

Quanex Building Products CORP  
Form 10-Q  
September 07, 2017

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

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FORM 10-Q

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(Mark One)

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

For the quarterly period ended July 31, 2017

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

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QUANEX BUILDING PRODUCTS CORPORATION  
(Exact name of registrant as specified in its charter)

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DELAWARE 26-1561397  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) 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

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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 | <input checked="" type="checkbox"/>                                    | Accelerated filer         | <input type="checkbox"/> |
| Non-accelerated filer   | <input type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company | <input type="checkbox"/> |
|                         |  | Emerging growth company   | <input type="checkbox"/> |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended period for complying with any new or revised financial accounting standards provided pursuant to Section 7(a)(2)(B) of the Securities Act. ☐

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 September 5, 2017 |
|-------|----------------------------------|

Common Stock, par value \$0.01 per share 34,741,716

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QUANEX BUILDING PRODUCTS CORPORATION

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

QUANEX BUILDING PRODUCTS CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Unaudited)

|  | July 31,<br>2017                     | October 31,<br>2016 |
|--|--------------------------------------|---------------------|
|  | (In thousands, except share amounts) |                     |
| <b>ASSETS</b>  |                                      |                     |
| Current assets:  |                                      |                     |
| Cash and cash equivalents  | \$ 15,791                            | \$ 25,526           |
| Accounts receivable, net of allowance for doubtful accounts of \$404 and \$251   | 78,046                               | 83,625              |
| Inventories, net (Note 3)  | 94,373                               | 84,335              |
| Prepaid and other current assets   | 8,119                                | 10,488              |
| Total current assets   | 196,329                              | 203,974             |
| Property, plant and equipment, net of accumulated depreciation of \$259,709 and \$245,128  | 214,829                              | 198,497             |
| Goodwill (Note 4)  | 222,153                              | 217,035             |
| Intangible assets, net (Note 4)  | 143,702                              | 154,180             |
| Other assets   | 8,046                                | 6,667               |
| Total assets   | \$ 785,059                           | \$ 780,353          |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                                      |                     |
| Current liabilities:   |                                      |                     |
| Accounts payable   | \$ 45,709                            | \$ 47,781           |
| Accrued liabilities  | 35,476                               | 55,101              |
| Income taxes payable (Note 8)  | 2,133                                | 732                 |
| Current maturities of long-term debt (Note 5)  | 26,364                               | 10,520              |
| Total current liabilities  | 109,682                              | 114,134             |
| Long-term debt (Note 5)  | 238,033                              | 259,011             |
| Deferred pension and postretirement benefits (Note 6)  | 10,704                               | 8,167               |
| Deferred income taxes (Note 8)   | 18,509                               | 18,322              |
| Other liabilities  | 15,460                               | 12,888              |
| Total liabilities  | 392,388                              | 412,522             |
| 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 37,508,877 and 37,560,249, respectively; outstanding 34,741,716 and 34,220,496, respectively | 375                                  | 376                 |
| Additional paid-in-capital   | 256,170                              | 254,540             |
| Retained earnings  | 216,553                              | 214,047             |
| Accumulated other comprehensive loss   | (27,491)                             | (38,765)            |
| Less: Treasury stock at cost, 2,767,161 and 3,339,753 shares, respectively   | (52,936)                             | (62,367)            |
| Total stockholders' equity   | 392,671                              | 367,831             |
| Total liabilities and stockholders' equity   | \$ 785,059                           | \$ 780,353          |
| The accompanying notes are an integral part of the financial statements.   |                                      |                     |

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

|   | Three Months Ended<br>July 31,           |           | Nine Months Ended<br>July 31, |           |
|---|--|-----------|-------------------------------|-----------|
|   | 2017                                     | 2016      | 2017                          | 2016      |
|   | (In thousands, except per share amounts) |           |                               |           |
| Net sales   | \$229,367                                | \$248,085 | \$634,406                     | \$679,013 |
| Cost and expenses:                                      |  |           |                               |           |
| Cost of sales (excluding depreciation and amortization) | 176,758                                  | 186,631   | 494,647                       | 522,476   |
| Selling, general and administrative                     | 20,478                                   | 28,551    | 74,839                        | 88,430    |
| Restructuring charges                                   | 864                                      | —         | 3,083                         | —         |
| Depreciation and amortization                           | 13,915                                   | 12,973    | 43,701                        | 39,759    |
| Operating income  | 17,352                                   | 19,930    | 18,136                        | 28,348    |
| Non-operating (expense) income:                         |  |           |                               |           |
| Interest expense  | (2,575)                                  | (22,200)  | (7,126)                       | (34,324)  |
| Other, net  | 46                                       | (2,523)   | 572                           | (4,036)   |
| Income (loss) before income taxes                       | 14,823                                   | (4,793)   | 11,582                        | (10,012)  |
| Income tax (expense) benefit                            | (4,608)                                  | 817       | (3,631)                       | 2,722     |
| Net income (loss)                                       | \$10,215                                 | \$(3,976) | \$7,951                       | \$(7,290) |
| Basic income (loss) per common share                    | \$0.30                                   | \$(0.12)  | \$0.23                        | \$(0.22)  |
| Diluted income (loss) per common share:                 | \$0.29                                   | \$(0.12)  | \$0.23                        | \$(0.22)  |
| Weighted-average common shares outstanding:             |  |           |                               |           |
| Basic   | 34,224                                   | 33,916    | 34,141                        | 33,850    |
| Diluted   | 34,924                                   | 33,916    | 34,771                        | 33,850    |
| Cash dividends per share                                | \$0.04                                   | \$0.04    | \$0.12                        | \$0.12    |

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

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

|  | Three Months<br>Ended<br>July 31,<br>2017 |            | Nine Months<br>Ended<br>July 31,<br>2017 |            |
|--|---|------------|--|------------|
|  | 2016                                      |            | 2016                                     |            |
|  | (In thousands)                            |            |  |            |
| Net income (loss)                                    | \$10,215                                  | \$(3,976 ) | \$7,951                                  | \$(7,290 ) |
| Other comprehensive income (loss):                   |   |            |  |            |
| Foreign currency translation adjustments gain (loss) | 4,698                                     | (12,161 )  | 11,274                                   | (17,883 )  |
| Other comprehensive income (loss)                    | 4,698                                     | (12,161 )  | 11,274                                   | (17,883 )  |
| Comprehensive income (loss)                          | \$14,913                                  | \$(16,137) | \$19,225                                 | \$(25,173) |

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

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

|  | Nine Months<br>Ended<br>July 31,<br>2017      2016<br>(In thousands) |            |
|--|--|------------|
| Operating activities:  |  |            |
| Net income (loss)  | \$7,951  | \$(7,290 ) |
| Adjustments to reconcile net income (loss) to cash provided by operating activities: |  |            |
| Depreciation and amortization  | 43,701   | 39,759     |
| Stock-based compensation   | 4,305  | 4,587      |
| Deferred income tax  | (1,847 )   | (6,370 )   |
| Excess tax benefit from share-based compensation                                     | (229 )   | (134 )     |
| Noncash charge for deferred loan costs and debt discount                             | —  | 15,883     |
| Other, net   | 1,136  | 543        |
| Changes in assets and liabilities, net of effects from acquisitions:                 |  |            |
| Decrease in accounts receivable  | 6,923  | 2,035      |
| Increase in inventory  | (8,576 )   | (1,530 )   |
| Increase in other current assets   | (379 )   | (1,239 )   |
| Decrease in accounts payable   | (3,145 )   | (2,092 )   |
| Decrease in accrued liabilities  | (12,303 )  | (2,139 )   |
| Increase in income taxes payable   | 4,349  | 2,990      |
| Increase in deferred pension and postretirement benefits                             | 2,537  | 2,485      |
| Increase in other long-term liabilities  | 1,226  | 894        |
| Other, net   | (389 )   | 676        |
| Cash provided by operating activities  | 45,260   | 49,058     |
| Investing activities:  |  |            |
| Acquisitions, net of cash acquired   | (8,497 )   | (245,904)  |
| Capital expenditures   | (27,098 )  | (25,938 )  |
| Proceeds from disposition of capital assets  | 1,232  | 984        |
| Cash used for investing activities   | (34,363 )  | (270,858)  |
| Financing activities:  |  |            |
| Borrowings under credit facilities   | 53,500   | 632,800    |
| Repayments of credit facility borrowings   | (74,125 )  | (389,000)  |
| Debt issuance costs  | —  | (11,795 )  |
| Repayments of other long-term debt   | (2,240 )   | (1,825 )   |
| Common stock dividends paid  | (4,127 )   | (4,101 )   |
| Issuance of common stock   | 6,379  | 3,368      |
| Excess tax benefit from share-based compensation                                     | 229  | 134        |
| Cash (used for) provided by financing activities                                     | (20,384 )  | 229,581    |
| Effect of exchange rate changes on cash and cash equivalents                         | (248 )   | 1,277      |
| (Decrease) increase in cash and cash equivalents                                     | (9,735 )   | 9,058      |
| Cash and cash equivalents at beginning of period                                     | 25,526   | 23,125     |
| Cash and cash equivalents at end of period   | \$15,791   | \$32,183   |
| The accompanying notes are an integral part of the financial statements.             |  |            |





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

| Nine Months Ended July 31, 2017             | 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, 2016                 | \$376   | \$254,540                        | \$214,047            | \$ (38,765 )                                  | \$(62,367)        | \$ 367,831                       |
| Net income                                  | —   | —                                | 7,951                | —   | —                 | 7,951                            |
| Foreign currency translation adjustment     | —   | —                                | —                    | 11,274  | —                 | 11,274                           |
| Common dividends (\$0.12 per share)         | —   | —                                | (4,127 )             | —   | —                 | (4,127 )                         |
| Stock-based compensation activity:          |   |                                  |                      |   |                   |                                  |
| Expense related to stock-based compensation | —   | 4,305                            | —                    | —   | —                 | 4,305                            |
| Stock options exercised                     | —   | (76 )                            | (1,225 )             | —   | 7,680             | 6,379                            |
| Tax effect from share-based compensation    | —   | 34                               | —                    | —   | —                 | 34                               |
| Restricted stock awards granted             | —   | (1,752 )                         | —                    | —   | 1,752             | —                                |
| Other                                       | (1 )  | (881 )                           | (93 )                | —   | (1 )              | (976 )                           |
| Balance at July 31, 2017                    | \$375   | \$256,170                        | \$216,553            | \$ (27,491 )                                  | \$(52,936)        | \$ 392,671                       |

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

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QUANEX BUILDING PRODUCTS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Nature of Operations and Basis of Presentation

Quanex Building Products Corporation is a component supplier to original equipment manufacturers (OEMs) in the building products industry. These components can be categorized as window and door (fenestration) components and kitchen and bath cabinet components. Examples of fenestration components 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. We also manufacture cabinet doors and other components for OEMs in the kitchen and bathroom cabinet industry. In addition, we provide certain other non-fenestration components and products, which include solar panel sealants, wood flooring, trim moldings, vinyl decking, fencing, water retention barriers, and conservatory roof components. We have organized our business into three reportable operating segments. For additional discussion of our reportable operating segments, see Note 14, "Segment Information." We use low-cost, short lead-time production processes and engineering expertise to provide our customers with specialized products for their specific window, door, and cabinet applications. We believe these capabilities provide us with unique competitive advantages. We serve a primary customer base in North America and the United Kingdom, and also serve customers in international markets through our 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 condensed consolidated balance sheet as of October 31, 2016 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, 2016. 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.

Restructuring

We accrue one-time severance costs pursuant to an approved plan of restructuring at the communication date, when affected employees have been notified of the potential severance and sufficient information has been provided for the employee to calculate severance benefits, in the event the employee is involuntarily terminated. In addition, we accrue costs associated with the termination of contractual commitments including operating leases at the time the lease is terminated pursuant to the lease provisions or in accordance with another agreement with the landlord. Otherwise, we continue to recognize operating lease expense through the cease-use date. After the cease-use date, we determine if our operating lease payments are at market. We assume sublet of the facility at the market rate. To the extent our lease obligations exceed the fair value rentals, we discount to arrive at the present value and record a liability. If the facility is not sublet, we expense the amount of the rental in the current period. For other costs directly related to the restructuring effort, such as equipment moving costs, we expense in the period incurred.

In October 2016, we announced the closure of three operating plants, two related to our United States vinyl operations, and one related to our kitchen and bathroom cabinet door business in Mexico. During the three and nine months ended July 31, 2017 and the year ended October 31, 2016, we expensed \$0.9 million, \$3.1 million and \$0.5 million, respectively, pursuant to these restructuring efforts. Our facility lease obligations were deemed to be at fair market value and we have not yet negotiated exit from our remaining lease obligations. We expect to continue to incur costs related to equipment moves, operating lease expense and other employee related costs associated with these restructuring efforts during fiscal 2017.

In addition, we evaluated the remaining depreciable lives of property, plant and equipment that will be abandoned or otherwise disposed as of the cease-use date of these plants. In October 2016, we recorded a change in estimate associated with the remaining useful lives of these assets which resulted in an increase in depreciation expense of \$1.0 million and \$3.9 million

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## QUANEX BUILDING PRODUCTS CORPORATION

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

for the three and nine months ended July 31, 2017, respectively. We continue to evaluate our property, plant and equipment with regard to these restructuring efforts and are determining the best use of this equipment within our business. We do not expect to incur additional accelerated depreciation or gains or losses on asset disposals related to these restructuring efforts. Concurrently, we evaluated the remaining service lives of intangible assets with defined lives associated with our United States vinyl extrusion business and recorded a change in estimate associated with the remaining useful lives of a customer relationship intangible and a utility process intangible asset resulting in an increase in amortization expense of \$0.3 million and \$1.6 million for the three and nine months ended July 31, 2017, respectively. We expect to incur incremental amortization expense totaling \$0.3 million associated with these intangible assets during the remainder of fiscal 2017.

In June 2017, we committed to a plan to close a Woodcraft plant in Lansing, Kansas, which we expect to complete later this year. We expect to incur costs of \$0.5 million related to equipment moves and employee costs, and to incur accelerated depreciation associated with this closure of \$0.2 million during the remainder of fiscal 2017.

## 2. Acquisitions

## Woodcraft

On November 2, 2015, we completed a merger of QWMS, Inc., a Delaware corporation which was a newly-formed and wholly-owned Quanex subsidiary, and WII Holding, Inc. (WII), a Delaware corporation. Upon satisfaction or waiver of conditions set forth in the merger agreement, QWMS, Inc. merged with and into WII, and WII became our wholly-owned subsidiary, and, as a result, we acquired all the subsidiaries of WII (referred to collectively as Woodcraft). Woodcraft is a manufacturer of cabinet doors and other components to OEMs in the kitchen and bathroom cabinet industry. Woodcraft operates 14 plants within the United States, including two which were transferred from the NA Engineered Components segment during the three months ended July 31, 2017, as well as a location in Lansing, Kansas, which will be closed later this year. We paid \$245.9 million in cash, net of cash acquired and including certain holdbacks with regard to potential indemnity claims, and received less than \$0.1 million from the sellers as a working capital true-up, resulting in goodwill totaling \$113.7 million. We recorded a charge of \$0.9 million related to restructuring efforts at Woodcraft for the nine months ended July 31, 2017. See Note 1, "Nature of Operations and Basis of Presentation - Restructuring." We believe this acquisition expanded our business into a new segment of the building products industry, which is experiencing favorable growth and which is less susceptible to the impact of seasonality due to inclement weather.

The Woodcraft purchase price is summarized in the table below.

|                                  | As of Date of<br>Opening Balance<br>Sheet<br>(In thousands) |
|----------------------------------|---|
| Net assets acquired:             |   |
| Accounts receivable              | \$ 23,944   |
| Inventory                        | 29,552  |
| Prepaid and other current assets | 4,081   |
| Property, plant and equipment    | 63,154  |
| Goodwill                         | 113,747   |
| Intangible assets                | 62,900  |
| Other non-current assets         | 24  |
| Accounts payable                 | (4,620 )  |

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|  |            |   |
|--|------------|---|
| Accrued expenses   | (9,492     | ) |
| Deferred income tax liabilities, net   | (37,386    | ) |
| Net assets acquired  | \$ 245,904 |   |
| Consideration:   |            |   |
| Cash, net of cash and cash equivalents acquired and working-capital true-up received | \$ 245,904 |   |

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. Intangible assets related to the Woodcraft acquisition included \$62.8 million of customer relationships and other intangibles of less than \$0.1 million, with original estimated useful lives of 12 years and 1 year, respectively. These intangible assets are being amortized on a straight-line

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## QUANEX BUILDING PRODUCTS CORPORATION

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

basis. The goodwill balance is not deductible for tax purposes. Woodcraft is allocated entirely to our North American Cabinet Components reportable operating segment.

**HLP**

As more fully described in our Annual Report on Form 10-K for the year ended October 31, 2016, we acquired the outstanding ownership shares of an extruder of vinyl lineal products and manufacturer of other plastic products incorporated and registered in England and Wales ("HLP") on June 15, 2015. The purchase agreement contained an earn-out provision which is calculated as a percentage of earnings before interest, tax and depreciation and amortization for a specified period, as defined in the purchase agreement. Pursuant to this earn-out provision, the former owner could select a base year upon which to calculate the earn-out (one of the next three succeeding twelve-month periods ended July 31). In August 2016, the former owner selected the twelve-month period ended July 31, 2016 as the measurement period for the earn-out calculation. On November 7, 2016, we paid \$8.5 million to settle the earn-out, which included a foreign currency adjustment of \$0.1 million. We have included this earn-out payment under the caption "Acquisitions, net of cash acquired" in the accompanying cash flow statement for the nine months ending July 31, 2017.

We assumed operating leases associated with the HLP acquisition for which our lessors are entities that were either wholly-owned subsidiaries or affiliates of HLP prior to the acquisition, and in which a former owner, who is now our employee, has an ownership interest. These leases include our primary operating facilities, a finished goods warehouse and a mixing plant. The lease for the manufacturing plant has a 20-year term which began in 2007, the lease for the warehouse has a 15-year term which began in 2012, and the lease for the mixing plant has a 13.5-year term which began in 2013. We have recorded rent expense pursuant to these agreements of approximately \$0.3 million and \$0.4 million, for the three-month periods ended July 31, 2017 and 2016, respectively, and \$0.9 million and \$1.1 million, respectively, for the nine-month periods then ended. Commitments under these lease arrangements are included in our operating lease commitments as disclosed in our Annual Report on Form 10-K for the year ended October 31, 2016.

On February 20, 2017, we entered into a capital lease arrangement with the same related party to purchase a new manufacturing facility at HLP. This capital lease resulted in a non-cash increase in property, plant and equipment and a corresponding increase in debt, as more fully described at Note 5, "Debt and Capital Lease Obligations - Other Debt Instruments", included herewith.

**3. Inventories**

Inventories consisted of the following at July 31, 2017 and October 31, 2016:

|                                    | July 31, October 31,<br>2017 2016 |           |
|------------------------------------|-----------------------------------|-----------|
|                                    | (In thousands)                    |           |
| Raw materials                      | \$51,977                          | \$ 50,584 |
| Finished goods and work in process | 44,701                            | 36,886    |
| Supplies and other                 | 2,723                             | 1,859     |
| Total                              | 99,401                            | 89,329    |
| Less: Inventory reserves           | 5,028                             | 4,994     |
| Inventories, net                   | \$94,373                          | \$ 84,335 |

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 July 31, 2017 and October 31, 2016 were valued using the following costing methods:

July 31,    October 31,

2017       2016

(In thousands)

LIFO \$4,962    \$ 4,017

FIFO 89,411    80,318

Total \$94,373    \$ 84,335

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## QUANEX BUILDING PRODUCTS CORPORATION

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

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 may 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 reserve adjustment for the three- and nine-month periods ended July 31, 2017 and 2016.

For inventories valued under the LIFO method, replacement cost exceeded the LIFO value by approximately \$1.1 million at July 31, 2017 and October 31, 2016.

## 4. Goodwill and Intangible Assets

## Goodwill

The change in the carrying amount of goodwill for the nine months ended July 31, 2017 was as follows:

|  | Nine<br>Months<br>Ended<br>July 31,<br>2017<br>(In<br>thousands) |
|--|--|
| Beginning balance as of November 1, 2016 | \$ 217,035   |
| Foreign currency translation adjustment  | 5,118  |
| Balance as of the end of the period      | \$ 222,153   |

During the fourth fiscal quarter of 2016, we evaluated our goodwill balances for indicators of impairment and performed our annual goodwill impairment test to determine the recoverability of these assets. At our annual testing date, August 31, 2016, we evaluated six reportable units with goodwill balances. The results of this testing is described at Note 1, "Nature of Operations, Basis of Presentation and Significant Accounting Policies - Long-Lived Assets - Goodwill" in our Annual Report on Form 10-K for the year ended October 31, 2016. The fair value of one of these reportable units, which is the sole unit in our NA Cabinet Components operating segment, exceeded its carry value by only 7%. The operating performance of this reportable unit during the nine months ended July 31, 2017 has been below our expectations. Therefore, we have reduced our short-term forecasts for this reportable unit. This change in forecasted results constituted a triggering event which required an evaluation of the related goodwill for impairment. We tested this reportable unit as of July 31, 2017 and determined that the fair value of this unit exceeded its carrying value by approximately 6%. Thus, goodwill was not impaired. We will conduct our annual goodwill testing as of August 31, 2017.

## Identifiable Intangible Assets

Amortizable intangible assets consisted of the following as of July 31, 2017 and October 31, 2016:

|                        | July 31, 2017               |                             | October 31, 2016            |                             |
|------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
|                        | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization |
|                        | (In thousands)              |                             |                             |                             |
| Customer relationships | \$ 155,029                  | \$ 45,314                   | \$ 152,146                  | \$ 35,693                   |



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|                              |           |           |           |           |
|------------------------------|-----------|-----------|-----------|-----------|
| Trademarks and trade names   | 56,376    | 29,002    | 55,481    | 26,288    |
| Patents and other technology | 22,272    | 15,659    | 24,571    | 16,037    |
| Other                        | —         | —         | 100       | 100       |
| Total                        | \$233,677 | \$ 89,975 | \$232,298 | \$ 78,118 |

In October 2016, we recorded a change in estimate with regard to the remaining service lives of certain intangible assets and recorded incremental amortization expense of \$0.3 million and \$1.6 million for the year ended October 31, 2016 and the nine months ended July 31, 2017, respectively. See additional disclosure at Note 1, "Nature of Operations, Basis of Presentation and Significant Accounting Policies - Restructuring."

For each of the three-month periods ended July 31, 2017 and 2016, we had aggregate amortization expense related to intangible assets of \$4.4 million, and for each of the corresponding nine-month periods, we had \$14.3 million and \$13.0 million of aggregate

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## QUANEX BUILDING PRODUCTS CORPORATION

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

amortization expense, respectively. In addition, during the nine-month period ended July 31, 2017, we retired \$2.4 million of fully amortized intangible assets from which no future benefit is expected.

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

|                               | Estimated<br>Amortization<br>Expense |
|-------------------------------|--------------------------------------|
| 2017 (remaining three months) | \$ 4,457                             |
| 2018                          | 16,099                               |
| 2019                          | 15,311                               |
| 2020                          | 14,252                               |
| 2021                          | 12,534                               |
| Thereafter                    | 81,049                               |
| Total                         | \$ 143,702                           |

## 5. Debt and Capital Lease Obligations

Debt consisted of the following at July 31, 2017 and October 31, 2016:

|  | July 31,<br>2017 | October 31,<br>2016 |
|--|------------------|---------------------|
|  | (In thousands)   |                     |
| Revolving Credit Facility                                    | \$105,000        | \$120,000           |
| Term Loan A  | 142,500          | 148,125             |
| City of Richmond, Kentucky Industrial Building Revenue Bonds | —                | 400                 |
| Capital lease obligations and other                          | 19,125           | 3,683               |
| Unamortized deferred financing fees                          | (2,228 )         | (2,677 )            |
| Total debt   | \$264,397        | \$269,531           |
| Less: Current maturities of long-term debt                   | 26,364           | 10,520              |
| Long-term debt   | \$238,033        | \$259,011           |

As described in our Annual Report on Form 10-K for the year ended October 31, 2016, on July 29, 2016, we refinanced and retired our prior credit facilities and entered into a \$450.0 million credit agreement comprised of a \$150.0 million Term Loan A and a \$300.0 million revolving credit facility (collectively, the “Credit Agreement”), with Wells Fargo Bank, National Association, as Agent, Swingline Lender and Issuing Lender, and Bank of America, N.A. serving as Syndication Agent. The Credit Agreement has a five-year term, maturing on July 29, 2021, and requires interest payments calculated, at our election and depending upon our Consolidated Leverage Ratio, at either a Base Rate plus an applicable margin or the LIBOR Rate plus an applicable margin. At the time of the initial borrowing, the applicable rate was LIBOR + 2.00%. In addition, we are subject to commitment fees for the unused portion of the Credit Agreement.

The applicable margin and commitment fees are outlined in the following table:

| Pricing<br>Level | Consolidated Leverage Ratio        | Commitment<br>Fee | LIBOR Rate<br>Loans | Base Rate<br>Loans |
|------------------|------------------------------------|-------------------|---------------------|--------------------|
| I                | Less than or equal to 1.50 to 1.00 | 0.200%            | 1.50%               | 0.50%              |
| II               |                                    | 0.225%            | 1.75%               | 0.75%              |

|     |  |        |       |       |
|-----|--|--------|-------|-------|
|     | Greater than 1.50 to 1.00, but less than or equal to<br>2.25 to 1.00 |        |       |       |
| III | Greater than 2.25 to 1.00, but less than or equal to<br>3.00 to 1.00 | 0.250% | 2.00% | 1.00% |
| IV  | Greater than 3.00 to 1.00  | 0.300% | 2.25% | 1.25% |

In the event of default, outstanding borrowings would accrue interest at the Default Rate, as defined, whereby the obligations will bear interest at a per annum rate equal to 2% above the total per annum rate otherwise applicable.

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## QUANEX BUILDING PRODUCTS CORPORATION

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

The term loan portion of the Credit Agreement requires quarterly principal payments on the last business day of each fiscal quarter in accordance with a stated repayment schedule. Required aggregate principal repayments total \$15.0 million for the succeeding twelve-month period, and are included in the accompanying condensed consolidated balance sheet under the caption “Current Maturities of Long-term Debt.” No stated principal payments are required under the revolving credit portion of the Credit Agreement, except upon maturity. If our Consolidated Leverage Ratio is less than 2.25 to 1.00, then we are required to make mandatory prepayments of “excess cash flow” as defined in the agreement.

The Credit Agreement contains a: (1) Consolidated Fixed Charge Coverage Ratio requirement whereby we must not permit the Consolidated Fixed Charge Coverage Ratio, as defined, to be less than 1.10 to 1.00, and (2) Consolidated Leverage Ratio requirement, as summarized by period in the following table:

| Period                                    | Maximum Ratio |
|---|---------------|
| Closing Date through January 30, 2017     | 3.50 to 1.00  |
| January 31, 2017 through January 30, 2018 | 3.25 to 1.00  |
| January 31, 2018 and thereafter           | 3.00 to 1.00  |

In addition to maintaining these financial covenants, the Credit Agreement also limits our ability to enter into certain business transactions, such as to incur indebtedness or liens, to acquire businesses or dispose of material assets, make restricted payments, pay dividends (limited to \$10.0 million per year) and other transactions as further defined in the Credit Agreement. Substantially all of our domestic assets, with the exception of real property, are utilized as collateral for the Credit Agreement.

As of July 31, 2017, we had \$247.5 million of borrowings outstanding under the Credit Agreement (reduced by unamortized debt issuance costs of \$2.2 million), \$5.4 million of outstanding letters of credit and \$19.1 million outstanding under capital leases and other debt vehicles. We had \$189.6 million available for use under the Credit Agreement at July 31, 2017. These borrowings outstanding under the Credit Agreement accrue interest at 3.23% per annum. Our weighted average borrowing rate for borrowings outstanding during the nine months ended July 31, 2017 and 2016 was 2.87% and 6.10%, respectively. We were in compliance with our debt covenants as of July 31, 2017. During August 2017, we repaid \$10.0 million of borrowings outstanding under our revolving credit facility as of July 31, 2017. Therefore, we have included these borrowings in current maturities of long term debt on the accompanying condensed consolidated balance sheet as of July 31, 2017.

**Other Debt Instruments**

Historically, we have maintained certain capital lease obligations related to equipment purchases. On February 20, 2017, we entered into a capital lease for warehouse space at HLP with a related-party company that is owned by our employee, the former owner of HLP. This new warehouse was anticipated at the time of the HLP acquisition in June 2015, and the lease was negotiated at arms-length. The lease accrues interest at 3.57% per annum, and extends for a twenty-year period through the year 2036. We recorded the leased asset at inception at fair value of \$16.6 million and recorded a corresponding liability for our obligation under this lease. The accompanying statement of cash flows as of July 31, 2017 excludes these assets and related obligations as non-cash investing and financing activities. We are recognizing interest expense using the effective interest method over the term. Our cash commitments under this lease are £0.9 million per year for an aggregate of £17.8 million (or approximately \$23.5 million). The cost and accumulated depreciation of property, plant and equipment under capital leases at July 31, 2017 was \$23.9 million and \$1.9 million, respectively, including \$16.9 million and \$0.2 million, respectively, related to this warehouse lease. As of July 31, 2017, our obligations under capital leases and other total \$19.1 million, of which \$1.9 million is classified in the current portion of long-term debt and \$17.2 million is classified as long-term debt on the

accompanying unaudited condensed consolidated balance sheet. These obligations accrue interest at an average rate of 3.7%, and extend through the year 2036.

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## 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 in the United States excluding employees of recent acquisitions. Employees of acquired companies may be covered after a transitional period. The net periodic pension cost for this plan for the three- and nine-month periods ended July 31, 2017 and 2016 was as follows:

|                                | Three<br>Months<br>Ended<br>July 31,<br>2017 |        | Nine Months<br>Ended<br>July 31,<br>2016 |          |
|--------------------------------|--|--------|--|----------|
|                                | 2017   | 2016   | 2017                                     | 2016     |
|                                | (In thousands)                               |        |  |          |
| Service cost                   | \$949  | \$928  | \$2,845                                  | \$2,784  |
| Interest cost                  | 215  | 207    | 642                                      | 621      |
| Expected return on plan assets | (466 )                                       | (404 ) | (1,397 )                                 | (1,213 ) |
| Amortization of net loss       | 144  | 96     | 430                                      | 288      |
| Net periodic benefit cost      | \$842  | \$827  | \$2,520                                  | \$2,480  |

During 2016, we contributed \$3.7 million to fund our plan, and we expect to make a contribution to our plan in September 2017 of approximately \$3.6 million.

## 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 July 31, 2017 and October 31, 2016, our liability under the supplemental benefit plan was approximately \$3.2 million and \$2.7 million, respectively, and the liability associated with the deferred compensation plan was approximately \$3.9 million and \$3.5 million, respectively. We record the current portion of liabilities associated with these plans under the caption "Accrued Liabilities," and the long-term portion under the caption "Other Liabilities" in the accompanying condensed consolidated 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. 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.

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:

Nine  
Months  
Ended  
July 31,  
2017

|  | (In<br>thousands) |
|--|-------------------|
| Beginning balance as of November 1, 2016           | \$ 446            |
| Provision for warranty expense                     | (2 )              |
| Change in accrual for preexisting warranties       | 4                 |
| Warranty costs paid                                | (65 )             |
| Total accrued warranty as of the end of the period | \$ 383            |
| Less: Current portion of accrued warranty          | 211               |
| Long-term portion of accrued warranty              | \$ 172            |

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QUANEX BUILDING PRODUCTS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

8. Income Taxes

To determine our income tax expense or benefit 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 for the nine-month periods ended July 31, 2017 and 2016 were 31.4% (expense) and 27.2% (benefit), respectively. The 2016 effective rate was impacted by an additional discrete benefit item for the R&D credit which was made permanent in December 2015. Excluding this item, the effective tax rate would have been 25.8%.

The acquisition of Woodcraft in November 2015 established a net noncurrent deferred tax liability of \$37.4 million primarily reflecting the book to tax basis difference in intangibles, fixed assets and inventory.

As of July 31, 2017, our liability for uncertain tax positions (UTP) of \$0.6 million relates to certain state tax items regarding the interpretation of tax laws and regulations. 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. The disallowance of the UTP would not materially affect the annual effective tax rate. We do not believe any of the UTP at July 31, 2017 will be recognized within the next twelve months.

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 \$1.2 million at July 31, 2017.

Our federal income tax return for the pre-acquisition short period of January 1, 2015 to November 2, 2015 for Woodcraft is currently under audit by the United States Internal Revenue Service.

9. Contingencies

Remediation and Environmental Compliance Costs

Under applicable state and federal laws, we may be responsible for, among other things, all or part of the costs required to remove or remediate wastes or hazardous substances at locations we, or our predecessors, have owned or operated. From time to time, we also have been alleged to be liable for all or part of the costs incurred to clean up third-party sites where there might have been an alleged improper disposal of hazardous substances. At present, we are not involved in any such matters.

From time to time, we incur routine expenses and capital expenditures associated with compliance with existing environmental regulations, including control of air emissions and water discharges, and plant decommissioning costs. We have not incurred any material expenses or capital expenditures related to environmental matters during the past three fiscal years, and do not expect to incur a material amount of such costs in fiscal 2017. While we will continue to have future expenditures related to environmental matters, any such amounts are impossible to reasonably estimate at this time. Based upon our experience to date, we do not believe that our compliance with environmental requirements will have a material adverse effect on our operations, financial condition or cash flows.

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 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. The balance of the accrual for this matter was \$0.8 million and \$1.1 million at October 31, 2016 and July 31, 2017. During the nine months ended July 31, 2017, we incurred additional claims of



\$1.1 million, which was offset by payments of \$0.8 million. We cannot estimate any future liability with regard to unasserted claims. We evaluate this reserve at each balance sheet date. We investigate any 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, including those arising from or related to contractual matters, commercial disputes, intellectual property, personal injury, environmental matters, product performance or warranties, product liability, insurance coverage and personnel and employment disputes. For example, we were recently party to litigation incidental to our business relating to alleged defects in a

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## QUANEX BUILDING PRODUCTS CORPORATION

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

commercial sealant product manufactured and sold by one of our subsidiaries during the 2000s. The plaintiff in that case sought a substantial amount in monetary damages from us and four other co-defendants. The parties ultimately settled the matter during trial in a mutually agreeable manner and without any material impact to our business, financial condition, results of operations or cash flows. We paid \$0.5 million in May 2017 as our portion of the claim settlement, with the remainder absorbed by our insurance carrier. We received a reimbursement of \$2.0 million from our insurance carrier in June 2017 associated with fees incurred to defend this claim. Other claims related to this commercial sealant product have been filed, however, and are proceeding. While we continue to strongly believe that our product was not defective and that we would prevail in such related commercial sealant product claims if taken to trial, the timing and ultimate resolution and impact of these claims is not presently determinable. Nevertheless, after taking into account all currently available information, advice of counsel, and our existing insurance coverage, we believe that the eventual outcome of such related claims will not have a material adverse effect on our overall financial condition, results of operations or cash flows. We have not recorded any accrual with regard to such related claims. We regularly review the status of all on-going proceedings with legal counsel and maintain insurance against these risks to the extent deemed prudent by our management and to the extent insurance is available. Given our defenses and existing insurance coverage, we believe that the ultimate disposition of our pending litigation matters will not, individually or in the aggregate, have a material adverse effect on us. However, there is no assurance that we will prevail in these matters, and we could, in the future, incur judgments, enter into settlements of claims or revise our expectations regarding the outcome of matters we face, which could materially impact our results of operations.

## 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 unaudited condensed consolidated statements of income (loss) for the three- and nine-month periods ended July 31, 2017 and 2016 as follows (in thousands):

|                             |          |          |
|-----------------------------|----------|----------|
|                             | Three    | Nine     |
|                             | Months   | Months   |
|                             | Ended    | Ended    |
|                             | July 31, | July 31, |
| Location of (losses) gains: | 2017     | 2016     |

|               |                              |          |          |
|---------------|------------------------------|----------|----------|
| Cost of sales | Aluminum derivatives         | \$—\$ 14 | \$—\$14  |
| Other, net    | Foreign currency derivatives | (32352   | (213180) |

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 the accompanying condensed consolidated balance sheets. Less than \$0.1 million of fair value related to foreign currency derivatives was included in prepaid and other current assets as of July 31, 2017 and October 31, 2016, and less than \$0.1 million of fair value related to foreign currency derivatives was included in accrued liabilities as of July 31, 2017 and October 31, 2016.

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

The following table summarizes the notional amounts and fair value of outstanding derivative contracts at July 31, 2017 and October 31, 2016 (in thousands):

|                               | Notional as indicated |                  | Fair Value in \$ |                  |
|-------------------------------|-----------------------|------------------|------------------|------------------|
|                               | July 31, 2017         | October 31, 2016 | July 31, 2017    | October 31, 2016 |
| Foreign currency derivatives: |                       |                  |                  |                  |
| Sell EUR, buy USD             | EUR \$2,765           | \$ 5,251         | \$(52)           | \$ (79 )         |
| Sell CAD, buy USD             | CAD 260               | 186              | (1 )             | 1                |
| Sell GBP, buy USD             | GBP 38                | 187              | (1 )             | (1 )             |
| Buy EUR, sell GBP             | EUR 47                | 130              | —                | 1                |
| Buy USD, sell EUR             | USD 34                | 1                | (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 data 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.

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

|                              | July 31, 2017 |         |         |       | October 31, 2016 |         |         |       |
|------------------------------|---------------|---------|---------|-------|------------------|---------|---------|-------|
|                              | Level 1       | Level 2 | Level 3 | Total | Level 1          | Level 2 | Level 3 | Total |
| <b>Assets</b>                |               |         |         |       |                  |         |         |       |
| Foreign currency derivatives | \$ —          | \$ —    | \$ —    | \$ —  | \$ 2             | \$ —    | \$ —    | \$ 2  |
| Total assets                 | \$ —          | \$ —    | \$ —    | \$ —  | \$ 2             | \$ —    | \$ —    | \$ 2  |
| <b>Liabilities</b>           |               |         |         |       |                  |         |         |       |
| Foreign currency derivatives | \$ 55         | \$ —    | \$ —    | \$ 55 | \$ 80            | \$ —    | \$ —    | \$ 80 |
| Contingent consideration     | —             | —       | —       | —     | —                | 8,376   | —       | 8,376 |

Total liabilities                      ~~\$~~55    \$    ~~—~~\$ 55    ~~\$~~80    \$8,376    \$8,456

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. Contingent consideration of \$8.4 million associated with the HLP acquisition was included above as an October 31, 2016 Level 3 measurement (see Note 2, "Acquisitions"). This contingent consideration was settled in November 2016, resulting in a foreign exchange loss of \$0.1 million.

We have recorded land totaling approximately \$2.4 million at fair value on a non-recurring basis which is classified as Level 3 as of July 31, 2017 and October 31, 2016. The fair value was based on broker opinions.

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## QUANEX BUILDING PRODUCTS CORPORATION

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

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 is 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 July 31, 2017, and October 31, 2016 (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. In February 2011 and February 2014, shareholders approved an increase of the aggregate shares available for grant by 2,400,000 shares and 2,350,000 shares, respectively. Any officer, key employee and/or non-employee director is eligible for awards under the 2008 Plan. Historically, our practice has been 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. In May 2015, the Nominating & Corporate Governance Committee of our Board of Directors changed the annual grant to our directors to a grant of restricted stock units on the first day of the new fiscal year, November 1, eliminating the grant of stock options to the directors. Once approved by the Compensation & Management Development Committee of our Board of Directors in December, we grant stock options, restricted stock awards, 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.

A summary of non-vested restricted stock awards activity during the nine months ended July 31, 2017 is presented below:

|                                | Restricted Stock Awards | Weighted Average Grant Date Fair Value per Share |
|--------------------------------|-------------------------|--|
| Non-vested at October 31, 2016 | 266,700                 | \$ 19.19   |
| Granted                        | 93,800                  | 19.46  |
| Cancelled                      | (3,100 )                | 19.65  |
| Vested                         | (73,100 )               | 17.67  |
| Non-vested at July 31, 2017    | 284,300                 | \$ 19.66   |

The total weighted average grant-date fair value of restricted stock awards that vested during each of the nine-month periods ended July 31, 2017 and 2016 was \$1.3 million and \$1.8 million, respectively. As of July 31, 2017, total unrecognized compensation cost related to unamortized restricted stock awards was \$2.6 million. We expect to recognize this expense over the remaining weighted average vesting period of 1.8 years.

### Stock Options

Historically, stock options have been awarded to key employees, officers and non-employee directors. Effective May 2015, the director compensation structure was revised to eliminate the annual grant of stock options to non-employee directors. 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. For employees who are nearing retirement-eligibility, we recognize stock option expense ratably over the shorter of the vesting period or the period from the grant-date to the retirement-eligibility date.

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, 2016.

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## QUANEX BUILDING PRODUCTS CORPORATION

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

The following table provides a summary of assumptions used to estimate the fair value of our stock options issued during the nine-month periods ended July 31, 2017 and 2016.

|  | Nine Months<br>Ended<br>July 31,<br>2017 2016 |        |
|--|---|--------|
| Weighted-average expected volatility       | 34.7%   | 37.1%  |
| Weighted-average expected term (in years)  | 5.7   | 5.4    |
| Risk-free interest rate                    | 2.0%  | 1.7%   |
| Expected dividend yield over expected term | 1.0%  | 1.0%   |
| Weighted average grant date fair value     | \$6.25  | \$6.32 |

The following table summarizes our stock option activity for the nine months ended July 31, 2017:

|   | Stock<br>Options | Weighted<br>Average<br>Exercise<br>Price | Weighted Average<br>Remaining Contractual<br>Term (in years) | Aggregate<br>Intrinsic<br>Value (000s) |
|---|------------------|--|--|--|
| Outstanding at October 31, 2016             | 2,386,220        | \$ 16.84                                 |  |  |
| Granted                                     | 292,600          | 19.45                                    |  |  |
| Exercised                                   | (411,242 )       | 15.51                                    |  |  |
| Forfeited/Expired                           | (13,402 )        | 19.50                                    |  |  |
| Outstanding at July 31, 2017                | 2,254,176        | \$ 17.40                                 | 5.4  | \$ 9,232                               |
| Vested or expected to vest at July 31, 2017 | 2,251,420        | \$ 16.81                                 | 5.4  | \$ 9,229                               |
| Exercisable at July 31, 2017                | 1,746,068        | \$ 17.40                                 | 4.4  | \$ 8,181                               |

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. The total intrinsic value of stock options exercised during the nine months ended July 31, 2017 and 2016 was \$2.5 million and \$1.0 million. The weighted-average grant date fair value of stock options that vested during the nine months ended July 31, 2017 and 2016 was \$1.8 million and \$1.9 million, respectively. As of July 31, 2017, total unrecognized compensation cost related to stock options was \$0.9 million. We expect to recognize this expense over the remaining weighted average vesting period of 1.9 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 non-employee director restricted stock units vest immediately but are payable only upon the director's cessation of service unless an election is made by the non-employee director to settle and pay the award on an earlier specified date. 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.

As of July 31, 2017, there were no non-vested restricted stock units. During the nine-month periods ended July 31, 2017 and 2016, non-employee directors received 24,560 and 20,445 restricted stock units, respectively, at a grant date



fair value of \$15.65 and \$19.56, respectively, which vested immediately. During the nine-month periods ended July 31, 2017 and 2016, there were no payments to settle restricted stock units.

Performance Share Awards

We have awarded annual grants of performance shares to key employees and officers. These awards cliff vest after a three-year period with service and performance measures (relative total shareholder return and earnings per share growth) as vesting conditions. 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.

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QUANEX BUILDING PRODUCTS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

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, the change in valuation of the Monte Carlo simulation over the vesting period, and the underlying price of our common stock.

We granted performance shares as follows: November 2016 - 186,500 shares, January 2016 - 4,300 shares, December 2015 - 158,100 shares, December 2014 - 137,400 shares and December 2013 - 155,800 shares. Depending on the achievement of the performance conditions, 0% to 200% of the awarded performance shares may ultimately vest. As of July 31, 2017, 2,400 of the performance shares granted in 2016 were forfeited, 11,100 of the performance shares granted in 2015 were forfeited, and 13,800 of the performance shares granted in 2014 were forfeited. On December 5, 2016, 135,100 shares vested pursuant to the December 2013 grant, resulting in the issuance of 67,550 shares of common stock and a cash payment of \$1.2 million. The November 2016 grant includes a return on invested capital (ROIC) metric which, if achieved, could enhance the number of shares that are ultimately issued but cannot exceed the maximum (200%). Due to the uncertainty with regard to achieving this metric, no value has been assigned. In the event and at such time the metric is deemed achievable, compensation expense will begin to be recognized through the remaining vesting period. For the three- and nine-month periods ended July 31, 2017 and 2016, we have recorded \$1.0 million and \$0.9 million, respectively, and \$2.7 million and \$2.5 million, respectively, of compensation expense related to our performance share awards.

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. As of July 31, 2017, we have deemed 61,800 shares related to the December 2014 grant of performance shares as probable to be issued. We expect to issue these shares in December 2017 and to pay the value of the equivalent number of shares in cash when settled, along with accrued dividends thereon.

**Treasury Shares**

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. A deficiency of such proceeds relative to costs would be applied to reduce paid-in-capital associated with prior issuances to the extent available, with the remainder recorded as a charge to retained earnings. We recorded a charge to retained earnings of \$1.3 million

during the nine months ended July 31, 2017.

The following table summarizes the treasury stock activity during the nine months ended July 31, 2017:

|  | Nine<br>Months<br>Ended<br>July 31,<br>2017 |
|--|---|
| Beginning balance as of November 1, 2016 | 3,339,753                                   |
| Restricted stock awards granted          | (93,800 )                                   |
| Performance share awards vested          | (67,550 )                                   |
| Stock options exercised                  | (411,242 )                                  |
| Balance at July 31, 2017                 | 2,767,161                                   |

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## QUANEX BUILDING PRODUCTS CORPORATION

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

## 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- and nine-month periods ended July 31, 2017 and 2016:

|   | Three Months<br>Ended<br>July 31,<br>2017 |           | Nine Months<br>Ended<br>July 31,<br>2017 |           |
|---|---|-----------|--|-----------|
|   | 2016                                      |           | 2016                                     |           |
|   | (In thousands)                            |           |  |           |
| Foreign currency transaction gains (losses) | \$362                                     | \$(2,491) | \$727                                    | \$(3,699) |
| Foreign currency derivative (losses) gains  | (323 )                                    | 252       | (213 )                                   | (180 )    |
| Interest income                             | 22  | 41        | 68                                       | 79        |
| Other                                       | (15 )                                     | (325 )    | (10 )                                    | (236 )    |
| Other income (expense)                      | \$46                                      | \$(2,523) | \$572                                    | \$(4,036) |

## 14. Segment Information

We present three reportable business segments in accordance with Topic 280-10-50, "Segment Reporting" (ASC 280): (1) North American Engineered Components segment ("NA Engineered Components"), comprised of four operating segments primarily focused on the fenestration market in North America including vinyl profiles, insulating glass (IG) spacers, screens & other fenestration components; (2) European Engineered Components segment ("EU Engineered Components"), comprised of our United Kingdom-based vinyl extrusion business, manufacturing vinyl profiles & conservatories, and the European insulating glass business manufacturing IG spacers; and (3) North American Cabinet Components segment ("NA Cabinet Components"), comprised solely of the North American cabinet door and components business acquired in November 2015. We maintain an Unallocated Corporate & Other grouping which includes LIFO inventory adjustments, corporate office charges, and inter-segment eliminations, less an allocation of a portion of the general and administrative costs associated with the corporate office which have been allocated to the reportable business segments, based upon a relative measure of profitability, in order to more accurately reflect each reportable business segment's administrative cost. Certain costs are not allocated to the reportable operating segments, but remain in Unallocated Corporate & Other, including transaction expenses, stock-based compensation, long-term incentive awards based on the performance of our common stock and other factors, certain severance and legal costs not deemed to be allocable to all segments, depreciation of corporate assets, interest expense, other, net, income taxes and inter-segment eliminations. The accounting policies of our operating segments are the same as those used to prepare the accompanying condensed consolidated financial statements. Corporate general and administrative expense allocated during the three- and nine-month periods ended July 31, 2017 and 2016 were \$4.6 million and \$5.0 million, respectively, and \$13.2 million and \$13.8 million, respectively.

ASC 280 permits aggregation of operating segments 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 OEMs; (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.

Segment information for the three- and nine months ended July 31, 2017 and 2016, and total assets as of July 31, 2017 and October 31, 2016 are summarized in the following table (in thousands):



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## QUANEX BUILDING PRODUCTS CORPORATION

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

|                                  | NA Eng.<br>Comp. | EU Eng.<br>Comp. | NA<br>Cabinet<br>Comp. | Unallocated<br>Corp. &<br>Other | Total      |
|----------------------------------|------------------|------------------|------------------------|---------------------------------|------------|
| Three Months Ended July 31, 2017 |                  |                  |                        |                                 |            |
| Net sales                        | \$ 126,446       | \$ 40,359        | \$ 63,839              | \$ (1,277 )                     | \$ 229,367 |
| Depreciation and amortization    | 7,899            | 2,391            | 3,491                  | 134                             | 13,915     |
| Operating income (loss)          | 11,822           | 3,804            | 1,705                  | 21                              | 17,352     |
| Capital expenditures             | 5,068            | 1,770            | 2,476                  | 234                             | 9,548      |
| Three Months Ended July 31, 2016 |                  |                  |                        |                                 |            |
| Net sales                        | \$ 145,040       | \$ 40,217        | \$ 64,920              | \$ (2,092 )                     | \$ 248,085 |
| Depreciation and amortization    | 6,930            | 2,340            | 3,568                  | 135                             | 12,973     |
| Operating income (loss)          | 17,783           | 4,448            | 1,675                  | (3,976 )                        | 19,930     |
| Capital expenditures             | 5,087            | 1,002            | 2,390                  | 40                              | 8,519      |
| Nine Months Ended July 31, 2017  |                  |                  |                        |                                 |            |
| Net sales                        | \$ 343,694       | \$ 106,133       | \$ 188,359             | \$ (3,780 )                     | \$ 634,406 |
| Depreciation and amortization    | 26,377           | 6,753            | 10,160                 | 411                             | 43,701     |
| Operating income (loss)          | 15,861           | 8,944            | 2,880                  | (9,549 )                        | 18,136     |
| Capital expenditures             | 14,468           | 6,721            | 5,473                  | 436                             | 27,098     |
| Nine Months Ended July 31, 2016  |                  |                  |                        |                                 |            |
| Net sales                        | \$ 390,257       | \$ 110,250       | \$ 185,049             | \$ (6,543 )                     | \$ 679,013 |
| Depreciation and amortization    | 21,049           | 7,191            | 11,084                 | 435                             | 39,759     |
| Operating income (loss)          | 31,488           | 8,991            | 2,412                  | (14,543 )                       | 28,348     |
| Capital expenditures             | 14,975           | 4,904            | 5,939                  | 120                             | 25,938     |
| As of July 31, 2017              |                  |                  |                        |                                 |            |
| Total assets                     | \$ 265,906       | \$ 218,047       | \$ 289,578             | \$ 11,528                       | \$ 785,059 |
| As of October 31, 2016           |                  |                  |                        |                                 |            |
| Total assets                     | \$ 282,370       | \$ 190,995       | \$ 295,367             | \$ 11,621                       | \$ 780,353 |

During the three months ended July 31, 2017, we transferred two operating plants that manufacture wood products (fenestration and non-fenestration products) from the NA Engineered Components segment to the NA Cabinet Components segment, to better align wood-related products under a common segment management team, which is expected to generate operational efficiencies and synergies. The operating results and total assets presented reflect this transfer as if it occurred on the first day of the earliest period shown for all comparable periods presented herein. The following tables reconcile our segment presentation, as previously reported in our Quarterly Report on Form 10-Q for the three- and nine months ended July 31, 2016, to the current presentation (in thousands):

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## QUANEX BUILDING PRODUCTS CORPORATION

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

| Three Months Ended July 31, 2016 | As<br>Previously<br>Reported<br>(in thousands) | Reclassification | Current<br>Presentation |
|----------------------------------|--|------------------|-------------------------|
| NA Engineered Components         |  |                  |                         |
| Net sales                        | \$ 150,462                                     | \$ (5,422 )      | \$ 145,040              |
| Depreciation and amortization    | 7,063  | (133 )           | 6,930                   |
| Operating income (loss)          | 18,478   | (695 )           | 17,783                  |
| Capital expenditures             | \$ 5,131                                       | \$ (44 )         | \$ 5,087                |
| EU Engineered Components         |  |                  |                         |
| Net sales                        | \$ 40,217                                      | \$ —             | \$ 40,217               |
| Depreciation and amortization    | 2,340  | —                | 2,340                   |
| Operating income (loss)          | 4,448  | —                | 4,448                   |
| Capital expenditures             | \$ 1,002                                       | \$ —             | \$ 1,002                |
| NA Cabinet Components            |  |                  |                         |
| Net sales                        | \$ 58,826                                      | \$ 6,094         | \$ 64,920               |
| Depreciation and amortization    | 3,435  | 133              | 3,568                   |
| Operating income (loss)          | 980  | 695              | 1,675                   |
| Capital expenditures             | \$ 2,346                                       | \$ 44            | \$ 2,390                |
| Unallocated Corporate & Other    |  |                  |                         |
| Net sales                        | \$ (1,420 )                                    | \$ (672 )        | \$ (2,092 )             |
| Depreciation and amortization    | 135  | —                | 135                     |
| Operating income (loss)          | (3,976 )                                       | —                | (3,976 )                |
| Capital expenditures             | \$ 40  | \$ —             | \$ 40                   |
| Nine Months Ended July 31, 2016  | As<br>Previously<br>Reported<br>(in thousands) | Reclassification | Current<br>Presentation |
| NA Engineered Components         |  |                  |                         |
| Net sales                        | \$ 406,029                                     | \$ (15,772 )     | \$ 390,257              |
| Depreciation and amortization    | 21,424   | (375 )           | 21,049                  |
| Operating income (loss)          | 33,785   | (2,297 )         | 31,488                  |
| Capital expenditures             | \$ 15,226                                      | \$ (251 )        | \$ 14,975               |
| EU Engineered Components         |  |                  |                         |
| Net sales                        | \$ 110,250                                     | \$ —             | \$ 110,250              |
| Depreciation and amortization    | 7,191  | —                | 7,191                   |
| Operating income (loss)          | 8,991  | —                | 8,991                   |
| Capital expenditures             | \$ 4,904                                       | \$ —             | \$ 4,904                |
| NA Cabinet Components            |  |                  |                         |
| Net sales                        | \$ 166,906                                     | \$ 18,143        | \$ 185,049              |
| Depreciation and amortization    | 10,709   | 375              | 11,084                  |
| Operating income (loss)          | 115  | 2,297            | 2,412                   |

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|                               |            |             |             |
|-------------------------------|------------|-------------|-------------|
| Capital expenditures          | \$5,688    | \$ 251      | \$ 5,939    |
| Unallocated Corporate & Other |            |             |             |
| Net sales                     | \$(4,172 ) | \$ (2,371 ) | \$ (6,543 ) |
| Depreciation and amortization | 435        | —           | 435         |
| Operating income (loss)       | (14,543 )  | —           | (14,543 )   |
| Capital expenditures          | \$120      | \$ —        | \$ 120      |

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## QUANEX BUILDING PRODUCTS CORPORATION

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

The following tables reconciles our segment presentation of total assets, as previously reported in our Annual Report on Form 10-K for the year ended October 31, 2016, to the current presentation (in thousands):

| As of October 31, 2016        | As<br>Previously<br>Reported<br>(in thousands) | Reclassification | Current<br>Presentation |
|-------------------------------|--|------------------|-------------------------|
| Total Assets                  |  |                  |                         |
| NA Engineered Components      | \$290,725                                      | \$ (8,355 )      | \$ 282,370              |
| EU Engineered Components      | 190,995  | —                | 190,995                 |
| NA Cabinet Components         | 287,012  | 8,355            | 295,367                 |
| Unallocated Corporate & Other | 11,621   | —                | 11,621                  |
| Total Assets                  | \$780,353                                      | \$ —             | \$ 780,353              |

The following table summarizes the change in the carrying amount of goodwill by segment for the nine months ended July 31, 2017 (in thousands):

|   | NA<br>Eng.<br>Comp. | EU<br>Eng.<br>Comp. | NA<br>Cabinet<br>Comp. | Unallocated<br>Corp. &<br>Other | Total     |
|---|---------------------|---------------------|------------------------|---------------------------------|-----------|
| Balance as of October 31, 2016          | \$38,712            | \$64,576            | \$113,747              | \$ —                            | \$217,035 |
| Foreign currency translation adjustment | —                   | 5,118               | —                      | —                               | 5,118     |
| Balance as of July 31, 2017             | \$38,712            | \$69,694            | \$113,747              | \$ —                            | \$222,153 |

For further details of Goodwill, see Note 4, "Goodwill & Intangible Assets", located herewith.

We did not allocate non-operating income (expense) or income tax expense to the reportable segments. The following table reconciles operating income (loss) as reported above to net income (loss) for the three- and nine months ended July 31, 2017 and 2016:

|                              | Three Months<br>Ended<br>July 31,<br>2017 |            | Nine Months<br>Ended<br>July 31,<br>2017 |            |
|------------------------------|---|------------|--|------------|
|                              | 2016                                      |            | 2016                                     |            |
|                              | (In thousands)                            |            |  |            |
| Operating income             | \$17,352                                  | \$19,930   | \$18,136                                 | \$28,348   |
| Interest expense             | (2,575 )                                  | (22,200 )  | (7,126 )                                 | (34,324 )  |
| Other, net                   | 46  | (2,523 )   | 572                                      | (4,036 )   |
| Income tax (expense) benefit | (4,608 )                                  | 817        | (3,631 )                                 | 2,722      |
| Net income (loss)            | \$10,215                                  | \$(3,976 ) | \$7,951                                  | \$(7,290 ) |

## Product Sales

We produce a wide variety of products that are used in the fenestration industry, including: window and door systems; 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 kitchen and bath cabinet doors and components, flooring and trim moldings, solar edge tape, plastic decking, fencing, water retention barriers, conservatory roof components, and other products.



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## QUANEX BUILDING PRODUCTS CORPORATION

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

The following table summarizes our product sales for the three- and nine-month periods ended July 31, 2017 and 2016 into general groupings by segment to provide additional information to our shareholders. For all periods presented, this table reflects the reclassification of the two operating plants transferred from the NA Engineered Components segment to the NA Cabinet Components segment, as applicable.

|                                  | Three months ended<br>July 31,<br>2017 |            | Nine Months Ended<br>July 31,<br>2017 |            |
|----------------------------------|--|------------|---------------------------------------|------------|
|                                  | 2016                                   | 2016       | 2016                                  | 2016       |
|                                  | (In thousands)                         |            |                                       |            |
| NA Engineered Components:        |  |            |                                       |            |
| United States - fenestration     | \$107,193                              | \$121,717  | \$289,231                             | \$328,957  |
| International - fenestration     | 9,959                                  | 9,530      | 24,945                                | 23,317     |
| United States - non-fenestration | 7,060                                  | 8,677      | 19,590                                | 24,237     |
| International - non-fenestration | 2,234                                  | 5,116      | 9,928                                 | 13,746     |
|                                  | \$126,446                              | \$145,040  | \$343,694                             | \$390,257  |
| EU Engineered Components:        |  |            |                                       |            |
| United States - fenestration     | \$190                                  | \$159      | \$304                                 | \$285      |
| International - fenestration     | 35,087                                 | 35,547     | 94,528                                | 98,744     |
| International - non-fenestration | 5,082                                  | 4,511      | 11,301                                | 11,221     |
|                                  | \$40,359                               | \$40,217   | \$106,133                             | \$110,250  |
| NA Cabinet Components:           |  |            |                                       |            |
| United States - fenestration     | \$4,322                                | \$3,008    | \$12,316                              | \$10,651   |
| United States - non-fenestration | 59,237                                 | 61,268     | 174,404                               | 172,273    |
| International - non-fenestration | 280                                    | 644        | 1,639                                 | 2,125      |
|                                  | \$63,839                               | \$64,920   | \$188,359                             | \$185,049  |
| Unallocated Corporate & Other    |  |            |                                       |            |
| Eliminations                     | \$(1,277 )                             | \$(2,092 ) | \$(3,780 )                            | \$(6,543 ) |
|                                  | \$(1,277 )                             | \$(2,092 ) | \$(3,780 )                            | \$(6,543 ) |
| Net sales                        | \$229,367                              | \$248,085  | \$634,406                             | \$679,013  |

## 15. Earnings Per Share

We compute basic earnings (loss) per share by dividing net income (loss) 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 earnings per share for the three and nine-month periods ended July 31, 2017 were calculated as follows (in thousands, except per share data):

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## QUANEX BUILDING PRODUCTS CORPORATION

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

|                                   | Three Months Ended July<br>31, 2017 |                               |              |
|-----------------------------------|-------------------------------------|-------------------------------|--------------|
|                                   | Net<br>Income                       | Weighted<br>Average<br>Shares | Per<br>Share |
| Basic earnings per common share   | \$10,215                            | 34,224                        | \$0.30       |
| Effect of dilutive securities:    |                                     |                               |              |
| Stock options                     | —                                   | 495                           |              |
| Restricted stock awards           | —                                   | 143                           |              |
| Performance shares                | —                                   | 62                            |              |
| Diluted earnings per common share | \$10,215                            | 34,924                        | \$0.29       |
|                                   | Nine Months Ended July<br>31, 2017  |                               |              |
|                                   | Net<br>Income                       | Weighted<br>Average<br>Shares | Per<br>Share |
| Basic earnings per common share   | \$7,951                             | 34,141                        | \$0.23       |
| Effect of dilutive securities:    |                                     |                               |              |
| Stock options                     | —                                   | 440                           |              |
| Restricted stock awards           | —                                   | 128                           |              |
| Performance shares                |                                     | 62                            |              |
| Diluted earnings per common share | \$7,951                             | 34,771                        | \$0.23       |

Basic and diluted loss per share was \$(0.12) and \$(0.22) for the three and nine months ended July 31, 2016, 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- and nine-month periods ended July 31, 2016, 334,760 shares and 291,938 shares of common stock equivalents, respectively, and 217,121 shares and 187,873 shares of restricted stock, respectively, were excluded from the computation of diluted earnings per share. In addition, 67,550 potentially dilutive contingent shares related to performance share awards for the three- and nine-month periods ended July 31, 2016 were excluded.

We had common stock equivalents that were potentially dilutive in future earnings per share calculations of 411,450 and 795,972 for the three-month periods ended July 31, 2017 and 2016, respectively, and 839,150 and 932,972 for the nine-month periods ended July 31, 2017 and 2016, respectively. 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 Guidance Adopted

In September 2015, the Financial Accounting Standards Board (FASB) issued ASU No. 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments. The amendment requires recognition of adjustments to estimated amounts identified during the measurement period in the reporting period that the adjustments are determined. The guidance requires the acquirer to record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the estimated amounts, calculated as if the accounting had been completed at the acquisition date. The guidance also requires an entity to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous

reporting periods if the adjustment to the estimated amounts had been recognized as of the acquisition date. We adopted this guidance prospectively as of November 1, 2016 with no impact on our consolidated financial statements. In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements-Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern, which requires management to evaluate whether conditions exist which raise substantial doubt about the entity's ability to continue as a going concern within one year after the date of the financial statements (or within one year of when the financial statements are available to be issued). If such conditions exist, disclosure is required of: (1) the principal conditions; (2) management's evaluation of the significance of the conditions on the entity's ability to meet obligations; and (3) management's plans to alleviate this substantial doubt related to the ability to continue as a going concern. If management's plans do not alleviate this substantial doubt, management must specifically disclose that there is substantial doubt about the entity's ability to continue as a going concern within one year after the date of

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QUANEX BUILDING PRODUCTS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

the financial statements (or the date the financial statements are available to be issued), in addition to the disclosure noted above. We adopted this guidance as of November 1, 2016 with no impact on our consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-12, Compensation - Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide 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 non-vesting condition that affects the grant-date fair value of an award, and provides explicit guidance for those awards. Our performance share award recipients could retire before the shares vest. In that circumstance we would treat this as a performance condition that affects vesting. This guidance became effective for fiscal years beginning on or after December 15, 2015. We adopted this guidance as of November 1, 2016 with no impact on our consolidated financial statements.

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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 in the United States, United Kingdom and Germany;
- changes in non-pass-through 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 service our debt facilities and remain in good standing with our lenders;
- 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, 2016.

### 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, United States 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.





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### 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 July 31, 2017, and for the three- and nine-month periods ended July 31, 2017 and 2016, 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, 2016.

#### Our Business

We manufacture components for original equipment manufacturers in the building products industry. These components can be categorized as window and door (fenestration) components and kitchen and bath cabinet components. Examples of fenestration components 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. We also manufacture cabinet doors and other components for OEMs in the kitchen and bathroom cabinet industry. In addition, we provide certain other non-fenestration components and products, which include solar panel sealants, wood flooring, trim moldings, vinyl decking, fencing, water retention barriers, and conservatory roof components. We use low-cost, short lead-time production processes and engineering expertise to provide our customers with specialized products for their specific window, door, and cabinet applications. We believe these capabilities provide us with unique competitive advantages. We serve a primary customer base in North America and the United Kingdom, and also serve customers in international markets through our operating plants in the United Kingdom and Germany, as well as through sales and marketing efforts in other countries.

We currently have three reportable business segments: (1) North American Engineered Components segment ("NA Engineered Components"), comprised of four operating segments primarily focused on the fenestration market in North America manufacturing vinyl profiles, IG spacers, screens & other fenestration components; (2) European Engineered Components segment ("EU Engineered Components"), comprised of our United Kingdom-based vinyl extrusion business, manufacturing vinyl profiles and conservatories, and the European insulating glass business manufacturing IG spacers; and (3) North American Cabinet Components segment ("NA Cabinet Components"), comprised solely of the North American cabinet door and components business acquired in November 2015. We maintain the grouping called Unallocated Corporate & Other for certain administrative costs, but a portion of the general and administrative costs associated with the corporate office have been allocated to the reportable business segments, based upon a relative measure of profitability in order to more accurately reflect each reportable business segment's administrative costs. Certain costs were not allocated and remain in Unallocated Corporate & Other, including transaction expenses, stock-based compensation, long-term incentive awards based on the performance of our common stock and other factors, certain severance and legal costs not deemed to be allocable to all segments, depreciation of corporate assets, interest expense, other, net, income taxes and inter-segment eliminations. The accounting policies of our operating segments are the same as those used to prepare our accompanying condensed consolidated financial statements. In an effort to focus on protecting margins and improving cash flows, we previously announced a strategy to stop manufacturing \$65.0 million to \$85.0 million of business, thereby reducing our sales volume with certain low-margin customers. This decrease in sales volume has impacted our operating results with regard to our United States vinyl business and Woodcraft for the nine months ended July 31, 2017. We have taken appropriate actions to rationalize capacity by closing two United States vinyl plants, one cabinet door plant in Mexico, and we are winding down a second cabinet door plant in Lansing, Kansas, in order to redeploy the assets.

We continue to invest in organic growth initiatives and intend to continue to pursue business acquisitions that allow us to expand our existing fenestration and cabinet component footprint, enhance our product offerings, provide new complementary technology, enhance our leadership position within the markets we serve, and expand into new markets or service lines. We have disposed of non-core businesses in the past, and continue to evaluate our business portfolio to ensure that we are investing in markets where we believe there is potential future growth.

#### Recent Transactions and Events

On November 2, 2015, we acquired Woodcraft, a manufacturer of cabinet doors and other components to OEMs in the kitchen and bathroom cabinet industry. We paid \$245.9 million in cash, resulting in goodwill totaling \$113.7 million. For additional details, see Note 2, "Acquisitions," to the accompanying unaudited condensed consolidated financial

statements contained elsewhere herein.

During the three months ended July 31, 2017, we transferred two operating plants that manufacture wood products (fenestration and non-fenestration) from the NA Engineered Components segment to the NA Cabinet Components segment, to better align wood-related products under a common segment management team, which is expected to generate operational efficiencies and synergies. The operating results and associated net assets for these plants have been reclassified accordingly for

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all periods presented herein. We did not modify the methodology for allocating certain corporate costs as a result of this change in segment presentation.

We perform an annual goodwill impairment test as of August 31, or more frequently if there are potential indicators of impairment. Actual operational performance of one of our reporting units is below expectation. Therefore, we performed this impairment test for that reportable unit as of July 31, 2017. We determined that the fair value of the net assets of that unit exceeded the related carrying value by 6%. Therefore, goodwill was not deemed to be impaired.

In conjunction with plant closures and other cost savings measures, we incurred restructuring charges during the three and nine months ended July 31, 2017 of \$0.8 million and \$2.2 million, respectively, at the United States vinyl business and \$0.1 million and \$0.9 million, respectively, at Woodcraft, and expect to incur other charges during fiscal 2017, as further described at Note 1, "Nature of Operations and Basis of Presentation - Restructuring," to the accompanying unaudited condensed consolidated financial statements contained elsewhere herein.

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## Market Overview and Outlook

We believe the primary drivers of our operating results continue to be North American 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 homebuilding and window industries, and we use this data, as published by or derived from third-party sources, to evaluate the market. We have historically evaluated the market using data from the National Association of Homebuilders ("NAHB") with regard to housing starts, and published reports by Ducker Worldwide, LLC ("Ducker"), a consulting and research firm, with regard to window shipments in the United States. To assess the housing market in the United Kingdom, we use published reports by D&G Consulting, a consulting and research firm. We obtain market data from Freedonia Group and Catalina Research, each a consulting and research firm, for insight into the United States residential wood cabinet demand.

Reports and forecasts from these sources indicate continued growth in the markets we serve. The NAHB has forecasted calendar-year housing starts (excluding manufactured units) to increase from 1.2 million units in 2016 and 2017 to 1.3 million units in 2018 and 1.4 million in 2019, reflecting increasing consumer confidence and a healthier economy, although housing starts in recent months have been lower than forecast. Ducker indicated that window shipments in the R&R market are expected to increase as per the following forecast: 2016 - 27.6 million units, 2017 - 28.6 million units, 2018 - 29.3 million units, and 2019 - 29.9 million units. These 2% - 4% annual growth projections are consistent with actual growth in R&R window shipments during the prior year. Derived from reports published by Ducker, the overall growth in window shipments for the trailing twelve-month period ended June 30, 2017 was 2.4%. During this period, growth in new construction increased 4.1%, while growth in R&R activity increased 1.2%. Growth in new construction continues to outpace the growth in R&R. D&G Consulting forecasts an increase in private housing in the United Kingdom through 2018, with a decline in public housing during this period, which should benefit HLP's primary customers. The Freedonia Group, which publishes cabinet growth data in 3-year intervals, projects residential cabinet demand in the U.S. to grow at 6.9% annually through 2019, while more recent projections from Catalina Research estimate a 7.4% annual growth rate through 2022 for U.S. residential cabinet demand. We utilize several commodities in our business for which pricing can fluctuate, including polyvinyl resin (PVC), titanium dioxide (TiO<sub>2</sub>), petroleum products, aluminum and wood. For the majority of our customers and critical suppliers, we have price adjusters in place which effectively share the base pass-through price changes for our primary commodities with our customers commensurate with the market at large. Our long-term exposure to these price fluctuations is somewhat mitigated due to the contractual component of the adjuster program. However, these adjusters are not in place with all customers, and there is a level of exposure to such volatility due to the lag associated with the timing of price updates in accordance with our customer agreements.

## Results of Operations

Three Months Ended July 31, 2017 Compared to Three Months Ended July 31, 2016

|   | Three Months Ended July 31, |         |           |            |
|---|-----------------------------|---------|-----------|------------|
|   | 2017                        | 2016    | Change \$ | % Variance |
|   | (Dollars in millions)       |         |           |            |
| Net sales   | \$229.4                     | \$248.1 | \$(18.7)  | (8)%       |
| Cost of sales (excluding depreciation and amortization) | 176.7                       | 186.6   | (9.9)     | 5%         |
| Selling, general and administrative                     | 20.5                        | 28.6    | (8.1)     | 28%        |
| Restructuring charges                                   | 0.9                         | —       | 0.9       | (100)%     |
| Depreciation and amortization                           | 13.9                        | 13.0    | 0.9       | (7)%       |
| Operating income  | \$17.4                      | \$19.9  | \$(2.5)   | (13)%      |
| Interest expense  | (2.6)                       | (22.2)  | 19.6      | 88%        |
| Other, net  | —                           | (2.5)   | 2.5       | 100%       |
| Income tax (expense) income                             | (4.6)                       | 0.8     | (5.4)     | (675)%     |
| Net income (loss)                                       | \$10.2                      | \$(4.0) | \$14.2    | 355%       |

Our period-over-period results by reportable segment follow.



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## Changes Related to Operating Income (Loss) by Reportable Segment:

## NA Engineered Components

|   | Three Months Ended July 31, |         |              |            |
|---|-----------------------------|---------|--------------|------------|
|   | 2017                        | 2016    | \$<br>Change | % Variance |
|   | (Dollars in millions)       |         |              |            |
| Net sales   | \$126.5                     | \$145.0 | \$(18.5 )    | (13)%      |
| Cost of sales (excluding depreciation and amortization) | 94.2                        | 105.1   | (10.9 )      | 10%        |
| Selling, general and administrative                     | 11.7                        | 15.2    | (3.5 )       | 23%        |
| Restructuring charges                                   | 0.8                         | —       | 0.8          | (100)%     |
| Depreciation and amortization                           | 7.9                         | 6.9     | 1.0          | (14)%      |
| Operating income  | \$11.9                      | \$17.8  | \$(5.9 )     | (33)%      |
| Operating income margin                                 | 9                           | % 12    | %            |            |

Net Sales. Net sales decreased \$18.5 million, or 13%, for the three months ended July 31, 2017 compared to the same period in 2016. On a year-over-year basis, we experienced an \$19.2 million decrease in sales attributable to volume and \$1.2 million attributable to price, partially offset by an increase of \$1.9 million related to surcharges for commodities, particularly resin used in our vinyl business, and aluminum in our screens business. The significant decrease in volume was anticipated with regard to our previously-announced plan to shed low-margin business associated with our United States vinyl operations, although the decrease was at a greater pace than expected, partially offset by volume increases from new customers. The effect of this decline in volume on operating margins is largely offset by a decline in the cost of the raw materials used in our manufacturing process. Management continues to realign the cost structure in light of the anticipated volume reduction.

Cost of Sales. The cost of sales decreased \$10.9 million, or 10%, when comparing the three months ended July 31, 2017 to the same period in 2016. Corresponding with the net sales discussion above, cost of sales was impacted by changes in sales volume and product mix resulting in lower material and labor costs year-over-year, as well as lower freight and repair and maintenance costs, partially offset by normal wage inflation and higher health insurance costs.

Selling, General and Administrative. Our selling, general and administrative expenses decreased \$3.5 million, or 23% when comparing the three months ended July 31, 2017 to the same period in 2016. This decrease was due to lower salaries and wages due to headcount reductions and timing of hires, lower incentive accruals based on operating results, lower professional fees and reduced sales and marketing costs.

Restructuring Charges. Restructuring charges of \$0.8 million primarily include moving costs incurred in conjunction with the announced closure of two vinyl extrusion plants in the United States, and other related costs.

Depreciation and Amortization. Depreciation and amortization expense increased \$1.0 million, or 14% when comparing the three-month periods ended July 31, 2017 and 2016. The increase reflects incremental depreciation of \$1.0 million associated with an October 2016 change in estimate regarding the remaining service lives of assets involved in restructuring efforts, and accelerated amortization of \$0.3 million related to intangible assets. The incremental depreciation expense associated with property, plant and equipment placed into service during the trailing twelve months ended July 31, 2017, was largely offset by the run-off of depreciation expense associated with existing assets and disposals during this period.

## EU Engineered Components

|   | Three Months Ended July 31, |        |              |            |
|---|-----------------------------|--------|--------------|------------|
|   | 2017                        | 2016   | \$<br>Change | Variance % |
|   | (Dollars in millions)       |        |              |            |
| Net sales   | \$40.4                      | \$40.2 | \$ 0.2       | —%         |
| Cost of sales (excluding depreciation and amortization) | 29.0                        | 27.5   | 1.5          | (5)%       |
| Selling, general and administrative                     | 5.2                         | 5.9    | (0.7 )       | 12%        |
| Depreciation and amortization                           | 2.4                         | 2.3    | 0.1          | (4)%       |
| Operating income  | \$3.8                       | \$4.5  | \$(0.7 )     | (16)%      |

Operating income margin 9 % 11 %

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**Net Sales.** Net sales increased \$0.2 million when comparing the three months ended July 31, 2017 to the same period in 2016. This increase reflects favorable volume which contributed to increased sales of \$2.8 million in 2017 compared with 2016, partially offset by a \$2.6 million negative impact associated with changes in foreign exchange rates, primarily the devaluation of the British Pound Sterling relative to the United States dollar after the United Kingdom voted to leave the European Union in June 2016 (commonly referred to as “Brexit”).

**Cost of Sales.** The cost of sales increased \$1.5 million, or 5%, for the three months ended July 31, 2017 compared to the same period in 2016. Similar to the discussion above, cost of sales was impacted by higher sales volume, which was offset by the impact of foreign currency exchange rate changes. In addition, margins were negatively impacted for our vinyl profile business in the United Kingdom (UK) due to product mix, higher labor costs and costs associated with start-up of the new HLP warehouse.

**Selling, General and Administrative.** Our selling, general and administrative expense decreased \$0.7 million, for the three months ended July 31, 2017 compared to the same period in 2016. The decrease was primarily attributable to the effects of foreign currency, reduced selling expense in Germany and a decrease in the allocation of corporate expenses year-over-year.

**Depreciation and Amortization.** Depreciation and amortization expense increased \$0.1 million for the three months ended July 31, 2017 compared to the same period in 2016. The effect of changes in foreign exchange rates were offset by depreciation and amortization expense associated with property, plant and equipment placed into service during the trailing twelve months ended July 31, 2017.

#### NA Cabinet Components

|   | Three Months Ended July 31, |        |              |            |
|---|-----------------------------|--------|--------------|------------|
|   | 2017                        | 2016   | \$<br>Change | Variance % |
|   | (Dollars in millions)       |        |              |            |
| Net sales   | \$63.8                      | \$64.9 | \$ (1.1 )    | (2)%       |
| Cost of sales (excluding depreciation and amortization) | 54.5                        | 55.4   | (0.9 )       | 2%         |
| Selling, general and administrative                     | 4.0                         | 4.3    | (0.3 )       | 7%         |
| Restructuring charges                                   | 0.1                         | —      | 0.1          | (100)%     |
| Depreciation and amortization                           | 3.5                         | 3.6    | (0.1 )       | 3%         |
| Operating income  | \$1.7                       | \$1.6  | \$ 0.1       | 6%         |
| Operating income margin                                 | 3                           | % 2    | %            |            |

**Net Sales.** Net sales decreased \$1.1 million, or 2%, for the three months ended July 31, 2017 compared to the same period in 2016. On a year-over-year basis, we experienced a \$0.6 million decrease in sales attributable to volume and a decrease of \$1.3 million in revenues associated with raw materials surcharges, which was offset by an increase in price of \$0.8 million. Included in the net decrease in volume was a decrease of \$2.6 million related to lower-margin business pursuant to our previously-announced plan to shed less profitable business, substantially replaced by new volume. The two operating plants transferred from the NA Engineered Components segment contributed incremental volume of \$1.0 million year-over-year.

**Cost of Sales.** The cost of sales decreased \$0.9 million, or 2%, for the three months ended July 31, 2017 compared with the same period in 2016. This decrease correlates with the decrease in sales as discussed above. Overall, the change in the cost of sales reflects changes in volume and product mix with some labor inflation.

**Selling, General and Administrative.** Our selling, general and administrative expense decreased \$0.3 million for the three months ended July 31, 2017 compared to the same period in 2016, and related primarily to lower corporate allocations year-over-year.

**Restructuring Charges.** Restructuring charges of \$0.1 million represent equipment moving and other related costs associated with the Mexican plant closure effected in October 2016 and minor costs associated with the wind-down of the Lansing, Kansas plant.

**Depreciation and Amortization.** Depreciation and amortization expense decreased \$0.1 million for the three months ended July 31, 2017 compared with the same period in 2016. This decrease reflects incremental depreciation and amortization expense associated with property, plant and equipment placed into service during the trailing twelve



months ended July 31, 2017, more than offset by the normal run-off of depreciation expense associated with other existing assets and disposals during this period.

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## Unallocated Corporate &amp; Other

|   | Three Months Ended July 31, |         |              |            |
|---|-----------------------------|---------|--------------|------------|
|   | 2017                        | 2016    | \$<br>Change | Variance % |
|   | (Dollars in millions)       |         |              |            |
| Net sales   | \$(1.3)                     | \$(2.0) | \$ 0.7       | 35%        |
| Cost of sales (excluding depreciation and amortization) | (1.0 )                      | (1.4 )  | 0.4          | (29)%      |
| Selling, general and administrative                     | (0.4 )                      | 3.2     | (3.6 )       | 113%       |
| Depreciation and amortization                           | 0.1                         | 0.2     | (0.1 )       | 50%        |
| Operating loss  | \$—                         | \$(4.0) | \$ 4.0       | 100%       |

Net Sales. Net sales for Unallocated Corporate & Other represents the elimination of inter-segment sales for the three-month periods ended July 31, 2017 and 2016. The change between periods reflects the amount of inter-segment sales.

Cost of Sales. Cost of sales for Unallocated Corporate & Other consists of the elimination of inter-segment sales, profit in inventory, LIFO reserve adjustments and other costs. For the three months ended July 31, 2017 and 2016, the change of \$0.4 million was primarily related to the elimination of inter-segment sales.

Selling, General and Administrative. Our selling, general and administrative expenses decreased \$3.6 million for the three months ended July 31, 2017 compared to the same period in 2016, primarily due to a decrease in professional fees, severance costs, stock-based compensation, and incentive accruals based on financial performance. The decrease in professional fees in 2017 includes reimbursement of \$2.0 million from our insurance carrier for legal costs incurred to defend a claim of alleged defect in a commercial sealant product which settled, as described in Note 9, "Contingencies," to the accompanying unaudited condensed consolidated financial statements contained elsewhere herein. Partially offsetting these decreases in expense was a \$0.4 million decline in the amount of corporate costs allocated to the operating segments in 2017 compared to 2016.

Depreciation and Amortization. Depreciation and amortization expense decreased \$0.1 million for the three months ended July 31, 2017 compared to the same period in 2016. Relatively few new assets were placed in service at corporate during the trailing twelve months ended July 31, 2017.

#### Changes related to Non-Operating Items:

Interest Expense. Interest expense decreased \$19.6 million for the three months ended July 31, 2017 compared to the same period in 2016. Of this amount, \$16.7 million was attributable to the write-off of unamortized deferred financing fees, original issuer's discount and 1% prepayment penalty associated with the refinance and retirement of our Term Loan B and asset-based lending facilities on July 29, 2016. Also contributing to the decrease is a lower average outstanding debt balance with more favorable interest rates experienced for the three months ended July 31, 2017 compared to the same period in 2016.

Other, net. We recorded a loss of \$2.5 million for the three months ended July 31, 2016 due to net foreign exchange transaction losses.

Income Taxes. We recorded income tax expense of \$4.6 million for the three months ended July 31, 2017, an effective rate of 31.1%, and an income tax benefit of \$0.8 million for the three months ended July 31, 2016, an effective rate of 17.0%. The difference in the effective rates between these periods reflects the foreign tax rate differential as a greater portion of our taxable earnings in 2016 was contributed by our foreign operations in jurisdictions with statutory tax rates lower than the United States statutory rate.

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Nine Months Ended July 31, 2017 Compared to Nine Months Ended July 31, 2016

|   | Nine Months Ended July 31, |         |              |               |
|---|----------------------------|---------|--------------|---------------|
|   | 2017                       | 2016    | Change<br>\$ | %<br>Variance |
|   | (Dollars in millions)      |         |              |               |
| Net sales   | \$634.4                    | \$679.0 | \$(44.6)     | (7)%          |
| Cost of sales (excluding depreciation and amortization) | 494.6                      | 522.5   | (27.9)       | 5%            |
| Selling, general and administrative                     | 74.8                       | 88.4    | (13.6)       | 15%           |
| Restructuring charges                                   | 3.1                        | —       | 3.1          | (100)%        |
| Depreciation and amortization                           | 43.8                       | 39.8    | 4.0          | (10)%         |
| Operating income  | \$18.1                     | \$28.3  | \$(10.2)     | (36)%         |
| Interest expense  | (7.1)                      | (34.3)  | 27.2         | 79%           |
| Other, net  | 0.6                        | (4.0)   | 4.6          | 115%          |
| Income tax (expense) benefit                            | (3.6)                      | 2.7     | (6.3)        | (233)%        |
| Net income (loss)                                       | \$8.0                      | \$(7.3) | \$15.3       | 210%          |

Our period-over-period results by reportable segment follow.

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## Changes Related to Operating Income (Loss) by Reportable Segment:

## NA Engineered Components

|   | Nine Months Ended July 31, |         |              |            |
|---|----------------------------|---------|--------------|------------|
|   | 2017                       | 2016    | \$<br>Change | % Variance |
|   | (Dollars in millions)      |         |              |            |
| Net sales   | \$343.7                    | \$390.2 | \$(46.5 )    | (12)%      |
| Cost of sales (excluding depreciation and amortization) | 260.5                      | 292.0   | (31.5 )      | 11%        |
| Selling, general and administrative                     | 38.7                       | 45.7    | (7.0 )       | 15%        |
| Restructuring charges                                   | 2.2                        | —       | 2.2          | (100)%     |
| Depreciation and amortization                           | 26.4                       | 21.1    | 5.3          | (25)%      |
| Operating income  | \$15.9                     | \$31.4  | \$(15.5 )    | (49)%      |
| Operating income margin                                 | 5                          | % 8     | %            |            |

Net Sales. Net sales decreased \$46.5 million, or 12%, for the nine months ended July 31, 2017 compared to the same period in 2016. On a year-over-year basis, we experienced a \$49.5 million decrease in sales attributable to volume, an increase of \$3.9 million related to surcharges for commodities used in our business, primarily resin, and a decrease of \$0.9 million attributable to price. The significant decrease in volume was anticipated with regard to our previously-announced plan to shed low-margin business associated with our United States vinyl business, although the transition of this volume to other suppliers was at a quicker pace than originally expected. Overall, the impact of the decrease in volume is significantly offset by a decrease in the cost of the raw materials used in our manufacturing process, thereby reducing the negative impact on operating margins. Management continues to realign the cost structure in light of the anticipated volume reduction.

Cost of Sales. The cost of sales decreased \$31.5 million, or 11%, when comparing the nine months ended July 31, 2017 to the same period in 2016. Corresponding with the net sales discussion above, cost of sales was impacted by changes in sales volume and product mix resulting in lower material and labor costs year-over-year, as well as lower repair and maintenance costs, lower freight and some fixed-cost savings associated with restructuring efforts, partially offset by normal wage inflation, higher health insurance costs and fluctuations in commodity prices.

Selling, General and Administrative. Our selling, general and administrative expenses decreased \$7.0 million, or 15% when comparing the nine months ended July 31, 2017 to the same period in 2016. This decrease was primarily due to cost savings experienced at our vinyl business as a result of restructuring and headcount reductions, lower sales and marketing costs, lower incentive accruals based on operating results, and lower professional fees.

Restructuring Charges. Restructuring charges of \$2.2 million represent equipment and inventory moving costs incurred in conjunction with the announced closure of two vinyl extrusion plants in the United States, and other related costs including facility lease expense and employee benefit costs.

Depreciation and Amortization. Depreciation and amortization expense increased \$5.3 million, or 25% when comparing the nine-month periods ended July 31, 2017 and 2016. The increase reflects incremental depreciation of \$3.9 million associated with an October 2016 change in estimate associated with the remaining service lives of assets involved in restructuring efforts, and accelerated amortization of related intangible assets totaling \$1.6 million during the nine months ended July 31, 2017. Incremental depreciation expense associated with property, plant and equipment placed into service during the trailing twelve months ended July 31, 2017, was largely offset by the run-off of depreciation expense associated with existing assets and disposals during this period.

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## EU Engineered Components

|   | Nine Months Ended July 31, |         |              |            |
|---|----------------------------|---------|--------------|------------|
|   | 2017                       | 2016    | \$<br>Change | Variance % |
|   | (Dollars in millions)      |         |              |            |
| Net sales   | \$106.1                    | \$110.3 | \$ (4.2 )    | (4)%       |
| Cost of sales (excluding depreciation and amortization) | 75.3                       | 76.7    | (1.4 )       | 2%         |
| Selling, general and administrative                     | 15.1                       | 17.4    | (2.3 )       | 13%        |
| Depreciation and amortization                           | 6.8                        | 7.2     | (0.4 )       | 6%         |
| Operating income  | \$8.9                      | \$9.0   | \$ (0.1 )    | (1)%       |
| Operating income margin                                 | 8                          | % 8     | %            |            |

Net Sales. Net sales decreased \$4.2 million, or 4%, when comparing the nine months ended July 31, 2017 to the same period in 2016. This decrease is entirely attributable to an \$11.7 million negative impact associated with changes in foreign exchange rates. Excluding the foreign exchange impact, revenue increased \$7.6 million related to volume (primarily in the UK) with a slight decrease of \$0.1 million related to price.

Cost of Sales. The cost of sales decreased \$1.4 million, or 2%, for the nine months ended July 31, 2017 compared to the same period in 2016. Similar to the discussion above, cost of sales was impacted by foreign exchange rate movements, which offset an increase due to higher volume. Margins were negatively impacted by higher material costs and inefficiencies caused by delays associated with start-up of the new HLP warehouse.

Selling, General and Administrative. Our selling, general and administrative expense decreased \$2.3 million or 13%, for the nine months ended July 31, 2017 compared to the same period in 2016. The decrease was primarily attributable to a decrease in corporate allocations, lower selling and marketing costs, lower incentive accruals based on earnings, as well as the impact of changes in foreign currency exchange rates.

Depreciation and Amortization. Depreciation and amortization expense decreased \$0.4 million or 6%, for the nine months ended July 31, 2017 compared to the same period in 2016. The decrease was primarily attributable to the effect of changes in foreign exchange rates, somewhat offset by incremental depreciation and amortization expense associated with property, plant and equipment placed into service during the trailing twelve months ended July 31, 2017 which exceeded the run-off of depreciation expense associated with existing assets and disposals during this period.

## NA Cabinet Components

|   | Nine Months Ended July 31, |         |              |            |
|---|----------------------------|---------|--------------|------------|
|   | 2017                       | 2016    | \$<br>Change | Variance % |
|   | (Dollars in millions)      |         |              |            |
| Net sales   | \$188.3                    | \$185.0 | \$ 3.3       | 2%         |
| Cost of sales (excluding depreciation and amortization) | 161.7                      | 158.5   | 3.2          | (2)%       |
| Selling, general and administrative                     | 12.7                       | 13.0    | (0.3 )       | 2%         |
| Restructuring charges                                   | 0.9                        | —       | 0.9          | (100)%     |
| Depreciation and amortization                           | 10.2                       | 11.1    | (0.9 )       | 8%         |
| Operating income  | \$2.8                      | \$2.4   | \$ 0.4       | (17)%      |
| Operating income margin                                 | 1                          | % 1     | %            |            |

Net Sales. Net sales increased \$3.3 million, or 2%, for the nine months ended July 31, 2017 compared to the same period in 2016. On a year-over-year basis, we experienced a \$3.6 million increase in sales attributable to higher volume and an increase of \$1.6 million associated with pricing, partially offset by a decrease in raw material surcharge revenue of \$1.9 million. The increase in volume is net of the loss of \$6.1 million of lower-margin business pursuant to our previously-announced plan to shed less profitable business, reflecting new volume from spot sales, and incremental volume of \$1.4 million associated with the two plants transferred from the NA Engineered Components segment.

Cost of Sales. The cost of sales increased \$3.2 million, or 2%, for the nine months ended July 31, 2017 compared with the same period in 2016. This increase correlates with the increase in sales as discussed above. However, the results for the nine months ended July 31, 2016 include a charge of \$2.3 million related to purchase accounting (step-up and turn of inventory acquired), which did not recur in 2017. Excluding this item, cost of sales increased \$5.5 million, or 4%. Margins in 2017 were negatively

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impacted by some labor inefficiency, higher health insurance and benefit costs, less favorable material pricing and inventory adjustments and reserves. Overall, cost of sales reflects changes in sales volume and product mix.

Selling, General and Administrative. Our selling, general and administrative expense decreased \$0.3 million for the nine months ended July 31, 2017 compared to the same period in 2016 due primarily to a headcount reductions and lower incentive accruals based on earnings, partially offset by an increase in severance costs.

Restructuring Charges. Restructuring charges of \$0.9 million represent equipment moving and other related costs associated with the Mexican plant closure effected in October 2016, with minor costs incurred related to the wind-down of the Lansing, Kansas facility.

Depreciation and Amortization. Depreciation and amortization expense decreased \$0.9 million for the nine months ended July 31, 2017 compared with the same period in 2016. The decrease reflects the run-off of depreciation associated with certain assets given a short useful life as part of the purchase accounting recorded during 2016 and the expense true-up resulting from the valuation. These assets were fully depreciated prior to 2017. The incremental depreciation and amortization expense associated with property, plant and equipment placed into service during the trailing twelve months ended July 31, 2017, was offset by the run-off of depreciation expense associated with existing assets and disposals during this period.

#### Unallocated Corporate & Other

|   | Nine Months Ended July 31, |          |              |            |
|---|----------------------------|----------|--------------|------------|
|   | 2017                       | 2016     | \$<br>Change | Variance % |
|   | (Dollars in millions)      |          |              |            |
| Net sales   | \$(3.7)                    | \$(6.5)  | \$ 2.8       | 43%        |
| Cost of sales (excluding depreciation and amortization) | (2.9)                      | (4.7)    | \$ 1.8       | (38)%      |
| Selling, general and administrative                     | 8.3                        | 12.3     | \$ (4.0)     | 33%        |
| Depreciation and amortization                           | 0.4                        | 0.4      | \$ —         | —%         |
| Operating loss  | \$(9.5)                    | \$(14.5) | \$ 5.0       | 34%        |

Net Sales. Net sales for Unallocated Corporate & Other represents the elimination of inter-segment sales for the nine-month periods ended July 31, 2017 and 2016. The change between periods reflects the amount of inter-segment sales.

Cost of Sales. Cost of sales for Unallocated Corporate & Other consists of the elimination of inter-segment sales, profit in inventory, LIFO reserve adjustments and other costs. For the nine months ended July 31, 2017 and 2016, the change of \$1.8 million was primarily related to the elimination of inter-segment sales and the profit in inventory elimination.

Selling, General and Administrative. Our selling, general and administrative expenses decreased \$4.0 million for the nine months ended July 31, 2017 compared to the same period in 2016. Costs allocated to the operating segments declined \$0.6 million. Therefore, the decrease in expense between periods was \$4.6 million. This decrease was largely related to a net \$4.7 million decrease in transaction costs, primarily associated with the Woodcraft acquisition in 2016. An increase in professional fees in 2017 related primarily to legal costs incurred with regard to defense of an alleged product defect claim was substantially offset by a \$2.0 million insurance reimbursement for associated legal costs, as described in Note 9, "Contingencies," to the accompanying unaudited condensed consolidated financial statements contained elsewhere herein. Although we experienced higher salary and fringe benefit costs in 2017, this increase was offset by a decrease in severance costs year-over-year.

Depreciation and Amortization. Depreciation and amortization expense remained consistent at \$0.4 million for each of the nine-month periods ended July 31, 2017 and 2016.

#### Changes related to Non-Operating Items:

Interest Expense. Interest expense decreased \$27.2 million for the nine months ended July 31, 2017 compared to the same period in 2016. Of this amount, \$16.7 million was attributable to the write-off of unamortized deferred financing fees, original issuer's discount and 1% prepayment penalty associated with the refinance and retirement of our Term Loan B and asset-based lending facilities on July 29, 2016. Also contributing to the decrease is a lower average outstanding debt balance at July 31, 2017 compared to July 31, 2016. The weighted average interest rate for

borrowings outstanding for the nine months ended July 31, 2017 was 2.87% compared with 6.10% for the nine months ended July 31, 2016.

Other, net. We recorded a gain of \$0.6 million related to other, net for the nine months ended July 31, 2017 compared to a loss of \$4.0 million for the same period in 2016, primarily due to net foreign exchange transaction gains and losses.



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**Income Taxes.** We recorded income tax expense of \$3.6 million for the nine months ended July 31, 2017, an effective rate of 31.4%, and an income tax benefit of \$2.7 million for the nine months ended July 31, 2016, an effective rate of 27.2%. The 2016 effective rate was impacted by an additional discrete benefit item for the R&D credit which was made permanent in December 2015. Excluding this item, the effective tax rate would have been 25.8%. The overall change in the effective tax rate reflects the impact of permanent items, as well as the foreign tax rate differential, as a greater percentage of our taxable income for Fiscal 2016 was derived from our foreign operations, primarily the U.K., in jurisdictions with lower statutory tax rates than the United States statutory rate.

**Liquidity and Capital Resources****Overview**

Historically, our principal sources of funds have been cash on hand, cash flow from operations, and borrowings under our credit facilities.

We maintain a \$450.0 million credit agreement comprised of a \$150.0 million Term Loan A and a \$300.0 million revolving credit facility (collectively, the "Credit Agreement"). The Credit Agreement matures in 2021 (5-year term) and requires interest payments calculated, at our election and depending upon our Consolidated Leverage Ratio, at either a Base Rate plus an applicable margin (0.50% to 1.25%) or the LIBOR Rate plus an applicable margin (1.50% to 2.25%). The applicable rate during the nine months ended July 31, 2017 was LIBOR + 2.00%. In addition to the Consolidated Leverage Ratio covenant, we are required to meet a Consolidated Fixed Charge Coverage Ratio covenant, and there are limitations on certain transactions including our ability to incur indebtedness, incur liens, dispose of material assets, acquire businesses, make restricted payments and pay dividends (limited to \$10.0 million per year). We are amortizing deferred financing fees of \$2.2 million straight-line over the remaining term of the facility.

As of July 31, 2017, we had \$15.8 million of cash and equivalents, \$247.5 million outstanding under the Credit Agreement, \$5.4 million of outstanding letters of credit and \$19.1 million outstanding under capital leases and other debt vehicles. We had \$189.6 million available for use under the Credit Agreement at July 31, 2017.

**Analysis of Cash Flow**

The following table summarizes our cash flow results for the nine months ended July 31, 2017 and 2016:

|  | Nine Months<br>Ended<br>July 31,<br>2017    2016 |           |
|--|--|-----------|
|  | (In millions)                                    |           |
| Cash provided by operating activities            | \$45.3   | \$49.1    |
| Cash used for investing activities               | \$(34.4)   | \$(270.9) |
| Cash (used for) provided by financing activities | \$(20.4)   | \$229.6   |

**Operating Activities.** Cash provided by operating activities for the nine-month period ended July 31, 2017 decreased by approximately \$3.8 million compared to the nine-month period ended July 31, 2016. Our cash receipts and cash payments were impacted by the overall decline in sales volume. We invested more heavily in inventory which has not yet been sold, but is expected to turn during the remainder of fiscal 2017. Despite the decline in activity levels, cash receipts were impacted favorably by higher net income and cash collection experience, due in part to the collection of an income tax receivable. Cash payments were impacted by the timing of capital expenditures, material purchases and payroll cut-offs. Working capital was \$86.6 million, \$89.8 million and \$92.3 million at July 31, 2017, October 31, 2016 and July 31, 2016, respectively.

**Investing Activities.** Cash used for investing activities decreased \$236.5 million when comparing the nine months ended July 31, 2017 to the same period in 2016. In 2017, we paid \$8.5 million related to the HLP acquisition earn-out compared to \$245.9 million to purchase Woodcraft in 2016. We invested \$1.2 million more in capital expenditures for the nine months ended July 31, 2017 compared to the same period in 2016, which was partially offset by \$0.2 million in additional proceeds from the sale of capital assets during these periods.

**Financing Activities.** Cash used for financing activities was \$20.4 million for the nine months ended July 31, 2017, primarily attributable to \$22.9 million of net repayments of debt and dividends paid to our shareholders of \$4.1

million, partially offset by \$6.4 million of proceeds received from stock option exercises. For the nine months ended July 31, 2016, cash provided by financing activities was \$229.6 million, primarily attributed to net borrowings under debt facilities and capital lease arrangements totaling

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\$242.0 million and \$3.4 million of proceeds received from stock option exercises, partially offset by debt issuance cost of \$11.8 million and dividends paid to our shareholders totaling \$4.1 million.

### Liquidity Requirements

Our strategy for deploying cash is to invest in organic growth opportunities, develop our infrastructure and make strategic acquisitions. Other uses of cash have included paying cash dividends to our shareholders, opportunistically repurchasing our common stock (to the extent authorized through an established program by our Board of Directors) and servicing our debt commitments. We have historically invested cash and cash equivalents in commercial paper with terms of three months or less. Our investments are diversified across multiple institutions that we believe are financially sound. To the extent we have excess cash which has not been applied to reduce our outstanding borrowings under our credit facilities, we intend to remain in commercial paper, highly-rated money market funds, financial institutions and treasuries following a prudent investment philosophy. From time to time, to prepare for potential disruption in the money markets, we may temporarily move funds into operating bank accounts of highly-rated financial institutions to meet on-going operational liquidity requirements. We did not experience any material losses on our cash and marketable securities investments during the nine-month periods ended July 31, 2017 and 2016. We maintain cash balances in foreign countries which total \$7.9 million as of July 31, 2017. We do not intend to repatriate earnings of our foreign subsidiaries. However, we capitalized HLP with funds on hand and borrowings under our prior credit facility. We anticipate that we will utilize cash flow from HLP to fund the operation in the United Kingdom, and to repay a note arrangement implemented as part of the capitalization of the acquisition.

### Critical Accounting Policies and Estimates

The preparation of our financial statements in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) requires us to make estimates and assumptions that affect the reported amount of assets, liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. Estimates and assumptions about future events and their effects cannot be perceived with certainty. Estimates may change as new events occur, as more experience is acquired, as additional information becomes available and as our operating environment changes. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, and that we believe provide a basis for making judgments about the carrying value of assets and liabilities that are not readily available through open market quotes. We must use our judgment with regard to uncertainties in order to make these estimates. Actual results could differ from these estimates.

For a description of our critical accounting policies and estimates, see our Annual Report on Form 10-K for the fiscal year ended October 31, 2016. Our critical accounting policies and estimates have not changed materially during the nine months ended July 31, 2017.

### New Accounting Pronouncements

From time to time, new accounting pronouncements are issued by the Financial Accounting Standards Board (FASB) or other standards setting bodies that we adopt as of the specified effective date. Unless otherwise discussed, we believe the impact of any recently issued standards that are not yet effective are either not applicable to us at this time or will not have a material impact on our consolidated financial statements upon adoption. During the nine months ended July 31, 2017, we adopted several accounting standards with no impact to our financial statements. See Note 16, "New Accounting Guidance Adopted," to the accompanying unaudited condensed consolidated financial statements contained elsewhere herein, for further details.

In December 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers. This ASU is an update to ASU 2014-09, Revenue from Contracts with Customers. This update does not change the core revenue recognition principles included within ASU 2014-09, but rather provides technical corrections and improvements to guidance previously issued. We anticipate adopting ASU 2016-20 concurrently with ASU 2014-09 in fiscal 2019 and are currently evaluating the impact on our consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-07, Compensation - Retirement Benefits (Topic 715), Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. This update provides explicit guidance on how to present the service cost component and other components of net benefit cost in the income

statement and allows only the service cost component of net benefit cost to be eligible for capitalization. The amendments in this update are effective for annual periods beginning after December 15, 2017. We anticipate adopting ASU 2017-07 in fiscal 2018 and are currently evaluating the impact on our consolidated financial statements. Refer to our Annual Report on Form 10-K for the year ended October 31, 2016 for additional standards we are currently evaluating.

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## Item 3. Quantitative and Qualitative Disclosures About Market Risk

The following discussion of our exposure to various market risks contains “forward looking statements” regarding our estimates, assumptions and beliefs concerning our exposure. Although we believe these estimates and assumptions are reasonable in light of information currently available to us, we cannot provide assurance that these estimates will not materially differ from actual results due to the inherent unpredictability of interest rates, foreign currency rates and commodity prices as well as other factors. We do not use derivative financial instruments for speculative or trading purposes.

**Interest Rate Risk**

Our outstanding debt bears interest at variable rates and accordingly is sensitive to changes in interest rates. Based upon the balances of the variable rate debt at July 31, 2017, a hypothetical 1.0% increase or decrease in interest rates could result in approximately \$2.5 million of additional pretax charges or credit to our operating results per year. This sensitivity is impacted by the amount of borrowings under our credit facilities, and amounts outstanding under finance leases at HLP.

**Foreign Currency Rate Risk**

Our international operations have exposure to foreign currency rate risks, primarily due to fluctuations in the Euro, the British pound sterling and the Canadian dollar. From time to time, we enter into foreign exchange contracts associated with our operations to manage a portion of the foreign currency rate risk.

The notional and fair market values of these positions at July 31, 2017 and October 31, 2016, were as follows (in thousands):

|                               | Notional as<br>indicated |                     | Fair Value in \$ |                     |
|-------------------------------|--------------------------|---------------------|------------------|---------------------|
|                               | July 31,<br>2017         | October 31,<br>2016 | July 31,<br>2017 | October 31,<br>2016 |
| Foreign currency derivatives: |                          |                     |                  |                     |
| Sell EUR, buy USD             | EUR \$2,765              | \$ 5,251            | \$(52)           | \$ (79 )            |
| Sell CAD, buy USD             | CAD260                   | 186                 | (1 )             | 1                   |
| Sell GBP, buy USD             | GBP 38                   | 187                 | (1 )             | (1 )                |
| Buy EUR, sell GBP             | EUR 47                   | 130                 | —                | 1                   |
| Buy USD, sell EUR             | USD 34                   | 1                   | (1 )             | —                   |

At July 31, 2017 and October 31, 2016, we held foreign currency derivative contracts hedging cross-border intercompany and commercial activity for our insulating glass spacer business. Although these derivatives hedge our exposure to fluctuations in foreign currency rates, we do not apply hedge accounting and therefore, the change in the fair value of these foreign currency derivatives is recorded directly to other income and expense in the accompanying condensed consolidated statements of income (loss). To the extent the gain or loss on the derivative instrument offsets the gain or loss from the re-measurement of the underlying foreign currency balance, changes in exchange rates should have no effect. See Note 10, "Derivative Instruments," to the accompanying unaudited condensed consolidated financial statements contained elsewhere herein.

We currently have an unhedged foreign currency position associated with the debt borrowed to facilitate the HLP acquisition. We are evaluating our options with regard to hedging our exposure. For the three months ended July 31, 2017 and 2016, we recorded an unrealized loss of less than \$0.1 million and \$2.2 million, respectively, and for the nine months ended July 31, 2017 and 2016, an unrealized gain of \$0.6 million and an unrealized loss of \$3.7 million, respectively, associated with this foreign currency exposure.

**Commodity Price Risk**

We purchase polyvinyl resin (PVC) as the significant raw material consumed in the manufacture of vinyl extrusions. We have a monthly resin adjuster in place with a majority of our customers and our resin supplier that is adjusted based upon published industry indices for resin prices for the prior month. This adjuster effectively shares the base pass-through price changes of PVC with our customers commensurate with the market at large. Our long-term exposure to changes in PVC prices is somewhat mitigated due to the contractual component of the resin adjuster program. In addition, there is a level of exposure to short-term volatility due to the one month lag.



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We also charge certain customers a surcharge related to petroleum-based raw materials. The surcharge is intended to offset the rising cost of products which are highly correlated to the price of oil including butyl and other oil-based raw materials. The surcharge is in place with the majority of our customers who purchase these products and is adjusted monthly based upon the 90-day average published price for Brent crude. The oil-based raw materials that we purchase are subject to similar pricing schemes. As such, our long-term exposure to changes in oil-based raw material prices is significantly reduced under this surcharge program.

Similarly, Woodcraft includes a surcharge provision in the majority of its customer contracts to insulate against significant fluctuations in the price for various hardwood products used as the primary raw material for kitchen and bathroom cabinets. Like our vinyl extrusion business, we are exposed to short-term volatility in wood prices due to a lag in the timing of price updates which generally could extend for up to three months.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures pursuant to Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 ("1934 Act") as of July 31, 2017. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of July 31, 2017, the disclosure controls and procedures are effective.

Changes in Internal Control over Financial Reporting

There have been no changes in internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the 1934 Act) during the most recent fiscal quarter that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

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## PART II. OTHER INFORMATION

## Item 1A. Risk Factors

## Company Risks

The impact of Hurricanes Harvey and Irma could result in (a) lower purchase amounts from customers located in Texas and the Southeastern United States, and (b) increased costs for certain raw materials that are sourced from Texas and the Southeastern United States.

A number of our customers and suppliers are located in Texas, Florida, Georgia, and other southeastern states. If these customers experience extensive damage or destruction of their manufacturing facilities, we could experience a decrease in revenue. If our suppliers located in those areas are unable to produce or effectively transport raw materials, we may experience operational delays or higher raw material costs resulting from supply disruptions.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

## Issuer Purchases of Equity Securities

During the three months ended July 31, 2017, we repurchased common stock as follows:

|                                       | Periods Ended (a)<br>Total Number of<br>Shares Purchased<br>(1) | Periods Ended<br>(b) Average<br>Price Paid per<br>Share | Periods Ended (c) Total<br>Number of Shares Purchased<br>as Part of Publicly<br>Announced Plans or<br>Programs | Periods Ended (d) Maximum US<br>Dollars Remaining that May Yet<br>Be Used to Purchase Shares<br>Under the Plans or Programs |
|---------------------------------------|---|---|--|---|
| May 1, 2017<br>through May 31, 2017   | 930   | \$20.70   | —  | —   |
| June 1, 2017<br>through June 30, 2017 | —   | —   | —  | —   |
| July 1, 2017<br>through July 31, 2017 | —   | —   | —  | —   |
| Total                                 | 930   | \$20.70   | —  |   |

(1) Shares cancelled in connection with tax withholding related to the vesting of restricted share awards. Shares so cancelled are cancelled pursuant to the terms of our 2008 Omnibus Incentive Plan, as amended, and are not part of any publicly announced share repurchase authorizations.

## Item 6. Exhibits

The exhibits required to be furnished pursuant to Item 6 are listed in the Exhibit Index filed herewith, which Exhibit Index is incorporated herein by reference.



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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

QUANEX BUILDING PRODUCTS CORPORATION

Date: September 7, 2017 /s/ Brent L. Korb

Brent L. Korb

Senior Vice President – Finance and Chief Financial Officer  
(Principal Financial Officer)

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EXHIBIT INDEX

| Exhibit Number | Description of Exhibits  |
|----------------|--|
| <u>3.1</u>     | <u>Restated Certificate of Incorporation of the Registrant dated as of March 4, 2016, filed as Exhibit 3.1 of the Registrant's Current Report on Form 8-K (Reg. No. 001-33913) as filed with the Securities and Exchange Commission on March 7, 2016, and incorporated herein by reference.</u>  |
| <u>3.2</u>     | <u>Third Amended and Restated Bylaws of the Registrant as of March 4, 2016, filed as Exhibit 3.2 of the Registrant's Quarterly Report on Form 10-Q (Reg. No. 001-33913) for the quarter ended July 31, 2016, and incorporated herein by reference.</u>   |
| <u>4.1</u>     | <u>Form of Registrant's Common Stock certificate, filed as Exhibit 4.1 of Amendment No. 1 to the Registrant's Registration Statement on Form 10 (Reg. No. 001-33913) as filed with the Securities and Exchange Commission on February 14, 2008, and incorporated herein by reference.</u>  |
| <u>4.2</u>     | <u>Credit Agreement dated as of July 29, 2016, among the Company; certain of its subsidiaries as guarantors; Wells Fargo Bank, National Association, as administrative agent; Bank of America, N.A., as syndication agent; Wells Fargo Securities LLC and Merrill Lynch, Pierce, Fenner &amp; Smith Incorporated as joint lead arrangers; and the lenders party thereto, filed as Exhibit 10.1 of the Registrant's Current Report on Form 8-K (Reg. No. 001-33913) as filed with the Securities and Exchange Commission on August 1, 2016, and incorporated herein by reference.</u> |
| <u>10.1</u>    | <u>Agreement between Quanex Building Products Corporation and George Wilson, effective August 1, 2017, filed as Exhibit 10.1 of the Registrant's Current Report on Form 8-K (Reg. No. 001-33919) as filed with the Securities and Exchange Commission on July 27, 2017.</u>  |
| <u>10.2</u>    | <u>Change in Control Agreement between Quanex Building Products Corporation and George Wilson, effective August 1, 2017, filed as Exhibit 10.2 of the Registrant's Current Report on Form 8-K (Reg. No. 001-33919) as filed with the Securities and Exchange Commission on July 27, 2017.</u>  |
| <u>10.3</u>    | <u>Form of Indemnity Agreement between Quanex Building Products Corporation and George Wilson, effective August 1, 2017, in the form filed as Exhibit 10.2 of the Registrant's Current Report on Form 8-K (Reg. No. 001-33913), as filed with the Securities and Exchange Commission on August 29, 2008, and incorporated herein by reference.</u>   |
| <u>*31.1</u>   | <u>Certification by chief executive officer pursuant to Rule 13a-14(a)/15d-14(a).</u>  |
| <u>*31.2</u>   | <u>Certification by chief financial officer pursuant to Rule 13a-14(a)/15d-14(a).</u>  |
| <u>*32.1</u>   | <u>Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>  |
| *101.INS       | XBRL Instance Document   |
| *101.SCH       | XBRL Taxonomy Extension Schema Document  |
| *101.CAL       | XBRL Taxonomy Extension Calculation Linkbase Document  |
| *101.DEF       | XBRL Taxonomy Extension Definition Linkbase Document   |

\*101.LAB XBRL Taxonomy Extension Label Linkbase Document

\*101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

\* Filed herewith

As permitted by Item 601(b)(4)(iii)(A) of Regulation S-K, the Registrant has not filed with this Quarterly Report on Form 10-Q certain instruments defining the rights of holders of long-term debt of the Registrant and its subsidiaries because the total amount of securities authorized under any of such instruments does not exceed 10% of the total assets of the Registrant and its subsidiaries on a consolidated basis. The Registrant agrees to furnish a copy of any such agreements to the Securities and Exchange Commission upon request.