extrusion and laminating technology to produce highly engineered window spacer products produced from butyl, EPDM, and silicone-based raw materials. These window spacer products are used to separate two or three panes of glass in an IG unit to improve its thermal performance. Engineered Products customers' end-use applications include windows and window components, entry and patio door systems, custom hardwood architectural moldings and flooring, and thin film solar panels. Engineered Products' key success factors include design expertise, engineering support, quality audit support, marketing support, industry and governmental advocacy, new technology development, flexible, world-class quality manufacturing capability, unique patented products, customer service, and just-in-time delivery.

Aluminum Sheet Products

The Aluminum Sheet Products segment is comprised of an aluminum mini-mill operation and three stand-alone aluminum sheet finishing operations. Aluminum sheet finishing capabilities include reducing reroll coil (hot-rolled aluminum sheet) to specific gauge, annealing, slitting and custom coating. Customer end-use applications of the finished sheet include residential windows and screens, patio doors, exterior home trim, siding, fascias, roof edgings, soffits, downspouts and gutters. A secondary market includes transportation (truck trailer, RV and mobile home).

The segment's aluminum mini-mill can produce approximately 360 million annualized finished pounds using an in-line casting process. The mini-mill converts aluminum scrap to reroll through melting, continuous casting, and in-line hot rolling processes. It also has scrap shredding and blending capabilities, as well as specialized equipment such as two rotary barrel melting furnaces, a delacquering furnace and a dross recovery system that broaden the mini-mill's use of raw materials, allowing it to utilize a broader range of scrap while improving raw material yields. Scrap is blended using computerized processes to most economically achieve the desired aluminum alloy composition. Management believes its production capabilities result in both cost advantages and savings from reduced raw material costs, optimized scrap utilization, reduced unit energy cost and lower labor costs.

Table of Contents

For financial information related to each segment, see Note 12 of the Financial Statements contained in this Annual Report on Form 10-K.

Strategy

Management's vision is to be the preferred supplier in every market we serve. Execution of the following strategies will be essential for attainment of this vision:

Achieve robust organic growth, both within our current customer base and through new market opportunities with national and regional customers, fueled by a robust system of quality and unmatched customer service, new product introduction, a systems approach and development of superior product attributes, particularly thermal efficiency, enhanced functionality, weatherability, appearance and best-in-class quality for Engineered Products;

Realize improved Aluminum Sheet profitability through a strong preventive maintenance program and through investments focused on furthering our best-in-class processes, including the specialized ability to process low grades of scrap aluminum, while increasing capacity through internal advancements and expanding sales of value added products;

Lead the Company's industry in safety, the reduction of accidents and education of the Company's work force in safety practices;

Offer logistic solutions that provide our customers with just-in-time service that reduces their processing costs;

Enhance our profitability through continued efforts to adopt, promulgate and formalize Lean Manufacturing practices within our current businesses and future acquisitions, including eliminating waste, minimizing scrap, optimizing work flow and improving productivity;

Attract and retain outstanding leadership and facilitate broad-based employee development through open communication, active feedback, meaningful goal setting and well-designed incentives; and

- Pursue an active acquisition program to grow the existing fenestration footprint into clear leadership positions through expansion of components and systems the Company offers and markets it serves.

Raw Materials and Supplies

The Engineered Products businesses purchase a diverse range of raw materials, which include polyvinyl chloride (PVC), epoxy resin, butyl, desiccant powder, silicone and EPDM rubber compounds, coated and uncoated aluminum sheet and wood (both hardwood and softwood). In most cases, the raw materials are available from several suppliers at market prices. Aluminum sheet is generally purchased from the Aluminum Sheet Products business at prices based upon arms-length transactions. Sole sourcing arrangements are entered into from time to time if beneficial savings can be realized and only when it is determined that a vendor can reliably supply all of the business' raw material requirements.

The Aluminum Sheet Products business' most significant raw material is aluminum scrap that is purchased on the open market, where availability and delivery can be adversely affected by, among other things, extreme weather conditions. Firm fixed price forward purchases matched to firm fixed price forward sales are used on a limited basis to hedge against fluctuations in the price of aluminum scrap required to manufacture products for fixed-price sales contracts.

To a lesser extent, aluminum ingot futures contracts are bought and sold on the London Metal Exchange to hedge aluminum scrap requirements.

Although the Company has material sole sourcing arrangements, its agreements have clauses that allow for termination. In addition, there are several other qualified suppliers from which the Company could purchase raw materials and supplies.

Competition

The Company's products are sold under highly competitive conditions. The Company competes with a number of companies, some of which have greater financial resources than Quanex. Competitive factors include product quality, price, delivery, and the ability to manufacture to customer specifications. The volume of aluminum sheet products and engineered building products that the Company manufactures represent a small percentage of annual domestic consumption.

Engineered Products competes against a range of small and midsize metal, vinyl and wood products suppliers and wood molding companies. The Company also competes against IG spacer manufacturing firms. IG systems are used in numerous end markets including residential housing, commercial, appliances and transportation vehicles, but the Company primarily serves the residential housing market. Competition is primarily based on regional presence, custom engineering, product development, quality,

Table of Contents

service and price. The business also competes with in-house operations of vertically integrated fenestration OEMs. Some of the primary competitors of the Engineered Products business include Royal Group, Veka, Deceuninck, Vision Extrusions, GED Integrated Solutions, Technoform, Swiss Spacer, Thermix, Allmetal and Endura.

The Aluminum Sheet Products business competes with small to large aluminum sheet manufacturers such as Aleris, Jupiter, and JW Aluminum, some of which are divisions or subsidiaries of major corporations with substantially greater resources than the Company. The Company competes in common alloy coil-coated and mill finished products, primarily on the basis of the breadth of product lines, the quality and responsiveness of its services, and price.

Sales, Marketing, and Distribution

The Company has sales representatives whose territories essentially cover all of the United States, Canada, much of Europe, and to a lesser extent, the Middle East, Latin and South America, Australia and Asia as the Company sells into numerous countries worldwide. Engineered Products segment sales are primarily to window and door OEMs through a direct sales force, along with the limited use of distributors and independent sales agents. In 2010, its three standalone sales and marketing groups (one group for each of its three divisions) were combined into one unified group, which is tasked with selling and marketing Engineered Products' complete range of components, products and systems to national and regional OEMs. The Edgetech sales and marketing resources were integrated into this unified group during 2011 and 2012. Aluminum Sheet Products segment sales are to OEM and distribution customers through both direct and indirect sales representatives.

Seasonal Nature of Business

Sales of Engineered Products and Aluminum Sheet Products businesses are seasonal. Winter weather typically reduces homebuilding and home improvement activity. The Company typically experiences its lowest sales during the first half of its fiscal year. Profits tend to be lower in quarters with lower sales because a high percentage of manufacturing overhead and operating expense is due to labor and other costs that are generally semi-variable throughout the year.

Working Capital

The Company funds operations through a combination of available cash and equivalents, short-term investments, and cash flow generated from operations. In addition, the Company's revolving credit facility is available for working capital needs. The Company extends credit to its domestic customers in the ordinary course of business generally for 30 to 60 day terms and its international customers varying from cash advance to 90 day terms. Inventory of raw materials are carried in quantities deemed necessary to ensure a smooth production process, some of which are governed by consignment agreements with suppliers. The Company maintains minimal finished goods inventories sufficient to manage customer needs.

Service Marks, Trademarks, Trade Names, and Patents

The Company's federally registered trademarks or service marks include QUANEX, QUANEX and design, "Q" design, TRUSEAL TECHNOLOGIES, DURASEAL, DURALITE, SOLARGAIN EDGE TAPE, ENVIROSEALED WINDOWS, EDGETHERM, COLONIAL CRAFT, EDGETECH, ECOBLEND, SUPER SPACER, TSS, TRUE WARM, E & Design, QUIET EDGE, HEALTH SMART WINDOWS, ENERGY WISE WINDOWS, DESI-ROPE, 360 and design, INTELLICLIP, SUSTAINAVIEW, MIKRON, MIKRONWOOD, MIKRONBLEND, MIKRON BLEND and design, ENERGYCORE, FUSION INSULATED SYSTEM, AIRCELL, SUPERCOAT, SUPERCAP, STYLELOCK, STYLELOCK and design, K2 MIKRON and design, HOMESHIELD, HOMESHIELD and design, and STORM SEAL. The trade name Nichols Aluminum is used in connection with the sale of our aluminum mill sheet products. The HOMESHIELD, COLONIAL CRAFT, TRUSEAL TECHNOLOGIES, EDGETECH, MIKRON

and QUANEX word and design marks and associated trade names are considered valuable in the conduct of business. The Company's business generally does not depend upon patent protection, but patents obtained at its vinyl extrusion, fabricated metal component operations and window sealant business units remain critical in providing a competitive advantage over other building products manufacturers. The Company's vinyl extrusion business unit obtains patent protection for various dies and other tooling created in connection with its production of customer-specific designs and extrusions. The Company's fabricated metal components business obtains patent protection for its thresholds, which gives it an advantage in the threshold markets. The Company's window sealant business unit relies on patents to protect the design of several of its window spacer products. Although the Company holds numerous patents, the proprietary process technology that has been developed is also the source of considerable competitive advantage.

Research and Development

Although not technically defined as research and development for accounting purposes, a significant amount of time,

Table of Contents

effort and expense is devoted to (a) custom engineering which qualifies products for specific customer applications, (b) developing superior, proprietary process technology and (c) partnering with customers to develop new products.

Environmental and Employee Safety Matters

The Company is subject to extensive laws and regulations concerning the discharge of materials into the environment, the remediation of chemical contamination and worker safety. To satisfy such requirements, the Company must make capital and other expenditures on an ongoing basis. The cost of environmental matters and worker safety has not had a material adverse effect on the Company's operations or financial condition in the past, and management is not currently aware of any existing conditions that it believes are likely to have a material adverse effect on its operations, financial condition, or cash flows.

Worker Safety

The Company for many years has maintained effective compliance policies that have helped to minimize liabilities and other financial impacts related to worker safety and environmental issues. These policies include extensive employee training and education, as well as internal policies embodied in the Company's Code of Conduct and elsewhere. The Company has a Quanex-wide Safety Council, comprised of leaders from across the organization, which meets regularly to discuss safety issues and drive safety improvements. In addition, the Company hired its first company-wide Director of Environmental, Health and Safety during 2012. The Company plans to continue these practices in the future and believes that they are a vital component of the Company's improving performance.

Remediation

Under applicable state and federal laws, the Company may be responsible for, among other things, all or part of the costs required to remove or remediate wastes or hazardous substances at locations it has owned or operated at any time. The Company currently is engaged in material environmental remediation activities at only one of its plant sites. From time to time, the Company also has been alleged to be liable for all or part of the costs incurred to clean up third-party sites where it is alleged to have arranged for disposal of hazardous substances. At present, the Company is not involved in any such matters.

Total environmental reserves and corresponding recovery as of October 31, 2012 and October 31, 2011 were as follows:

	October 31, 2012	October 31, 2011
	(In thousands)	
Current ⁽¹⁾	\$1,700	\$1,965
Non-current	9,827	11,221
Total environmental reserves	\$11,527	\$13,186
Receivable for recovery of remediation costs ⁽²⁾	\$11,195	\$12,304

⁽¹⁾ Reported in Accrued liabilities on the Consolidated Balance Sheets

⁽²⁾ The current portion reported in Accounts receivable and non-current portion reported in Other assets on the Consolidated Balance Sheets

The Company currently is engaged in ongoing remediation activities at one of its subsidiaries, Nichols Aluminum-Alabama, LLC (NAA). NAA operates a plant in Decatur, Alabama that is subject to an Alabama Hazardous Wastes Management and Minimization Act Post-Closure Permit. Among other things, the permit requires NAA to remediate, as directed by the state, historical environmental releases of wastes and waste constituents. Consistent with the permit, NAA has undertaken various studies of site conditions and, during the first quarter of 2006, started a phased program to treat in-place free product petroleum that had been released underneath the plant. During the second quarter 2010, NAA submitted to the state the first component of its proposed workplan for implementing a site-wide remedy. The full workplan was submitted to the state during the third quarter 2010, revised during the second quarter 2011 to reflect both additional sampling data and responses to state comments, and revised

again in the fourth quarter 2011 in response to another round of state comments. Based on those plans, which remain subject to further comment, revision, and state approval, the Company's remediation reserve at NAA's Decatur plant is \$11.5 million as of October 31, 2012. Approximately \$1.1 million of the October 31, 2012 reserve represents administrative costs; the balance of \$10.4 million represents estimated costs for investigation, studies, cleanup, and treatment. The reserve has not been discounted.

NAA was acquired through a stock purchase in which the sellers agreed to indemnify Quanex and NAA for identified

7

Table of Contents

environmental matters related to the business and based on conditions initially created or events initially occurring prior to the acquisition. Environmental conditions are presumed to relate to the period prior to the acquisition unless proved to relate to releases occurring entirely after closing. The limit on indemnification is