

Quanex Building Products CORP  
Form 10-Q  
June 01, 2016

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 April 30, 2016

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

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

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

| Class                                    | Outstanding at May 25, 2016 |
|--|-----------------------------|
| Common Stock, par value \$0.01 per share | 34,253,103                  |



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)

|  | April 30,<br>2016                    | October 31,<br>2015 |
|--|--------------------------------------|---------------------|
|  | (In thousands, except share amounts) |                     |
| <b>ASSETS</b>  |                                      |                     |
| Current assets:  |                                      |                     |
| Cash and cash equivalents  | \$ 29,001                            | \$ 23,125           |
| Accounts receivable, net of allowance for doubtful accounts of \$853 and \$673   | 83,734                               | 64,080              |
| Inventories, net (Note 3)  | 97,338                               | 63,029              |
| Prepaid and other current assets   | 11,829                               | 7,992               |
| Total current assets   | 221,902                              | 158,226             |
| Property, plant and equipment, net of accumulated depreciation of \$232,178 and \$217,512  | 201,657                              | 140,672             |
| Deferred income taxes (Note 8)   | —                                    | 8,783               |
| Goodwill (Note 4)  | 240,592                              | 129,770             |
| Intangible assets, net (Note 4)  | 171,866                              | 120,810             |
| Other assets   | 15,400                               | 8,529               |
| Total assets   | \$ 851,417                           | \$ 566,790          |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                                      |                     |
| Current liabilities:   |                                      |                     |
| Accounts payable   | \$ 51,822                            | \$ 47,778           |
| Accrued liabilities  | 44,245                               | 37,364              |
| Income taxes payable (Note 8)  | 1,196                                | 747                 |
| Current maturities of long-term debt (Note 5)  | 5,260                                | 2,359               |
| Total current liabilities  | 102,523                              | 88,248              |
| Long-term debt (Note 5)  | 304,090                              | 55,041              |
| Deferred pension and postretirement benefits (Note 6)  | 7,360                                | 5,701               |
| Deferred income taxes (Note 8)   | 24,369                               | —                   |
| Other liabilities  | 23,062                               | 22,505              |
| Total liabilities  | 461,404                              | 171,495             |
| 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 37,596,606 and 37,609,563, respectively; outstanding 34,226,244 and 33,962,460, respectively | 376                                  | 376                 |
| Additional paid-in-capital   | 252,712                              | 250,937             |
| Retained earnings  | 215,635                              | 222,138             |
| Accumulated other comprehensive loss   | (15,771 )                            | (10,049 )           |
| Less: Treasury stock at cost, 3,370,362 and 3,647,103 shares, respectively   | (62,939 )                            | (68,107 )           |
| Total stockholders' equity   | 390,013                              | 395,295             |
| Total liabilities and stockholders' equity   | \$ 851,417                           | \$ 566,790          |

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>April 30,          |           | Six Months Ended<br>April 30, |           |
|---|--|-----------|-------------------------------|-----------|
|   | 2016                                     | 2015      | 2016                          | 2015      |
|   | (In thousands, except per share amounts) |           |                               |           |
| Net sales   | \$229,460                                | \$141,970 | \$430,928                     | \$269,863 |
| Cost and expenses:  |  |           |                               |           |
| Cost of sales (excluding depreciation and amortization)                                 | 176,497                                  | 110,812   | 335,845                       | 216,616   |
| Selling, general and administrative   | 28,591                                   | 19,638    | 59,879                        | 39,134    |
| Depreciation and amortization   | 13,816                                   | 7,831     | 26,786                        | 16,039    |
| Operating income (loss)   | 10,556                                   | 3,689     | 8,418                         | (1,926 )  |
| Non-operating income (expense):   |  |           |                               |           |
| Interest expense  | (5,633 )                                 | (145 )    | (12,124 )                     | (286 )    |
| Other, net  | 848                                      | (115 )    | (1,513 )                      | (266 )    |
| Income (loss) from continuing operations before income taxes                            | 5,771                                    | 3,429     | (5,219 )                      | (2,478 )  |
| Income tax (expense) benefit  | (1,836 )                                 | (1,135 )  | 1,905                         | 1,678     |
| Income (loss) from continuing operations  | 3,935                                    | 2,294     | (3,314 )                      | (800 )    |
| Income from discontinued operations, net of tax of \$0, \$0, \$0 and \$15, respectively | —  | —         | —                             | 23        |
| Net income (loss)   | \$3,935                                  | \$2,294   | \$(3,314 )                    | \$(777 )  |
| Basic income (loss) per common share:   |  |           |                               |           |
| From continuing operations  | \$0.12                                   | \$0.07    | \$(0.10 )                     | \$(0.02 ) |
| From discontinued operations  | —  | —         | —                             | —         |
| Income (loss) per share, basic  | \$0.12                                   | \$0.07    | \$(0.10 )                     | \$(0.02 ) |
| Diluted income (loss) per common share:   |  |           |                               |           |
| From continuing operations  | \$0.11                                   | \$0.07    | \$(0.10 )                     | \$(0.02 ) |
| From discontinued operations  | —  | —         | —                             | —         |
| Income (loss) per share, diluted  | \$0.11                                   | \$0.07    | \$(0.10 )                     | \$(0.02 ) |
| Weighted-average common shares outstanding:   |  |           |                               |           |
| Basic   | 33,873                                   | 33,621    | 33,818                        | 34,362    |
| Diluted   | 34,449                                   | 34,166    | 33,818                        | 34,362    |
| Cash dividends per share  | \$0.04                                   | \$0.04    | \$0.08                        | \$0.08    |

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>April 30,<br>2016 |         | Six Months Ended<br>April 30,<br>2016 |           |
|---|--|---------|---------------------------------------|-----------|
|   | 2015                                       | 2016    | 2015                                  | 2016      |
|   | (In thousands)                             |         |                                       |           |
| Net income (loss)   | \$3,935                                    | \$2,294 | \$(3,314)                             | \$(777 )  |
| Other comprehensive income (loss):                            |  |         |                                       |           |
| Foreign currency translation adjustments gain (loss) (pretax) | 4,303                                      | 277     | (5,722 )                              | (2,572 )  |
| Change in pension from net unamortized gain tax benefit       | —  | 41      | —                                     | 70        |
| Other comprehensive income (loss), net of tax                 | 4,303                                      | 318     | (5,722 )                              | (2,502 )  |
| Comprehensive income (loss)                                   | \$8,238                                    | \$2,612 | \$(9,036)                             | \$(3,279) |

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)

|   | Six Months Ended<br>April 30, |           |
|---|-------------------------------|-----------|
|   | 2016                          | 2015      |
|   | (In thousands)                |           |
| Operating activities:   |                               |           |
| Net loss  | \$(3,314 )                    | \$(777 )  |
| Adjustments to reconcile net loss to cash provided by operating activities: |                               |           |
| Depreciation and amortization   | 26,786                        | 16,039    |
| Stock-based compensation  | 3,830                         | 2,329     |
| Deferred income tax   | (4,253 )                      | (2,963 )  |
| Excess tax benefit from share-based compensation                            | (1 )                          | (60 )     |
| Other, net  | 1,503                         | (447 )    |
| Changes in assets and liabilities, net of effects from acquisitions:        |                               |           |
| Decrease in accounts receivable   | 3,059                         | 4,553     |
| Increase in inventory   | (5,181 )                      | (6,047 )  |
| (Increase) decrease in other current assets                                 | (1,527 )                      | 601       |
| Decrease in accounts payable  | (157 )                        | (5,799 )  |
| Decrease in accrued liabilities   | (1,769 )                      | (5,253 )  |
| Increase in income taxes payable  | 3,394                         | 260       |
| Increase in deferred pension and postretirement benefits                    | 1,659                         | 1,201     |
| Increase (decrease) in other long-term liabilities                          | 695                           | (128 )    |
| Other, net  | (136 )                        | (201 )    |
| Cash provided by operating activities                                       | 24,588                        | 3,308     |
| Investing activities:   |                               |           |
| Acquisitions, net of cash acquired  | (245,904)                     | —         |
| Capital expenditures  | (17,419 )                     | (13,381 ) |
| Proceeds from property insurance claim                                      | —                             | 513       |
| Proceeds from disposition of capital assets                                 | 935                           | 202       |
| Cash used for investing activities  | (262,388)                     | (12,666 ) |
| Financing activities:   |                               |           |
| Borrowings under credit facilities  | 332,800                       | —         |
| Repayments of credit facility borrowings                                    | (79,775 )                     | —         |
| Debt issuance costs   | (8,713 )                      | —         |
| Repayments of other long-term debt  | (1,165 )                      | (148 )    |
| Common stock dividends paid   | (2,731 )                      | (2,803 )  |
| Issuance of common stock  | 3,042                         | 4,181     |
| Excess tax benefit from share-based compensation                            | 1                             | 60        |
| Purchase of treasury stock  | —                             | (52,719 ) |
| Cash provided by (used for) financing activities                            | 243,459                       | (51,429 ) |
| Effect of exchange rate changes on cash and cash equivalents                | 217                           | 433       |
| Increase (decrease) in cash and cash equivalents                            | 5,876                         | (60,354 ) |
| Cash and cash equivalents at beginning of period                            | 23,125                        | 120,384   |
| Cash and cash equivalents at end of period                                  | \$29,001                      | \$60,030  |

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)

| Six Months Ended April 30, 2016             | 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, 2015                 | \$376   | \$250,937                        | \$222,138            | \$ (10,049 )                                  | \$(68,107)        | \$ 395,295                       |
| Net loss                                    | —   | —                                | (3,314 )             | —   | —                 | (3,314 )                         |
| Foreign currency translation adjustment     | —   | —                                | —                    | (5,722 )                                      | —                 | (5,722 )                         |
| Common dividends (\$0.08 per share)         | —   | —                                | (2,731 )             | —   | —                 | (2,731 )                         |
| Stock-based compensation activity:          |   |                                  |                      |   |                   |                                  |
| Expense related to stock-based compensation | —   | 3,830                            | —                    | —   | —                 | 3,830                            |
| Stock options exercised                     | —   | (105 )                           | (452 )               | —   | 3,599             | 3,042                            |
| Tax effect from share-based compensation    | —   | (262 )                           | —                    | —   | —                 | (262 )                           |
| Restricted stock awards granted             | —   | (1,563 )                         | (6 )                 | —   | 1,569             | —                                |
| Other                                       | —   | (125 )                           | —                    | —   | —                 | (125 )                           |
| Balance at April 30, 2016                   | \$376   | \$252,712                        | \$215,635            | \$ (15,771 )                                  | \$(62,939)        | \$ 390,013                       |

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 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 consolidated balance sheet as of October 31, 2015 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, 2015. In our opinion, the accompanying financial statements contain all adjustments (which consist of normal recurring adjustments, except as disclosed herein) necessary to fairly present our financial position, results of operations and cash flows for the interim periods. The results of operations for the periods presented are not necessarily indicative of the results to be expected for the full year or for any future periods.

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

**Discontinued Operations**

On April 1, 2014, we sold our interest in a limited liability company which held the assets of the Nichols Aluminum business (Nichols) to Aleris International, Inc. (Aleris), as further discussed in our Annual Report on Form 10-K as of October 31, 2015. We accounted for this sale as a discontinued operation.

We have historically purchased rolled aluminum product from Nichols. We expect to continue to purchase aluminum from Nichols in the normal course of business. Our purchases of aluminum product from Nichols for the three- and six-month periods ended April 30, 2016 and 2015 were \$1.2 million and \$1.6 million, respectively, and \$2.9 million and \$3.3 million, respectively.

We recorded income from discontinued operations of less than \$0.1 million for the six months ended April 30, 2015, which included a gain on involuntary conversion associated with property insurance proceeds of \$0.5 million, less an expense of approximately \$0.5 million associated with a stop-loss health insurance claim reimbursement.

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

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## QUANEX BUILDING PRODUCTS CORPORATION

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

doors and other components to OEMs in the kitchen and bathroom cabinet industry. Woodcraft operates 12 plants within the United States and one in Mexico. 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 a preliminary estimate of goodwill totaling \$114.2 million. For the three- and six-month periods ended April 30, 2016, our consolidated operating results include revenues of \$59.6 million and \$108.1 million, respectively, and net losses of \$3.5 million and \$3.8 million, respectively, associated with Woodcraft. We believe this acquisition expands 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. We are still determining the purchase price allocation for Woodcraft. A preliminary purchase price allocation of the fair value of the assets acquired and liabilities assumed is included in the table below. These estimates are subject to change and will likely result in an increase or decrease in goodwill, particularly with regard to third-party valuations and our estimates of fixed assets, intangible assets, inventory, and deferred taxes, during the measurement period, which may extend up to one year from the acquisition date. During the three months ended April 30, 2016, we increased goodwill as of November 2, 2015 by \$1.1 million, reflecting valuation estimates of inventory, fixed assets, accounts receivable and the related current and deferred tax effects, which included a value-added tax receivable adjustment associated with our Mexican operations.

|  | As of Date of<br>Opening Balance<br>Sheet<br>(In thousands) |
|--|---|
| Net assets acquired:   |   |
| Accounts receivable  | \$ 23,427   |
| Inventory  | 29,552  |
| Prepaid and other current assets   | 4,248   |
| Property, plant and equipment  | 63,313  |
| Goodwill   | 114,247   |
| Intangible assets  | 62,900  |
| Other non-current assets   | 24  |
| Accounts payable   | (4,620 )  |
| Accrued expenses   | (9,492 )  |
| Other non-current liabilities  | (343 )  |
| Deferred income tax liabilities, net   | (37,352 )   |
| 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 preliminary 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 as of November 2, 2015 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 will be amortized on a straight-line basis. The goodwill balance is not deductible for tax purposes. Woodcraft is allocated entirely to our North American Cabinet Components reportable

operating segment.

HLP

On June 15, 2015, we acquired the outstanding ownership shares of Flamstead Holdings Limited, an extruder of vinyl lineal products and manufacturer of other plastic products incorporated and registered in England and Wales, for \$131.7 million in cash, net of cash acquired, debt assumed of \$7.7 million and contingent consideration of \$10.3 million, resulting in preliminary goodwill on the transaction of approximately \$61.3 million. Following a pre-sale reorganization and purchase, Flamstead Holdings Limited owned 100% of the ownership shares of the following subsidiaries: HL Plastics Limited, Vintage Windows Limited, Wegoma Machinery Sales Limited (recently renamed Avantek Machinery Limited), and Liniar Limited (collectively referred to as "HLP"), each registered in England and Wales. The agreement contains 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 can select a base year upon which to calculate the earn-out (one of the next three succeeding

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## QUANEX BUILDING PRODUCTS CORPORATION

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

twelve-month periods ended July 31). The earn-out has been calculated using a probability weighting and has been adjusted for the time-value of money, with greater weight given to the third (and final) twelve-month period (when the earnings before interest, tax, depreciation and amortization is expected to be greatest).

We assumed operating leases associated with the HLP acquisition for which our lessors are entities that were either wholly-owned subsidiaries or affiliates of Flamstead Holdings Limited prior to the pre-acquisition reorganization, 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 \$0.4 million and \$0.7 million for the three and six months ended April 30, 2016. Commitments under these lease arrangements are included in our operating lease commitments as disclosed in our Annual Report on Form 10-K as of October 31, 2015.

We believe the acquisition of HLP: (1) expanded our international presence in the global fenestration business, particularly in the United Kingdom housing market; (2) expanded our vinyl extrusion product offerings, including house systems, supplemented with the brand recognition related to Liniar; (3) continues to provide synergies and an opportunity to sell complementary products, while adding new product offerings such as water retention barriers and conservatory roofing products; and (4) aligns well with our strategy to be the preferred supplier of quality products to our customers, while maintaining safe, efficient manufacturing facilities.

Our consolidated operating results include revenues of \$24.8 million and \$46.7 million, respectively, and net income of \$3.0 million and \$2.4 million, respectively, associated with HLP for the three and six months ended April 30, 2016. The purchase price has been allocated to the fair value of the assets acquired and liabilities assumed, as indicated in the table below. Changes in the contingent consideration due to the passage of time and potential differences between projected and actual operating results for HLP for the earn-out period will be recorded as period costs as incurred. We recorded expense related to the change in contingent consideration of \$0.1 million and \$0.2 million for the three and six months ended April 30, 2016. In addition, we recorded certain final adjustments related to the fair value of fixed assets and accrued liabilities resulting in a decrease in goodwill of \$0.2 million during the six months ended April 30, 2016.

|                               | As of Date of<br>Opening Balance<br>Sheet<br>(In thousands) |
|-------------------------------|---|
| Net assets acquired:          |   |
| Accounts receivable           | \$ 12,104   |
| Inventory                     | 16,015  |
| Prepaid and other assets      | 722   |
| Property, plant and equipment | 27,218  |
| Goodwill                      | 61,323  |
| Intangible assets             | 61,101  |
| Other non-current assets      | 2,252   |
| Accounts payable              | (9,375 )  |
| Income taxes payable          | (948 )  |
| Accrued expenses              | (6,239 )  |

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|   |            |   |
|---|------------|---|
| Deferred tax liabilities                        | (14,492    | ) |
| Net assets acquired                             | \$ 149,681 |   |
| Consideration:                                  |            |   |
| Cash, net of cash and cash equivalents acquired | \$ 131,689 |   |
| Debt assumed in acquisition (capital leases)    | 7,673      |   |
| Contingent consideration (earn-out)             | 10,319     |   |
|   | \$ 149,681 |   |

We used recognized valuation techniques to determine the fair value of the assets and liabilities, including the income approach for customer relationships and trade names, and the cost approach to value patents, with a discount rate that reflects the risk of the

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## QUANEX BUILDING PRODUCTS CORPORATION

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

expected future cash flows. Net intangible assets resulting from the HLP acquisition as of June 15, 2015 included customer relationships of \$45.9 million, trade names of \$14.3 million, and patents and other of \$0.6 million, with original estimated useful lives of 20 years, 15 years, and approximately 13 years, respectively. The goodwill balance is not deductible for tax purposes. HLP is allocated entirely to our European Engineered Components reportable operating segment.

## Pro Forma Results

We calculated the pro forma impact of the HLP and Woodcraft acquisitions and the associated debt financing on our operating results for the three and six months ended April 30, 2015. The following pro forma results give effect to these acquisitions, assuming the transactions occurred on November 1, 2014.

|                                   | Pro Forma Results |           |
|-----------------------------------|-------------------|-----------|
|                                   | For the           | For the   |
|                                   | Three             | Six       |
|                                   | Months            | Months    |
|                                   | Ended             | Ended     |
|                                   | April 30,         | April 30, |
|                                   | 2015              | 2015      |
| Net sales                         | \$225,821         | \$431,161 |
| Income from continuing operations | \$4,864           | \$3,606   |
| Net income                        | \$4,864           | \$3,629   |
| Basic income per share            | \$0.14            | \$0.11    |
| Diluted income per share          | \$0.14            | \$0.10    |

We derived the pro forma results for the HLP and Woodcraft acquisitions based on historical financial information obtained from the sellers and certain management assumptions. Our pro forma adjustments relate to incremental depreciation and amortization expense associated with property, plant and equipment and intangible assets and interest expense associated with borrowings to effect the transactions, assuming a November 1, 2014 effective date. In addition, we calculated the tax impact of these adjustments at a 35% statutory rate in the United States and a 20% statutory rate in the United Kingdom, as applicable.

These pro forma results do not purport to be indicative of the results that would have been obtained had the acquisitions of HLP and Woodcraft been completed on November 1, 2014, or that may be obtained in the future.

## 3. Inventories

Inventories consisted of the following at April 30, 2016 and October 31, 2015:

|                                    | April 30, October 31, |           |
|------------------------------------|-----------------------|-----------|
|                                    | 2016                  | 2015      |
|                                    | (In thousands)        |           |
| Raw materials                      | \$35,795              | \$ 36,865 |
| Finished goods and work in process | 65,124                | 32,206    |
| Supplies and other                 | 1,905                 | 2,064     |
| Total                              | 102,824               | 71,135    |
| Less: Inventory reserves           | 5,486                 | 8,106     |
| Inventories, net                   | \$97,338              | \$ 63,029 |



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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 April 30, 2016 and October 31, 2015 were valued using the following costing methods:

|                | April 30,<br>2016 | October 31,<br>2015 |
|----------------|-------------------|---------------------|
| (In thousands) |                   |                     |
| LIFO           | \$4,626           | \$ 3,642            |
| FIFO           | 92,712            | 59,387              |
| Total          | \$97,338          | \$ 63,029           |

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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 six-month periods ended April 30, 2016 and 2015.

For inventories valued under the LIFO method, replacement cost exceeded the LIFO value by approximately \$1.3 million at April 30, 2016 and October 31, 2015.

## 4. Goodwill and Intangible Assets

## Goodwill

The change in the carrying amount of goodwill for the six months ended April 30, 2016 was as follows:

|   | Six Months Ended<br>April 30, 2016<br>(In thousands) |   |
|---|--|---|
| Beginning balance<br>as of November 1, 2015   | 129,770  |   |
| Woodcraft<br>acquisition                      | 114,247  |   |
| Other   | (575)  | ) |
| Foreign currency<br>translation<br>adjustment | (2,850)  | ) |
| Balance as of the<br>end of the period        | \$ 240,592   |   |

During the fourth fiscal quarter of 2015, we evaluated our goodwill balances for indicators of impairment and performed our annual goodwill impairment test to determine the recoverability of these assets. We determined that our goodwill was not impaired and there have been no triggering events to indicate impairment during the six months ended April 30, 2016, so no additional testing was deemed necessary. For a summary of the change in the carrying amount of goodwill by segment, see Note 14, "Segment Information", included herewith.

## Identifiable Intangible Assets

Amortizable intangible assets consisted of the following as of April 30, 2016 and October 31, 2015:

|                              | April 30, 2016              |                             | October 31, 2015            |                             |
|------------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
|                              | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization |
|                              | (In thousands)              |                             |                             |                             |
| Customer relationships       | \$159,134                   | \$ 30,326                   | \$98,750                    | \$ 24,628                   |
| Trademarks and trade names   | 58,165                      | 25,194                      | 58,916                      | 23,416                      |
| Patents and other technology | 25,847                      | 16,088                      | 25,881                      | 15,158                      |
| Other                        | 1,894                       | 1,566                       | 1,767                       | 1,302                       |

Total                                \$245,040 \$ 73,174                \$185,314 \$ 64,504

We do not estimate a residual value associated with these intangible assets. Included in net intangible assets as of April 30, 2016 were \$60.2 million of customer relationships and other intangibles of less than \$0.1 million related to the Woodcraft acquisition. See Note 2, "Acquisitions", included herewith.

For the three- and six-month periods ended April 30, 2016 and 2015, we had aggregate amortization expense related to intangible assets of \$2.3 million and \$5.5 million, respectively, and \$2.2 million and \$4.5 million, respectively.

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## QUANEX BUILDING PRODUCTS CORPORATION

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

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

|                             | Estimated<br>Amortization<br>Expense |
|-----------------------------|--------------------------------------|
| 2016 (remaining six months) | \$ 8,592                             |
| 2017                        | 16,943                               |
| 2018                        | 16,695                               |
| 2019                        | 15,909                               |
| 2020                        | 14,848                               |
| Thereafter                  | 98,879                               |
| Total                       | \$ 171,866                           |

## 5. Debt and Capital Lease Obligations

Debt consisted of the following at April 30, 2016 and October 31, 2015:

|  | April 30,<br>2016 | October 31,<br>2015 |
|--|-------------------|---------------------|
|  | (In thousands)    |                     |
| Revolving Credit Facility                                    | \$—               | \$ 50,000           |
| Term Loan B (net of unamortized discount of \$5,743 and \$0) | 303,482           | —                   |
| City of Richmond, Kentucky Industrial Building Revenue Bonds | 400               | 500                 |
| Capital lease obligations                                    | 5,468             | 6,900               |
| Total debt   | 309,350           | 57,400              |
| Less: Current maturities of long-term debt                   | 5,260             | 2,359               |
| Long-term debt   | \$304,090         | \$ 55,041           |

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

The Retired Facility required us to comply with certain financial covenants, the terms of which were defined therein. Specifically, on a quarterly basis, we were not permitted to allow our ratio of consolidated EBITDA to consolidated interest expense as defined (Minimum Interest Coverage Ratio), to fall below 3.00:1 or our ratio of consolidated funded debt to consolidated EBITDA, as defined (Maximum Consolidated Leverage Ratio), to exceed 3.25:1. The Maximum Consolidated Leverage Ratio is the ratio of consolidated EBITDA to consolidated interest expense, in each case for the previous four consecutive fiscal quarters. EBITDA was defined by the indenture to include proforma EBITDA of acquisitions and to exclude certain items such as goodwill and intangible asset impairments and certain other non-cash charges and non-recurring items. Subject to our compliance with the covenant requirements, the amount available under the Retired Facility was a function of: (1) our trailing twelve month EBITDA; (2) the Minimum Interest Coverage Ratio and Maximum Consolidated Leverage Ratio allowed under the Retired Facility;

and (3) the aggregate amount of our outstanding debt and letters of credit.

Effective June 15, 2015, in conjunction with the acquisition of HLP, we borrowed \$92.0 million, at a weighted average borrowing rate of 1.28%, under the Retired Facility and subsequently repaid \$42.0 million prior to October 31, 2015. As of October 31, 2015, we had outstanding revolver borrowings of \$50.0 million, outstanding letters of credit of \$5.9 million, and the remaining amount available to us for use under the Retired Facility was \$86.6 million. Our borrowing rates under the Retired Facility were 3.50% and 1.45% for the swing-line sub facility and the revolver, respectively, at October 31, 2015.

On November 2, 2015, we refinanced and retired the Retired Facility by entering into a \$310.0 million Term Loan Credit Agreement and a \$100.0 million ABL Credit Agreement (collectively the “New Credit Facilities”) with Wells Fargo, National

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## QUANEX BUILDING PRODUCTS CORPORATION

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

Association, as Agent, and Bank of America, N.A. serving as Syndication Agent. The term loan portion of the New Credit Facilities matures on November 2, 2022, and requires quarterly principal payments equal to 0.25% of the aggregate borrowings. Interest is computed, at our election, based on a Base Rate plus applicable margin of 4.25%, or LIBOR plus applicable margin of 5.25% (with the stipulation that LIBOR cannot be less than 1%). In the event of default, outstanding borrowings will 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. The term loan provides for incremental term loan commitments for a minimum principal amount of \$25.0 million, up to an aggregate amount of \$50.0 million, to the extent that such borrowings do not cause the Consolidated Senior Secured Leverage Ratio to exceed 3.00 to 1.00. The term loan agreement permits prepayment of the term loan of at least an aggregate amount of \$5.0 million or any whole multiple of \$1.0 million in excess thereof without penalty, except if such prepayment is made on or before November 2, 2016, we will pay a fee equal to 1% of such prepayment. The ABL portion of the New Credit Facilities matures on November 2, 2020 with no stated principal repayment terms prior to maturity. Borrowing capacity and availability is determined based upon the dollar equivalent of certain working capital items including receivables and inventory, subject to eligibility as determined by Wells Fargo, National Association, as Administrative Agent, up to the facility maximum of \$100.0 million. Interest is computed, at our election, on a grid as the Base Rate plus an Applicable Margin, as defined in the agreement, or LIBOR plus an Applicable Margin. The Applicable Margin is outlined in the following table:

| Level | Average Aggregate Excess Availability   | Applicable Margin Relative to Base Rate Loans | Applicable Margin Relative to LIBOR Rate Loans |
|-------|---|---|--|
| I     | > 66.7% of the Maximum Revolver Amount  | 0.50 percentage points                        | 1.50 percentage points                         |
| II    | < 66.7% of the Maximum Revolver Amount and 33.3% of the Maximum Revolver Amount | 0.75 percentage points                        | 1.75 percentage points                         |
| III   | < 33.3% of the Maximum Revolver Amount  | 1.00 percentage points                        | 2.00 percentage points                         |

With regard to the applicable margin calculation, Level I was applied for the period from November 2, 2015 to April 30, 2016.

In addition, the ABL portion of the New Credit Facilities requires payment of a commitment fee (unused line fee) in accordance with the following table:

| Level | Average Revolver Usage               | Applicable Unused Line Fee Percentage |
|-------|--------------------------------------|---------------------------------------|
| I     | > 50% of the Maximum Revolver Amount | 0.25 percentage points                |
| II    | < 50% of the Maximum Revolver Amount | 0.375 percentage points               |

With regard to the unused line fee, Level II was applied for the period from November 2, 2015 to April 30, 2016.

The New Credit Facilities contain restrictive debt covenants which include: (1) as of the last day of each fiscal quarter through October 30, 2017, our Consolidated Total Leverage Ratio, as defined in the agreement, must not exceed 4.50 to 1.00. For the last day of each fiscal quarter after October 30, 2017, this ratio cannot exceed 4.00 to 1.00; (2) as of the last day of each fiscal month, we must maintain a trailing twelve-month Consolidated Fixed Charge Coverage Ratio, as defined in the agreement, of at least 1.10 to 1.00; (3) if our ABL Revolver Usage, as defined, exceeds the Borrowing Base, we must repay the excess amount on an accelerated basis to bring down the borrowing level; (4) if we receive consideration for the sale of assets other than “permitted assets” or for any insurance or condemnation event related to the ABL collateral, we are required to repay this amount as an ABL prepayment; if such payment is received with regards to assets that are not related to the ABL collateral, then we are required to repay this amount as a term loan prepayment; and (5) for each year we have “Excess Cash Flow,” as defined, we are required to make a

mandatory prepayment of the term loan calculated in accordance with the terms outlined in the credit agreement. Furthermore, the New Credit Facilities require periodic reporting, as well as monthly borrowing base calculation pursuant to the ABL portion of the facility, and could restrict or limit our ability to engage in certain business activities such as: (1) future business acquisitions or liquidations; (2) incurring new indebtedness, liens or encumbrances; (3) merging or consolidating operations; (4) disposing of significant assets; (5) prepaying subordinated debt; (6) engaging in certain transactions with affiliates; or (7) modifying incentive plans or governance documents, amongst other restrictions (including a limitation on annual dividend payments of \$8.0 million).

As of April 30, 2016, we had \$309.2 million outstanding under the term loan facility (reduced by unamortized loan discount of \$5.7 million), no borrowings outstanding under the ABL facility, \$5.9 million of outstanding letters of credit and \$5.9 million

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## QUANEX BUILDING PRODUCTS CORPORATION

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

outstanding under capital leases and other debt vehicles. We had \$82.8 million available under our credit facilities at April 30, 2016. The borrowings outstanding as of April 30, 2016 under the term loan accrue interest at 6.25% per annum, and our weighted average borrowing rate for borrowings outstanding during the six months ended April 30, 2016 was 6.09%. We were in compliance with our debt covenants as of April 30, 2016.

**Other Debt Instruments**

We maintain certain capital lease obligations related to equipment purchases. In conjunction with the acquisition of HLP, we assumed additional capital lease obligations of approximately \$7.7 million. These capital lease obligations relate to equipment purchases and accrue interest at an average rate of 5.5%, and extend through the year 2020. As of April 30, 2016, our obligations under the HLP capital leases total \$5.4 million, of which \$2.0 million is classified as the current portion of long-term debt and \$3.4 million is classified as long-term debt on the accompanying unaudited condensed consolidated balance sheet.

**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 six-month periods ended April 30, 2016 and 2015 was as follows:

|                                | Three Months<br>Ended<br>April 30,<br>2016 |        | Six Months<br>Ended<br>April 30,<br>2015 |         |
|--------------------------------|--|--------|--|---------|
|                                | 2016                                       | 2015   | 2016                                     | 2015    |
|                                | (In thousands)                             |        |  |         |
| Service cost                   | \$1,061                                    | \$802  | \$1,856                                  | \$1,683 |
| Interest cost                  | 218  | 257    | 414                                      | 510     |
| Expected return on plan assets | (386 )                                     | (443 ) | (809 )                                   | (904 )  |
| Amortization of net loss       | 125  | 40     | 193                                      | 79      |
| Net periodic benefit cost      | \$1,018                                    | \$656  | \$1,654                                  | \$1,368 |

During 2015, we contributed approximately \$2.8 million to fund our plan, and we expect to make a contribution to our plan in September 2016 of approximately \$3.7 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 April 30, 2016 and October 31, 2015, our liability under the supplemental benefit plan was approximately \$2.2 million and \$1.7 million, respectively, and the liability associated with the deferred compensation plan was approximately \$3.6 million and \$3.3 million, respectively. We record the current portion of liabilities under 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:

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## QUANEX BUILDING PRODUCTS CORPORATION

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

|  | Six Months<br>Ended<br>April 30,<br>2016<br>(In<br>thousands) |
|--|---|
| Beginning balance as of November 1, 2015           | \$ 535  |
| Provision for warranty expense                     | 168   |
| Change in accrual for preexisting warranties       | (192 )  |
| Warranty costs paid                                | (48 )   |
| Total accrued warranty as of the end of the period | \$ 463  |
| Less: Current portion of accrued warranty          | 291   |
| Long-term portion of accrued warranty              | \$ 172  |

## 8. Income Taxes

To determine our income tax expense for interim periods, consistent with accounting standards, we apply the estimated annual effective income tax rate to year-to-date results. Our estimated annual effective tax rates from continuing operations for the six months ended April 30, 2016 and 2015 were 36.5% and 67.7%, respectively. The 2016 effective rate was impacted by a discrete benefit item for the R&D credit which was made permanent in December 2015. Excluding this item, the effective tax rate was 32.3%. The increase in the 2015 effective tax rate is attributable to a discrete benefit item resulting from the reassessment of our uncertain tax position related to the 2008 spin-off of Quanex from a predecessor company in January 2015. Excluding this discrete item, the 2015 effective tax rate was 35.5%.

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. The acquisition of Flamstead Holdings, Ltd in June 2015 established a net noncurrent deferred tax liability of \$14.5 million primarily reflecting the book to tax basis difference in intangibles, fixed assets and inventory.

As of April 30, 2016, our unrecognized tax benefit (UTB) relates to certain state tax items regarding the interpretation of tax laws and regulations. In January 2015, we reassessed our unrecognized tax benefit related to the 2008 spin-off of Quanex from a predecessor company and recognized the full benefit of the tax positions taken. This reduced the liability for uncertain tax positions by \$4.0 million and increased deferred income taxes (non-current assets) by \$6.8 million and resulted in a non-cash increase in retained earnings of \$10.0 million, with an increase in income tax benefit of \$0.8 million. At April 30, 2016, \$0.5 million is recorded as a liability for uncertain tax positions. The disallowance of the UTB would not materially affect the annual effective tax rate.

Judgment is required in assessing the future tax consequences of events that have been recognized in our financial statements or tax returns. The final outcome of the future tax consequences of legal proceedings, if any, as well as the outcome of competent authority proceedings, changes in regulatory tax laws, or interpretation of those tax laws could impact our financial statements. We are subject to the effect of these matters occurring in various jurisdictions. We do not believe any of the UTB at April 30, 2016 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 \$1.1 million at April 30, 2016.

In November 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes. The amendments require deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. We adopted ASU No. 2015-17 as of November 1, 2015 on a retrospective basis. As a result, our presentation of deferred taxes at April 30, 2016 and October 31, 2015 is consistent with this guidance, and therefore the October 31, 2015 presentation reflects a reclassification of current deferred income tax asset of \$14.0 million and the noncurrent deferred income tax liability of \$5.2 million as a noncurrent deferred income tax asset of \$8.8 million.

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QUANEX BUILDING PRODUCTS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

9. Contingencies

Environmental

We are subject to extensive laws and regulations concerning the discharge of materials into the environment and the remediation of chemical contamination. We accrue our best estimates of our remediation obligations and adjust these accruals when further information becomes available or circumstances change. We are currently not subject to any remediation activities.

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 at October 31, 2015 was \$1.1 million. The accrual balance increased to \$1.5 million at April 30, 2016, reflecting net claim payments of \$0.7 million, additional claims received of \$1.0 million, and foreign currency impacts of \$0.1 million. We cannot estimate any future liability with regard to unasserted claims. However, we have received new claims during fiscal 2016 which we continue to investigate. We evaluate this reserve at each balance sheet date. We will investigate any future claims, but we are not obligated to honor any future claims.

Affordable Care Act

We are subject to the employer-shared responsibility requirements (more commonly referred to as the employer mandate) of the Affordable Care Act (ACA). The employer mandate requires us to offer health care insurance that meets minimum value and affordability requirements to our full-time employees and certain potential common law employees within a specified coverage threshold. Effective January 1, 2015, and for each calendar year ended December 31, we may be subject to a penalty in the form of an excise tax under the ACA if we do not meet these requirements. Furthermore, we must comply with the annual disclosure and reporting requirements. We have implemented mechanisms to comply with the ACA requirements.

Litigation

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

10. Derivative Instruments

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

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

derivative contracts.

We have not designated any of our derivative contracts as hedges for accounting purposes in accordance with the provisions under the Accounting Standards Codification Topic 815 "Derivatives and Hedging" (ASC 815). Therefore, changes in the fair value of these contracts and the realized gains and losses are recorded in the condensed consolidated statements of income (loss) for the three- and six-month periods ended April 30, 2016 and 2015 as follows (in thousands):

|                             |                              | Three<br>Months<br>Ended<br>April 30,<br>2016 | 2015 | Six Months<br>Ended<br>April 30,<br>2016 | 2015 |
|-----------------------------|------------------------------|---|------|--|------|
| Location of (losses) gains: |                              |   |      |  |      |
| Other, net                  | Foreign currency derivatives | (586)   | (38) | (432)                                    | 614  |

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## QUANEX BUILDING PRODUCTS CORPORATION

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

We have chosen not to offset any of our derivative instruments in accordance with the provisions of ASC 815. Therefore, the assets and liabilities are presented on a gross basis on our accompanying condensed consolidated balance sheets. Less than \$0.1 million of fair value related to foreign currency derivatives was included in prepaid and other current assets as of each period ended April 30, 2016 and October 31, 2015, and approximately \$0.2 million of fair value related to foreign currency derivatives was included in accrued liabilities as of April 30, 2016. The following table summarizes the notional amounts and fair value of outstanding derivative contracts at April 30, 2016 and October 31, 2015 (in thousands):

|                               | Notional as indicated |                  | Fair Value in \$ |                  |
|-------------------------------|-----------------------|------------------|------------------|------------------|
|                               | April 30, 2016        | October 31, 2015 | April 30, 2016   | October 31, 2015 |
| Foreign currency derivatives: |                       |                  |                  |                  |
| Sell EUR, buy USD             | EUR \$7,235           | \$ 8,076         | \$(174)          | \$ 37            |
| Sell CAD, buy USD             | CAD 279               | 280              | (3)              | 1                |
| Sell GBP, buy USD             | GBP 317               | 226              | (6)              | 3                |
| Buy EUR, sell USD             | EUR —                 | 807              | —                | 3                |
| Buy EUR, sell GBP             | EUR 86                | 2                | 1                | —                |
| Buy USD, sell EUR             | USD 251               | —                | (5)              | —                |
| Buy GBP, sell EUR             | GBP 8                 | —                | —                | —                |

For the classification in the fair value hierarchy, see Note 11, "Fair Value Measurement of Assets and Liabilities", included herewith. In addition, we have entered into a derivative contract to limit our exposure to changes in the value of aluminum, a commodity used in our screen products. Included in prepaid and other current assets as of April 30, 2016 was less than \$0.1 million related to derivatives with a notional amount of approximately 1.4 million pounds.

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

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

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

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

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

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## QUANEX BUILDING PRODUCTS CORPORATION

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

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

|                              | April 30, 2016 |         |          | October 31, 2015 |         |          |         |          |
|------------------------------|----------------|---------|----------|------------------|---------|----------|---------|----------|
|                              | Level 1        | Level 2 | Level 3  | Total            | Level 1 | Level 2  | Level 3 | Total    |
| <b>Assets</b>                |                |         |          |                  |         |          |         |          |
| Foreign currency derivatives | \$—            | \$1     | \$—      | \$1              | \$—     | \$44     | \$—     | \$44     |
| Aluminum derivatives         | —              | 84      | —        | 84               | —       | —        | —       | —        |
| Total assets                 | \$—            | \$85    | \$—      | \$85             | \$—     | \$44     | \$—     | \$44     |
| <b>Liabilities</b>           |                |         |          |                  |         |          |         |          |
| Foreign currency derivatives | \$—            | \$188   | \$—      | \$188            | \$—     | \$—      | \$—     | \$—      |
| Contingent consideration     | —              | —       | 10,047   | 10,047           | —       | 10,414   | —       | 10,414   |
| Total liabilities            | \$—            | \$188   | \$10,047 | \$10,235         | \$—     | \$10,414 | \$—     | \$10,414 |

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 associated with the HLP acquisition is included above as a Level 3 measurement (see Note 2, "Acquisitions").

We had approximately \$2.4 million of certain property, plant and equipment that was recorded at fair value on a non-recurring basis and classified as Level 3 as of April 30, 2016 and October 31, 2015. The fair value was based on broker opinions.

Carrying amounts reported on the balance sheet for cash, cash equivalents, accounts receivable and accounts payable approximate fair value due to the short-term maturity of these instruments. Our outstanding debt 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, as adjusted for unamortized discount of \$5.7 million at April 30, 2016, approximates carrying value at April 30, 2016, and October 31, 2015 (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.



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## QUANEX BUILDING PRODUCTS CORPORATION

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

A summary of non-vested restricted stock awards activity during the six months ended April 30, 2016 is presented below:

|                                | Restricted<br>Stock<br>Awards | Weighted Average<br>Grant Date Fair<br>Value per Share |
|--------------------------------|-------------------------------|--|
| Non-vested at October 31, 2015 | 293,000                       | \$ 18.70   |
| Granted                        | 84,000                        | 19.21  |
| Cancelled                      | (5,200 )                      | 18.67  |
| Vested                         | (26,000 )                     | 21.10  |
| Non-vested at April 30, 2016   | 345,800                       | \$ 18.65   |

The total weighted average grant-date fair value of restricted stock awards that vested during each of the six-month periods ended April 30, 2016 and 2015 was \$0.5 million. As of April 30, 2016, total unrecognized compensation cost related to unamortized restricted stock awards was \$2.5 million. We expect to recognize this expense over the remaining weighted average vesting period of 1.7 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, 2015.

The following table provides a summary of assumptions used to estimate the fair value of our stock options issued during the six-month periods ended April 30, 2016 and 2015.

|  | Six Months<br>Ended<br>April 30, |        |
|--|----------------------------------|--------|
|  | 2016                             | 2015   |
| Weighted-average expected volatility       | 37.1%                            | 47.7%  |
| Weighted-average expected term (in years)  | 5.4                              | 5.6    |
| Risk-free interest rate                    | 1.7%                             | 1.6%   |
| Expected dividend yield over expected term | 1.0%                             | 1.0%   |
| Weighted average grant date fair value     | \$6.32                           | \$8.40 |

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## QUANEX BUILDING PRODUCTS CORPORATION

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

The following table summarizes our stock option activity for the six months ended April 30, 2016:

|  | 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, 2015              | 2,352,188        | \$ 16.46                                 |  |  |
| Granted                                      | 294,400          | 19.23                                    |  |  |
| Exercised                                    | (192,741 )       | 15.90                                    |  |  |
| Forfeited/Expired                            | (28,318 )        | 20.01                                    |  |  |
| Outstanding at April 30, 2016                | 2,425,529        | \$ 16.79                                 | 5.6  | \$ 6,063                               |
| Vested or expected to vest at April 30, 2016 | 2,416,563        | \$ 16.79                                 | 5.6  | \$ 6,058                               |
| Exercisable at April 30, 2016                | 1,944,788        | \$ 16.27                                 | 4.8  | \$ 5,863                               |

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 six months ended April 30, 2016 and 2015 was \$0.8 million and \$1.1 million. The weighted-average grant date fair value of stock options that vested during the six months ended April 30, 2016 and 2015 was \$1.9 million and \$2.3 million, respectively. As of April 30, 2016, total unrecognized compensation cost related to stock options was \$1.9 million. We expect to recognize this expense over the remaining weighted average vesting period of 1.5 years.

**Restricted Stock Units**

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

As of April 30, 2016, there were no non-vested restricted stock units. During the six-month period ended April 30, 2015, we paid \$1.7 million to settle certain restricted stock units.

**Performance Share Awards**

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

We have awarded annual grants of performance shares in December 2015, 2014 and 2013. In addition, we awarded performance shares in January 2016 to a new officer. All of these performance share awards are designed with the same performance measures (relative total shareholder return and earnings per share growth). However, the number of shares earned is variable depending on the metrics achieved, and the settlement method is 50% in cash and 50% in our common stock.

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

To value the shares subject to the market condition, we utilized a Monte Carlo simulation model to arrive at a grant-date fair value. This amount will be expensed over the three-year term of the award with a credit to additional paid-in-capital. To value the shares subject to the internal performance measure, we used the value of our common stock on the date of grant as the grant-date fair value per share. This amount is being expensed over the three-year term of the award, with a credit to additional paid-in-capital, and could fluctuate depending on the number of shares ultimately expected to vest based on our assessment of the probability that the performance conditions will be achieved. For both performance conditions, the portion of the award expected

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## QUANEX BUILDING PRODUCTS CORPORATION

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

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.

In conjunction with the annual grants in December 2015, 2014 and 2013, we awarded 158,100, 137,400 and 155,800 performance shares, respectively. We also awarded 4,300 performance shares in January 2016. Depending on the achievement of the performance conditions, 0% to 200% of the awarded performance shares may ultimately vest. During the six months ended April 30, 2016, 4,500 of the performance shares issued in December 2013 and 3,900 of the performance shares issued in December 2014 were forfeited. During 2015, 9,200 of the performance shares issued in December 2013 and 8,200 of the performance shares issued in December 2014 were forfeited. During 2014, 7,000 of the performance shares issued in December 2013 were forfeited. For the three- and six-month periods ended April 30, 2016 and 2015, we have recorded \$1.0 million and \$0.4 million, respectively, and \$1.5 million and \$0.8 million, respectively, of compensation expense related to these 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 April 30, 2016, we have deemed 67,550 shares related to the December 2013 grant of performance shares as probable to be issued. The value of the equivalent number of shares is expected to be paid in cash when settled, along with accrued dividends thereon.

**Treasury Shares**

On September 5, 2014, our Board of Directors cancelled our existing stock repurchase program and approved a new stock repurchase program authorizing us to use up to \$75.0 million to repurchase shares of our common stock. For the period from September 5, 2014 through October 31, 2014, we purchased 1,316,326 shares at a cost of \$24.2 million under the new program. During the year ended October 31, 2015, we purchased an additional 2,675,903 shares at a cost of \$50.8 million. From inception of the program, we purchased 3,992,229 shares at a cost of \$75.0 million.

We record treasury stock purchases under the cost method whereby the entire cost of the acquired stock is recorded as treasury stock. Shares are generally issued from treasury stock at the time of grant of restricted stock awards, and upon the exercise of stock options and upon the issuance of performance shares. On the subsequent issuance of treasury shares, we record proceeds in excess of cost as an increase in additional paid in capital. 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 \$0.5 million in the six months ended April 30, 2016.

The following table summarizes the treasury stock activity during the six months ended April 30, 2016:

|  | Six<br>Months<br>Ended<br>April 30,<br>2016 |
|--|---|
| Beginning balance as of November 1, 2015 | 3,647,103                                   |
| Restricted stock awards granted          | (84,000 )                                   |
| Stock options exercised                  | (192,741 )                                  |
| Balance at April 30, 2016                | 3,370,362                                   |



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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 six-month periods ended April 30, 2016 and 2015:

|   | Three Months<br>Ended<br>April 30,<br>2016 |         | Six Months<br>Ended<br>April 30,<br>2015 |         |
|---|--|---------|--|---------|
|   | 2016                                       | 2015    | 2016                                     | 2015    |
|   | (In thousands)                             |         |  |         |
| Foreign currency transaction gains (losses) | \$ 1,421                                   | \$(88 ) | \$(1,208)                                | \$(922) |
| Foreign currency derivative (losses) gains  | (586 )                                     | (38 )   | (432 )                                   | 614     |
| Interest income                             | 2  | 8       | 38                                       | 39      |
| Other                                       | 11   | 3       | 89                                       | 3       |
| Other income (expense)                      | \$848                                      | \$(115) | \$(1,513)                                | \$(266) |

## 14. Segment Information

In our Annual Report on Form 10-K as of October 31, 2015 we presented two reportable segments in accordance with ASC Topic 280-10-50, "Segment Reporting" (ASC 280): (1) Engineered Products, comprised of four operating segments, focused primarily on North American fenestration, and (2) International Extrusion, comprised solely of HLP that was acquired on June 15, 2015. In addition, we recorded LIFO inventory adjustments, corporate office charges and inter-segment eliminations as Corporate & Other.

With the acquisition of Woodcraft on November 2, 2015, we re-evaluated our reportable operating segment presentation and changed the presentation to 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 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 continue to maintain what was previously called Corporate & Other, now called Unallocated Corporate & Other, but a portion of the general and administrative costs associated with the corporate office have been allocated to the reportable operating segments, based upon a relative measure of profitability in order to more accurately reflect each reportable operating segment's administrative cost. Certain costs were 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, depreciation of corporate assets, interest expense, other, net, income taxes and inter-segment eliminations. This treatment was applied to avoid an asymmetrical allocation amongst the operating segments for the comparative period due to the timing of acquisitions. The accounting policies of our operating segments are the same as those used to prepare the accompanying condensed consolidated financial statements. The following table summarizes corporate general and administrative expense allocated during the three and six months ended April 30, 2016 and 2015:

|  | Three Months<br>Ended<br>April 30, | Six Months<br>Ended<br>April 30, |
|--|------------------------------------|----------------------------------|
|--|------------------------------------|----------------------------------|

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|  | 2016           | 2015    | 2016    | 2015    |
|--|----------------|---------|---------|---------|
|  | (In thousands) |         |         |         |
| NA Engineered Components                     | \$2,479        | \$2,334 | \$4,894 | \$4,799 |
| EU Engineered Components                     | 901            | 170     | 1,780   | 349     |
| NA Cabinet Components                        | 1,127          | —       | 2,225   | —       |
| Unallocated Corporate & Other                | —              | 1,740   | —       | 3,577   |
| Allocated general and administrative expense | \$4,507        | \$4,244 | \$8,899 | \$8,725 |

ASC Topic 280-10-50, "Segment Reporting" (ASC 280) permits aggregation of operating segments based on factors including, but not limited to: (1) similar nature of products serving an industry; (2) similar production processes, although there are some

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QUANEX BUILDING PRODUCTS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

differences in the amount of automation amongst operating plants; (3) similar types or classes of customers, namely the primary original equipment manufacturers (OEMs) in the window and door industry; (4) similar distribution methods for product delivery, although the extent of the use of third-party distributors will vary amongst the businesses; (5) similar regulatory environment; and (6) converging long-term economic similarities.

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## QUANEX BUILDING PRODUCTS CORPORATION

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

Segment information for the three and six months ended April 30, 2016 and 2015, and total assets as of April 30, 2016 and October 31, 2015 are summarized in the following table (in thousands):

|                                   | NA Eng.<br>Comp. | EU Eng.<br>Comp. | NA<br>Cabinet<br>Comp. | Unallocated<br>Corp. &<br>Other | Total     |
|-----------------------------------|------------------|------------------|------------------------|---------------------------------|-----------|
| Three Months Ended April 30, 2016 |                  |                  |                        |                                 |           |
| Net sales                         | \$134,519        | \$36,965         | \$59,555               | \$(1,579)                       | \$229,460 |
| Depreciation and amortization     | 7,153            | 2,393            | 4,129                  | 141                             | 13,816    |
| Operating income (loss)           | 9,723            | 3,167            | 396                    | (2,730)                         | 10,556    |
| Capital expenditures              | 4,742            | 1,649            | 2,368                  | 8                               | 8,767     |
| Three Months Ended April 30, 2015 |                  |                  |                        |                                 |           |
| Net sales                         | \$130,910        | \$12,125         | \$—                    | \$(1,065)                       | \$141,970 |
| Depreciation and amortization     | 7,247            | 391              | —                      | 193                             | 7,831     |
| Operating income (loss)           | 6,491            | 545              | —                      | (3,347)                         | 3,689     |
| Capital expenditures              | 5,360            | 700              | —                      | —                               | 6,060     |
| Six Months Ended April 30, 2016   |                  |                  |                        |                                 |           |
| Net sales                         | \$255,567        | \$70,033         | \$108,080              | \$(2,752)                       | \$430,928 |
| Depreciation and amortization     | 14,361           | 4,851            | 7,274                  | 300                             | 26,786    |
| Operating income (loss)           | 15,240           | 4,519            | (895)                  | (10,446)                        | 8,418     |
| Capital expenditures              | 10,095           | 3,902            | 3,342                  | 80                              | 17,419    |
| Six Months Ended April 30, 2015   |                  |                  |                        |                                 |           |
| Net sales                         | \$248,741        | \$23,307         | \$—                    | \$(2,185)                       | \$269,863 |
| Depreciation and amortization     | 14,549           | 812              | —                      | 678                             | 16,039    |
| Operating income (loss)           | 4,310            | 712              | —                      | (6,948)                         | (1,926)   |
| Capital expenditures              | 11,923           | 1,458            | —                      | —                               | 13,381    |
| As of April 30, 2016              |                  |                  |                        |                                 |           |
| Total assets                      | \$308,435        | \$221,825        | \$298,471              | \$22,686                        | \$851,417 |
| As of October 31, 2015            |                  |                  |                        |                                 |           |
| Total assets                      | \$314,397        | \$231,261        | \$—                    | \$21,132                        | \$566,790 |

The following tables reconcile our segment presentation, as previously reported in our Quarterly Report on Form 10-Q for the three and six months ended April 30, 2015, 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 April 30, 2015        | As<br>Previously<br>Reported | Reclassification | Current<br>Presentation |
|--|------------------------------|------------------|-------------------------|
| <b>Engineered Products</b>               |                              |                  |                         |
| Net sales                                | \$ 141,970                   | \$ (141,970 )    | \$ —                    |
| Depreciation and amortization            | 7,831                        | (7,831 )         | —                       |
| Operating income (loss)                  | 3,689                        | (3,689 )         | —                       |
| Capital expenditures                     | \$ 6,060                     | \$ (6,060 )      | \$ —                    |
| <b>NA Engineered Components</b>          |                              |                  |                         |
| Net sales                                | \$ —                         | \$ 130,910       | \$ 130,910              |
| Depreciation and amortization            | —                            | 7,247            | 7,247                   |
| Operating income (loss)                  | —                            | 6,491            | 6,491                   |
| Capital expenditures                     | \$ —                         | \$ 5,360         | \$ 5,360                |
| <b>EU Engineered Components</b>          |                              |                  |                         |
| Net sales                                | \$ —                         | \$ 12,125        | \$ 12,125               |
| Depreciation and amortization            | —                            | 391              | 391                     |
| Operating income (loss)                  | —                            | 545              | 545                     |
| Capital expenditures                     | \$ —                         | \$ 700           | \$ 700                  |
| <b>Unallocated Corporate &amp; Other</b> |                              |                  |                         |
| Net sales                                | \$ —                         | \$ (1,065 )      | \$ (1,065 )             |
| Depreciation and amortization            | —                            | 193              | 193                     |
| Operating income (loss)                  | —                            | (3,347 )         | (3,347 )                |
| Capital expenditures                     | \$ —                         | \$ —             | \$ —                    |

| Six months ended April 30, 2015 | As<br>Previously<br>Reported | Reclassification | Current<br>Presentation |
|---------------------------------|------------------------------|------------------|-------------------------|
| <b>Engineered Products</b>      |                              |                  |                         |
| Net sales                       | \$ 269,863                   | \$ (269,863 )    | \$ —                    |
| Depreciation and amortization   | 16,039                       | (16,039 )        | —                       |
| Operating income (loss)         | (1,926 )                     | 1,926            | —                       |
| Capital expenditures            | \$ 13,381                    | \$ (13,381 )     | \$ —                    |
| <b>NA Engineered Components</b> |                              |                  |                         |
| Net sales                       | \$ —                         | \$ 248,741       | \$ 248,741              |
| Depreciation and amortization   | —                            | 14,549           | 14,549                  |
| Operating income (loss)         | —                            | 4,310            | 4,310                   |
| Capital expenditures            | \$ —                         | \$ 11,923        | \$ 11,923               |
| <b>EU Engineered Components</b> |                              |                  |                         |
| Net sales                       | \$ —                         | \$ 23,307        | \$ 23,307               |
| Depreciation and amortization   | —                            | 812              | 812                     |
| Operating income (loss)         | —                            | 712              | 712                     |
| Capital expenditures            | \$ —                         | \$ 1,458         | \$ 1,458                |

Unallocated Corporate & Other

|                               |     |           |             |   |
|-------------------------------|-----|-----------|-------------|---|
| Net sales                     | \$— | \$ (2,185 | ) \$ (2,185 | ) |
| Depreciation and amortization | —   | 678       | 678         |   |
| Operating income (loss)       | —   | (6,948    | ) (6,948    | ) |
| Capital expenditures          | \$— | \$ —      | \$ —        |   |

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## QUANEX BUILDING PRODUCTS CORPORATION

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

The following table summarizes the change in the carrying amount of goodwill by segment for the six months ended April 30, 2016 (in thousands):

|   | NA<br>Eng.<br>Comp. | EU Eng.<br>Comp. | NA<br>Cabinet<br>Comp. | Unalloc.<br>Corp. &<br>Other | Total      |
|---|---------------------|------------------|------------------------|------------------------------|------------|
| Balance as of October 31, 2015          | \$51,314            | \$78,456         | \$—                    | \$                           | —\$129,770 |
| Woodcraft acquisition                   | —                   | —                | 114,247                | —                            | 114,247    |
| Other                                   | —                   | (575 )           | —                      | —                            | (575 )     |
| Foreign currency translation adjustment | —                   | (2,850 )         | —                      | —                            | (2,850 )   |
| Balance as of April 30, 2016            | \$51,314            | \$75,031         | \$114,247              | \$                           | —\$240,592 |

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

We did not allocate non-operating 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 six months ended April 30, 2016 and 2015:

|  | Three Months<br>Ended<br>April 30,<br>2016 |          | Six Months Ended<br>April 30,<br>2015 |           |
|--|--|----------|---------------------------------------|-----------|
|  | 2016                                       | 2015     | 2016                                  | 2015      |
|  | (In thousands)                             |          |                                       |           |
| Operating income (loss)                      | \$10,556                                   | \$3,689  | \$8,418                               | \$(1,926) |
| Interest expense                             | (5,633 )                                   | (145 )   | (12,124 )                             | (286 )    |
| Other, net                                   | 848  | (115 )   | (1,513 )                              | (266 )    |
| Income tax (expense) benefit                 | (1,836 )                                   | (1,135 ) | 1,905                                 | 1,678     |
| Net income (loss) from continuing operations | \$3,935                                    | \$2,294  | \$(3,314)                             | \$(800 )  |

**Product Sales**

We produce a wide variety of products that are used in the fenestration industry, including: window and door systems design, engineering and fabrication; accessory trim profiles with real wood veneers and wood grain laminate finishes; window spacer systems; extruded vinyl products; metal fabrication; and astragals, thresholds and screens. In addition, we produce certain non-fenestration products, including: 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 six months ended April 30, 2016 and 2015 into general groupings by segment to provide additional information to our shareholders.

|                                  | Three months ended<br>April 30, |            | Six months ended<br>April 30, |            |
|----------------------------------|---------------------------------|------------|-------------------------------|------------|
|                                  | 2016                            | 2015       | 2016                          | 2015       |
|                                  | (In thousands)                  |            |                               |            |
| NA Engineered Components:        |                                 |            |                               |            |
| United States - fenestration     | \$113,127                       | \$107,050  | \$214,884                     | \$205,403  |
| International - fenestration     | 6,880                           | 8,369      | 13,786                        | 14,256     |
| United States - non-fenestration | 10,159                          | 11,995     | 18,267                        | 21,134     |
| International - non-fenestration | 4,353                           | 3,496      | 8,630                         | 7,948      |
|                                  | \$134,519                       | \$130,910  | \$255,567                     | \$248,741  |
| EU Engineered Components:        |                                 |            |                               |            |
| United States - fenestration     | \$—                             | \$4        | \$—                           | \$44       |
| International - fenestration     | 33,313                          | 12,121     | 63,323                        | 23,263     |
| International - non-fenestration | 3,652                           | —          | 6,710                         | —          |
|                                  | \$36,965                        | \$12,125   | \$70,033                      | \$23,307   |
| NA Cabinet Components:           |                                 |            |                               |            |
| United States                    | \$58,729                        | \$—        | \$106,599                     | \$—        |
| International                    | 826                             | —          | 1,481                         | —          |
|                                  | \$59,555                        | \$—        | \$108,080                     | \$—        |
| Unallocated Corporate & Other    |                                 |            |                               |            |
| Eliminations                     | \$(1,579 )                      | \$(1,065 ) | \$(2,752 )                    | \$(2,185 ) |
|                                  | \$(1,579 )                      | \$(1,065 ) | \$(2,752 )                    | \$(2,185 ) |
| Net sales                        | \$229,460                       | \$141,970  | \$430,928                     | \$269,863  |

## 15. Earnings Per Share

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

Basic and diluted earnings per share from continuing operations for the three-month periods ended April 30, 2016 and 2015 were calculated as follows (in thousands, except per share data):

|  |                    |
|--|--------------------|
|  | Three Months Ended |
|  | April 30, 2016     |
|  | Net                |
|  | Income Weighted    |
|  | from Average       |
|  | Continuing         |
|  | Operations         |
|  | Per                |
|  | Share              |

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|                                   |         |        |        |
|-----------------------------------|---------|--------|--------|
| Basic earnings per common share   | \$3,935 | 33,873 | \$0.12 |
| Effect of dilutive securities:    |         |        |        |
| Stock options                     | —       | 317    |        |
| Restricted stock awards           | —       | 191    |        |
| Performance shares                |         | 68     |        |
| Diluted earnings per common share | \$3,935 | 34,449 | \$0.11 |

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## QUANEX BUILDING PRODUCTS CORPORATION

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

|                                   | Three Months Ended<br>April 30, 2015                               |        |              |
|-----------------------------------|--|--------|--------------|
|                                   | Net<br>Income Weighted<br>from Average<br>Continuing<br>Operations |        | Per<br>Share |
|                                   | Figures  |        |              |
| Basic earnings per common share   | \$2,294  | 33,621 | \$0.07       |
| Effect of dilutive securities:    |  |        |              |
| Stock options                     | —  | 429    |              |
| Restricted stock awards           | —  | 116    |              |
| Diluted earnings per common share | \$2,294  | 34,166 | \$0.07       |

Basic and diluted loss per share was \$(0.10) and \$(0.02) for the six months ended April 30, 2016 and 2015, 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 six-month periods ended April 30, 2016 and 2015, 371,934 and 451,590 shares of common stock equivalents, respectively, and 175,251 and 107,748 shares of restricted stock, respectively, were excluded from the computation of diluted earnings per share. There were 67,550 potentially dilutive contingent shares related to performance share awards for the six-month period ended April 30, 2016; there were no corresponding contingent shares for the six-month period ended April 30, 2015.

For the three- and six-month periods ended April 30, 2016, we had 1,025,007 and 822,572 common stock equivalents, respectively, and we had 731,272 common stock equivalents for each of the three- and six-month periods ended April 30, 2015, that were potentially dilutive in future earnings per share calculations. Such dilution will be dependent on the excess of the market price of our stock over the exercise price and other components of the treasury stock method.

#### 16. New Accounting Guidance Adopted

In November 2015, the FASB issued ASU No. 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes. The amendments require deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. We adopted ASU No. 2015-17 as of November 1, 2015 on a retrospective basis. As a result, our presentation of deferred taxes at April 30, 2016 and October 31, 2015 is consistent with this guidance, and therefore the October 31, 2015 presentation reflects a reclassification of current deferred income tax asset of \$14.0 million and the noncurrent deferred income tax liability of \$5.2 million as a noncurrent deferred income tax asset of \$8.8 million (see Note 8, "Income Taxes").

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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, 2015.

### 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 April 30, 2016, and for the three- and six-month periods ended April 30, 2016 and 2015, 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, 2015.

Our Business

We manufacture components for original equipment manufacturers (OEM) 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. 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 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 continue to invest in organic growth initiatives and have completed several targeted business acquisitions. We intend to continue to pursue business acquisitions which may include vertically integrated vinyl extrusion businesses, screen manufacturers, cabinet component manufacturers or businesses in complementary industries 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.

As of October 31, 2015, we had two reportable business segments: (1) Engineered Products segment, comprised of four operating segments focused on the fenestration market, primarily within North America, and (2) International Extrusion segment, comprised solely of a United Kingdom-based vinyl extrusion business acquired on June 15, 2015. In addition, we recorded corporate office charges, last-in, first-out inventory adjustments and inter-segment eliminations as Corporate & Other. With the acquisition of the cabinet component business on November 2, 2015, we evaluated the composition of our reportable operating segments and have changed this presentation to reflect management's current view and to align with management's basis to allocate resources.

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 continue to maintain the grouping previously called Corporate & Other, now called Unallocated Corporate & Other, but a portion of the general and administrative costs associated with the corporate office have been allocated to the reportable operating segments, based upon a relative measure of profitability in order to more accurately reflect each reportable operating segment's administrative costs. Certain costs were 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, depreciation of corporate assets, interest expense, other, net, income taxes and inter-segment eliminations. This treatment was applied to avoid an asymmetrical allocation amongst the operating segments for the comparative period due to the timing of acquisitions. The accounting policies of our operating segments are the same as those used to prepare our accompanying condensed consolidated financial statements. The following table summarizes corporate general and administrative expense

allocated during the three and six months ended April 30, 2016 and 2015:

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|  | Three Months   |         | Six Months |         |
|--|----------------|---------|------------|---------|
|  | Ended          |         | Ended      |         |
|  | April 30,      |         | April 30,  |         |
|  | 2016           | 2015    | 2016       | 2015    |
|  | (In thousands) |         |            |         |
| NA Engineered Components                     | \$2,479        | \$2,334 | \$4,894    | \$4,799 |
| EU Engineered Components                     | 901            | 170     | 1,780      | 349     |
| NA Cabinet Components                        | 1,127          | —       | 2,225      | —       |
| Unallocated Corporate & Other                | —              | 1,740   | —          | 3,577   |
| Allocable general and administrative expense | \$4,507        | \$4,244 | \$8,899    | \$8,725 |

## 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 a preliminary estimate of goodwill totaling \$114.2 million. On June 15, 2015, we acquired HLP, an extruder of vinyl lineal products and manufacturer of other plastic products incorporated and registered in England and Wales, for \$131.7 million in cash, net of cash acquired, \$7.7 million of debt assumed and contingent consideration of \$10.3 million, resulting in goodwill of approximately \$61.3 million. For additional details of these acquisitions, see Note 2, "Acquisitions", contained elsewhere herein.

On April 1, 2014, we sold our interest in a limited liability company which held the assets of an aluminum sheet products business, Nichols Aluminum (Nichols), to Aleris International, Inc. (Aleris), a privately held Delaware corporation which provides aluminum rolled products and extrusions, aluminum recycling and specification aluminum alloy production. We do not expect to have results of operations associated with this discontinued operation during fiscal 2016.

## 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 home building 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 domestic 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. The NAHB has forecasted increases in calendar-year housing starts from 1.1 million units in 2015 to 1.2 million units in 2016 and 1.4 million units in 2017, reflecting increasing consumer confidence and a healthier economy, although tempered somewhat in recent months due to potential increases in interest rates by the U.S. Federal Reserve, and some instability of markets in other countries. Ducker indicated that window shipments by calendar year are expected to increase from 47.6 million units in 2015 to 51.4 million units in 2016 and 54.7 million units in 2017, with new construction window shipments forecasted to increase at a higher pace than R&R window shipments. Derived from reports published by Ducker, the overall growth in window shipments for the trailing twelve-month period ended March 31, 2016 was 4.4%. During this period, growth in new construction increased 8.6%, driven in part by an increase in multi-family housing, although there are recent indicators of a forecasted shift of some new construction growth to single-family homes, and growth in R&R activity increased 1.3%.

We have expanded our international presence with the acquisition of HLP in June 2015. This business is largely focused on the sale of vinyl systems under the trade name "Liniar" to smaller window manufacturers in the United Kingdom. To evaluate this market relative to housing starts, we use published reports from D&G Consulting (D&G), a consulting and research firm. D&G forecasts an increase in housing starts for private housing in the United Kingdom through 2018, while housing starts for public housing are forecasted to decline slightly beyond 2016, but thereafter remain relatively stable for 2017 and 2018.

Woodcraft manufactures kitchen and bathroom cabinet doors and components using a variety of woods from traditional hardwoods to engineered wood products. Currently, Woodcraft sells all of its products in North America, predominantly in the United States, so domestic housing starts and R&R activity constitute the primary drivers of this

business as well. Although NAHB forecasts indicate expected continued growth in the United States housing market, much of this anticipated growth is in new construction for multi-family dwellings, or rental properties, which tends to drive demand for stock cabinets as compared to the semi-custom cabinets Woodcraft is best suited to produce. Our business is seasonal, particularly our fenestration business, as inclement weather during the winter months tends to slow down construction, particularly as related to “outside of the house” construction. To some extent, we believe our acquisition of Woodcraft will lessen the impact of seasonality on our operating results, as the cabinet business is “inside of the house” and less susceptible to weather.

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We are impacted by regulation of energy standards. The United States government has been less aggressively pursuing higher energy efficiency standards in recent years. Higher energy efficiency standards are being implemented in Europe, which should bode well for our fenestration-related business in the European markets that we serve. In addition to the HLP vinyl extrusion business, we operate warm-edge spacer plants in the United Kingdom and in Germany. Our warm-edge spacer products are more energy efficient than older technology cold-edge spacers that are predominantly used in the European markets we serve.

We utilize several commodities in our business for which pricing can fluctuate, including polyvinyl resin (PVC), 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 these 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.

We are optimistic about our growth prospects in the near-term. We believe the recent acquisitions of HLP and Woodcraft diversify our product offerings and provide new avenues to grow our business, while we continue to focus on enhancing manufacturing efficiencies and customer service in order to provide a quality, value-added product to our North American fenestration customers.

## Results of Operations

Three Months Ended April 30, 2016 Compared to Three Months Ended April 30, 2015

|   | Three Months Ended April 30, |         | Change % |          |
|---|------------------------------|---------|----------|----------|
|   | 2016                         | 2015    | \$       | Variance |
|   | (Dollars in millions)        |         |          |          |
| Net sales   | \$229.5                      | \$141.9 | \$87.6   | 62 %     |
| Cost of sales (excluding depreciation and amortization) | 176.5                        | 110.8   | 65.7     | (59)%    |
| Selling, general and administrative                     | 28.6                         | 19.7    | 8.9      | (45)%    |
| Depreciation and amortization                           | 13.8                         | 7.8     | 6.0      | (77)%    |
| Operating income  | \$10.6                       | \$3.6   | \$7.0    | 194 %    |
| Interest expense  | (5.7 )                       | (0.1 )  | (5.6 )   | (5,600)% |
| Other, net  | 0.8                          | (0.1 )  | 0.9      | 900 %    |
| Income tax expense                                      | (1.8 )                       | (1.1 )  | (0.7 )   | (64)%    |
| Net income  | \$3.9                        | \$2.3   | \$1.6    | 70 %     |

Our operating results for the three months ended April 30, 2016 include the contributions of HLP and Woodcraft acquired on June 15, 2015 and November 2, 2015, respectively. We experienced overall sales growth of approximately 2.3% for the three months ended April 30, 2016 compared to the same period in 2015, excluding these acquisitions and certain foreign and other results.

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 April 30, |         |              |            |
|---|------------------------------|---------|--------------|------------|
|   | 2016                         | 2015    | \$<br>Change | % Variance |
|   | (Dollars in millions)        |         |              |            |
| Net sales   | \$134.5                      | \$130.9 | \$ 3.6       | 3%         |
| Cost of sales (excluding depreciation and amortization) | 101.2                        | 102.3   | (1.1 )       | 1%         |
| Selling, general and administrative                     | 16.4                         | 14.9    | 1.5          | (10)%      |
| Depreciation and amortization                           | 7.2                          | 7.2     | —            | —%         |
| Operating income  | \$9.7                        | \$6.5   | \$ 3.2       | 49%        |
| Operating income margin                                 | 7                            | % 5     | %            |            |

Net Sales. Net sales increased \$3.6 million, or 3%, for the three months ended April 30, 2016 compared to the same period in 2015. On a year-over-year basis, we experienced a \$6.6 million increase in sales attributable to higher volume, partially offset by a decrease of \$0.6 million in revenues associated with pricing and a decrease of \$2.4 million related to reduced surcharges for commodities such as aluminum, wood, and notably, oil for our butyl-based products due to a dramatic decline in oil prices throughout 2015, remaining relatively low for the first six months of 2016. The decreases of revenue associated with these surcharges are significantly offset by decreases in the cost of the raw materials used in our manufacturing process, resulting in minimal impact on operating margins.

Cost of Sales. The cost of sales decreased \$1.1 million, or 1%, when comparing the three months ended April 30, 2016 to the same period in 2015. Corresponding with the net sales discussion above, cost of sales was impacted by changes in sales volume and the resulting impact on product mix. However, these increases in expense were more than offset by the following: lower year-over-year repair and maintenance costs for our vinyl extrusion business; reduced material costs attributable to lower commodity prices and renegotiated supplier agreements; and reduced freight cost. Partially offsetting these declines was normal wage inflation, and higher current health insurance and workers' compensation insurance costs, less the benefit and timing associated with stop-loss insurance reimbursements.

Selling, General and Administrative. Our selling, general and administrative expenses increased \$1.5 million, or 10% when comparing the three months ended April 30, 2016 to the same period in 2015. This increase was largely due to incentive compensation accruals based on earnings and normal inflationary impacts on wages and benefit costs.

Depreciation and Amortization. Depreciation and amortization expense was consistent at \$7.2 million for the three-month periods ended April 30, 2016 and 2015. The incremental depreciation and amortization expense associated with property, plant and equipment and intangible assets placed into service during the trailing twelve months ended April 30, 2016, was offset by the run-off of depreciation expense associated with existing assets and disposals during this period.

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## European Engineered Components

|   | Three Months Ended April 30, |        |              |            |
|---|------------------------------|--------|--------------|------------|
|   | 2016                         | 2015   | \$<br>Change | Variance % |
|   | (Dollars in millions)        |        |              |            |
| Net sales   | \$37.0                       | \$12.1 | \$ 24.9      | 206%       |
| Cost of sales (excluding depreciation and amortization) | 25.5                         | 9.1    | \$ 16.4      | (180)%     |
| Selling, general and administrative                     | 5.9                          | 2.1    | \$ 3.8       | (181)%     |
| Depreciation and amortization                           | 2.4                          | 0.4    | \$ 2.0       | (500)%     |
| Operating income  | \$3.2                        | \$0.5  | \$ 2.7       | 540%       |
| Operating income margin                                 | 9                            | % 4    | %            |            |

Net Sales. Net sales increased \$24.9 million, or 206%, primarily due to a \$24.8 million contribution from HLP in 2016. In addition, an increase in sales of \$0.8 million associated with higher volume for the British and German plants, was offset by a decrease in revenue of \$0.6 million related to price and a \$0.1 million decrease related to the effect of changes in foreign exchange rates.

Cost of Sales. The cost of sales increased \$16.4 million, or 180%, primarily due to a \$16.7 million contribution from HLP. The remaining decline in cost of goods sold of \$0.3 million, or 3%, for the three months ended April 30, 2016 compared to the same period in 2015, was related to lower material costs in Germany, as a new mixing plant was installed in 2015, which eliminated the cost associated with processing by outside vendors. Otherwise, consistent with the revenue discussion, cost of goods sold increased as a result of the increase in volume in the United Kingdom and Germany, but was offset by the effect of exchange rate changes.

Selling, General and Administrative. Our selling, general and administrative expense increased \$3.8 million, of which \$3.7 million of expense was attributable to HLP.

Depreciation and Amortization. Depreciation and amortization expense increased \$2.0 million, reflecting the \$2.0 million contribution from HLP for the three months ended April 30, 2016. The incremental depreciation and amortization expense associated with property, plant and equipment placed into service during the trailing twelve months ended April 30, 2016, was offset by the run-off of depreciation expense associated with existing assets and disposals during this period.

## NA Cabinet Components

The NA Cabinet Components reportable segment is comprised solely of Woodcraft, which was acquired on November 2, 2015, and allocated corporate costs. The results of operations of Woodcraft for the three months ended April 30, 2016 are summarized in the following table:

|   | Three<br>months<br>ended<br>April 30,<br>2016<br>(Dollars<br>in<br>millions) |
|---|--|
| Net sales   | \$ 59.6  |
| Cost of sales (excluding depreciation and amortization) | 50.8   |
| Selling, general and administrative                     | 4.3  |
| Depreciation and amortization                           | 4.1  |
| Operating income  | \$ 0.4   |
| Operating income margin                                 | 1 %  |



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## Unallocated Corporate &amp; Other

|   | Three Months Ended April 30, |          |              |            |
|---|------------------------------|----------|--------------|------------|
|   | 2016                         | 2015     | \$<br>Change | Variance % |
|   | (Dollars in millions)        |          |              |            |
| Net sales   | \$ (1.6)                     | \$ (1.1) | \$ (0.5 )    | (45)%      |
| Cost of sales (excluding depreciation and amortization) | (1.0 )                       | (0.6 )   | (0.4 )       | (67)%      |
| Selling, general and administrative                     | 2.0                          | 2.7      | (0.7 )       | 26%        |
| Depreciation and amortization                           | 0.1                          | 0.2      | (0.1 )       | 50%        |
| Operating loss  | \$(2.7)                      | \$(3.4)  | \$ 0.7       | 21%        |

Net Sales. Net sales for Unallocated Corporate & Other represents the elimination of inter-segment sales for the three-month periods ended April 30, 2016 and 2015. The change between periods reflects the amount of inter-segment sales (between NA Engineered Components and EU Engineered Components).

Cost of Sales. Cost of sales for Unallocated Corporate & Other consists of the elimination of inter-segment sales, profit in inventory, changes in the LIFO reserve and other costs. The change for the three-month periods ended April 30, 2016 and 2015 of \$0.4 million was primarily related to the change in the profit in inventory elimination.

Selling, General and Administrative. Our selling, general and administrative expenses decreased \$0.7 million for the three months ended April 30, 2016 compared to the same period in 2015, reflecting an increase in the amount of corporate expense allocated to the divisions of \$2.0 million (based on the timing of the HLP and Woodcraft acquisitions, as no expense was allocated related to these businesses for the three months ended April 30, 2015), partially offset by higher year-over-year stock-based compensation and long-term incentive accruals (primarily related to compensation expense recognized pursuant to performance share awards).

Depreciation and Amortization. Depreciation and amortization expense decreased \$0.1 million, or 50%, for the three months ended April 30, 2016 compared to the same period in 2015, reflecting the run-off of depreciation during 2015 primarily related to computer software, hardware and licensing. Relatively few new assets were placed in service at corporate during the trailing twelve months ended April 30, 2016.

## Changes related to Non-Operating Items:

Interest Expense. Interest expense increased \$5.6 million for the three months ended April 30, 2016 compared to the same period in 2015 due to an increase in borrowings outstanding. We entered into a new credit facility in conjunction with the acquisition of Woodcraft, which contains a Term Loan B facility and an asset-based lending facility, each at variable interest rates. We borrowed \$320.5 million to acquire Woodcraft and to retire then-outstanding borrowings under a predecessor credit facility of \$50.0 million. The new credit facilities have higher interest rates, require loan commitment fees and were issued at a discount (resulting in additional interest expense as the discount is accreted over the term of the facilities). In addition, we paid \$9.2 million of deferred financing costs which are being amortized to interest expense over the term of the facilities. Also contributing to the increase in interest expense year-over-year is the expense associated with finance leases assumed with the acquisition of HLP in June 2015. The interest expense incurred during the three months ended April 30, 2015 was significantly less as our total debt outstanding was less than \$1.0 million.

Other, net. We recorded a gain of \$0.8 million related to other, net for the three months ended April 30, 2016 compared to a loss of \$0.1 million for the same period in 2015, primarily due to net foreign exchange transaction gains.

Income Taxes. We recorded income tax expense of \$1.8 million for the three months ended April 30, 2016, an effective rate of 31.8%, and income tax expense of \$1.1 million for the three months ended April 30, 2015, an effective rate of 33.1%. The difference in the effective rates between these periods relates primarily to the impact of the foreign tax rate differential and permanent items.

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Six Months Ended April 30, 2016 Compared to Six Months Ended April 30, 2015

|   | Six Months Ended April 30, |          | Change   | %        |    |
|---|----------------------------|----------|----------|----------|----|
|   | 2016                       | 2015     | \$       | Variance |    |
|   | (Dollars in millions)      |          |          |          |    |
| Net sales   | \$430.9                    | \$269.9  | \$161.0  | 60       | %  |
| Cost of sales (excluding depreciation and amortization) | 335.8                      | 216.6    | 119.2    | (55)     | )% |
| Selling, general and administrative                     | 59.9                       | 39.2     | 20.7     | (53)     | )% |
| Depreciation and amortization                           | 26.8                       | 16.0     | 10.8     | (68)     | )% |
| Operating income (loss)                                 | \$8.4                      | \$(1.9 ) | \$10.3   | 542      | %  |
| Interest expense  | (12.1 )                    | (0.3 )   | (11.8 )  | (3,933)  | )% |
| Other, net  | (1.5 )                     | (0.3 )   | (1.2 )   | (400)    | )% |
| Income tax benefit                                      | 1.9                        | 1.7      | 0.2      | 12       | %  |
| Net loss  | \$(3.3 )                   | \$(0.8 ) | \$(2.5 ) | (313)    | )% |

Our operating results for the six months ended April 30, 2016 include the contributions of HLP and Woodcraft acquired on June 15, 2015 and November 2, 2015, respectively. We experienced overall sales growth of approximately 2.7% for the six months ended April 30, 2016 compared to the same period in 2015, excluding these acquisitions and certain foreign and other results.

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

|   | Six Months Ended April 30, |         |              |            |
|---|----------------------------|---------|--------------|------------|
|   | 2016                       | 2015    | \$<br>Change | % Variance |
|   | (Dollars in millions)      |         |              |            |
| Net sales   | \$255.6                    | \$248.7 | \$ 6.9       | 3%         |
| Cost of sales (excluding depreciation and amortization) | 194.9                      | 200.2   | (5.3 )       | 3%         |
| Selling, general and administrative                     | 31.0                       | 29.7    | 1.3          | (4)%       |
| Depreciation and amortization                           | 14.5                       | 14.5    | —            | —%         |
| Operating income  | \$15.2                     | \$4.3   | \$ 10.9      | (253)%     |
| Operating income margin                                 | 6                          | % 2     | %            |            |

**Net Sales.** Net sales increased \$6.9 million, or 3%, for the six months ended April 30, 2016 compared to the same period in 2015. Our business was impacted in the prior year by lost volume in our vinyl profile business, as well as a decrease in revenue from oil surcharges year-over-year. On a year-over-year basis, we experienced an \$11.6 million increase in sales attributable to higher volume, partially offset by a decrease of \$0.8 million in revenues associated with pricing and a decline of \$4.1 million associated with reduced surcharges for commodities used in our business, primarily oil. To a large extent, the increased volume at lower pricing was related to our vinyl extrusion business, as we had lost volume during the first quarter of 2015 with certain profiles for a large customer, and although this volume was replaced during the first six months of 2016, the mix of earnings was at a lower average price. Our results continue to be impacted by reduced oil surcharges on our butyl-based products due to a dramatic decline in oil prices throughout 2015, remaining relatively low for the first six months of 2016 and reduced surcharges for other materials used in our business. The decrease of revenue associated with these surcharges is significantly offset by the decrease in the cost of the raw material used in our manufacturing process, resulting in minimal impact on operating margins.

**Cost of Sales.** The cost of sales decreased \$5.3 million, or 3%, when comparing the six months months ended April 30, 2016 to the same period in 2015. Corresponding with the net sales discussion above, cost of sales was impacted by changes in sales volume and the resulting impact on product mix. However, these increases in expense were more than offset by the following: lower year-over-year repair and maintenance costs for our vinyl extrusion business; reduced material costs attributable to lower commodity prices and renegotiated supplier agreements; reduced freight cost; and some favorable labor efficiencies. These labor efficiencies were somewhat offset by higher current health insurance and workers' compensation insurance costs, less the benefit and timing associated with stop-loss insurance reimbursements.

**Selling, General and Administrative.** Our selling, general and administrative expenses increased \$1.3 million, or 4% when comparing the six months ended April 30, 2016 to the same period in 2015. This increase was largely due to higher incentive accruals based on earnings, inflation and higher insurance costs.

**Depreciation and Amortization.** Depreciation and amortization expense was consistent at \$14.5 million for the six-month periods ended April 30, 2016 and 2015. The incremental depreciation and amortization expense associated with property, plant and equipment and intangible assets placed into service during the trailing twelve months ended April 30, 2016, was offset by the run-off of depreciation expense associated with existing assets and disposals during this period.

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## European Engineered Components

|   | Six Months Ended April 30, |        |              |            |
|---|----------------------------|--------|--------------|------------|
|   | 2016                       | 2015   | \$<br>Change | Variance % |
|   | (Dollars in millions)      |        |              |            |
| Net sales   | \$70.0                     | \$23.3 | \$ 46.7      | 200%       |
| Cost of sales (excluding depreciation and amortization) | 49.2                       | 17.6   | 31.6         | (180)%     |
| Selling, general and administrative                     | 11.5                       | 4.2    | 7.3          | (174)%     |
| Depreciation and amortization                           | 4.8                        | 0.8    | 4.0          | (500)%     |
| Operating income  | \$4.5                      | \$0.7  | \$ 3.8       | 543%       |
| Operating income margin                                 | 6                          | % 3    | %            |            |

Net Sales. Net sales increased \$46.7 million, or 200%, primarily due to a \$46.7 million contribution from HLP in 2016. In addition, an increase in sales of \$1.8 million associated with higher volume for the British and German plants, was offset by decreases in revenue of \$0.6 million related to price, and \$1.1 million for the effect of changes in foreign exchange rates.

Cost of Sales. The cost of sales increased \$31.6 million, or 180%, primarily due to a \$32.3 million contribution from HLP. The remaining decline in cost of goods sold of \$0.7 million, or 4%, for the six months ended April 30, 2016 compared to the same period in 2015, was related to lower material costs in Germany, as a new mixing plant was installed in 2015, which eliminated the cost associated with processing by outside vendors. Otherwise, consistent with the revenue discussion, cost of goods sold increased as a result of the increase in volume in the United Kingdom and Germany, but was offset by the effect of exchange rate changes.

Selling, General and Administrative. Our selling, general and administrative expense increased \$7.3 million, attributable to \$7.1 million of expense incurred at HLP in 2016, with slight increases at the IG plants associated with labor inflation and benefits.

Depreciation and Amortization. Depreciation and amortization expense increased \$4.0 million, reflecting the \$4.0 million contribution from HLP in 2016. The incremental depreciation and amortization expense associated with property, plant and equipment placed into service during the trailing twelve months ended April 30, 2016, was offset by the run-off of depreciation expense associated with existing assets and disposals during this period.

## NA Cabinet Components

The NA Cabinet Components reportable segment is comprised solely of Woodcraft, which was acquired on November 2, 2015, and allocated corporate costs. The results of operations of Woodcraft for the period November 2, 2015 through April 30, 2016 are summarized in the following table (including corporate allocation of \$2.2 million, and the effect of the step-up of inventory of \$2.3 million, for which no margin was earned during the six months ended April 30, 2016):

|   | Six<br>months<br>ended<br>April 30,<br>2016<br>(Dollars<br>in<br>millions) |
|---|--|
| Net sales   | \$108.1  |
| Cost of sales (excluding depreciation and amortization) | 93.3   |
| Selling, general and administrative                     | 8.4  |
| Depreciation and amortization                           | 7.3  |
| Operating loss  | \$(0.9 )   |
| Operating loss margin                                   | (1 )%  |



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## Unallocated Corporate &amp; Other

|   | Six Months Ended April 30, |           |              |            |
|---|----------------------------|-----------|--------------|------------|
|   | 2016                       | 2015      | \$<br>Change | Variance % |
|   | (Dollars in millions)      |           |              |            |
| Net sales   | \$ (2.8 )                  | \$ (2.1 ) | \$ (0.7 )    | (33)%      |
| Cost of sales (excluding depreciation and amortization) | (1.6 )                     | (1.2 )    | (0.4 )       | (33)%      |
| Selling, general and administrative                     | 9.0                        | 5.3       | 3.7          | (70)%      |
| Depreciation and amortization                           | 0.2                        | 0.7       | (0.5 )       | 71%        |
| Operating loss  | \$ (10.4 )                 | \$ (6.9 ) | \$ (3.5 )    | (51)%      |

Net Sales. Net sales for Unallocated Corporate & Other represents the elimination of inter-segment sales for the six-month periods ended April 30, 2016 and 2015. The change between periods reflects the amount of inter-segment sales (between NA Engineered Components and EU Engineered Components).

Cost of Sales. Cost of sales for Unallocated Corporate & Other consists of the elimination of inter-segment sales, profit in inventory, changes in the LIFO reserve and other costs. The change for the six-month periods ended April 30, 2016 and 2015 of \$0.4 million was primarily related to the change in the profit in inventory elimination.

Selling, General and Administrative. Our selling, general and administrative expenses increased \$3.7 million for the six months ended April 30, 2016 compared to the same period in 2015, primarily due to an increase in transaction related costs of \$4.9 million associated with the Woodcraft purchase on November 2, 2015, partially offset by an increase in the amount of corporate expense allocated to the divisions of \$3.6 million in 2016 (based on the timing of the HLP and Woodcraft acquisitions, as no expense was allocated related to these businesses for the six months ended April 30, 2015). The remaining increase in expense year-over-year was attributable to stock-based compensation, long-term incentive accruals (primarily related to compensation expense recognized pursuant to performance share awards), and higher incentive compensation accruals based on earnings.

Depreciation and Amortization. Depreciation and amortization expense decreased \$0.5 million, or 71%, for the six months ended April 30, 2016 compared to the same period in 2015, reflecting the run-off of depreciation during 2015 primarily related to computer software, hardware and licensing. Relatively few new assets were placed in service at corporate during the trailing twelve months ended April 30, 2016.

## Changes related to Non-Operating Items:

Interest Expense. Interest expense increased \$11.8 million for the six months ended April 30, 2016 compared to the same period in 2015 due to an increase in borrowings outstanding. We entered into a new credit facility in conjunction with the acquisition of Woodcraft, which contains a Term Loan B facility and an asset-based lending facility, each at variable interest rates. We borrowed \$320.5 million to acquire Woodcraft and to retire then-outstanding borrowings under a predecessor credit facility of \$50.0 million. The new credit facilities have higher interest rates, require loan commitment fees and were issued at a discount (resulting in additional interest expense as the discount is accreted over the term of the facilities). In addition, we paid \$9.2 million of deferred financing costs which are being amortized to interest expense over the term of the facilities. We also expensed unamortized deferred financing fees associated with the predecessor facility totaling \$0.5 million. Also contributing to the increase in interest expense year-over-year is the expense associated with finance leases assumed with the acquisition of HLP in June 2015. The interest expense incurred during the six months ended April 30, 2015 was significantly less as our total debt outstanding was less than \$1.0 million.

Other, net. The increase in other net expense of \$1.2 million for the six months ended April 30, 2016 compared to the same period in 2015 was primarily due to net foreign exchange transaction losses associated with an unhedged foreign currency position with regard to the borrowings to fund the HLP transaction, as well as net foreign exchange losses associated with our other foreign operations.

Income Taxes. We recorded an income tax benefit of \$1.9 million for the six months ended April 30, 2016, an effective rate of 36.5%, and an income tax benefit of \$1.7 million for the six months ended April 30, 2015, which included a discrete benefit of \$0.8 million associated with the reversal of a liability for tax benefit associated with an uncertain tax position that stemmed from the 2008 spin-off of Quanex from a predecessor company. Excluding this

discrete item, the effective tax rate would have been 35.5% for the six months ended April 30, 2015. The remaining difference in the effective rates between these periods relates to the impact of the foreign tax rate differential and permanent items.

Table of ContentsLiquidity and Capital Resources  
Overview

Historically, our principal sources of funds have been cash on hand, cash flow from operations, and borrowings under our \$150 million Senior Unsecured Revolving Credit Facility (the Retired Facility). As of October 31, 2015, we had \$23.1 million of cash and equivalents, \$86.6 million available under the Retired Facility and outstanding letters of credit of \$5.9 million, which included \$50.0 million of borrowings outstanding under the Retired Facility and \$6.9 million outstanding under capital leases and other debt vehicles.

On November 2, 2015, we acquired Woodcraft for \$245.9 million in cash, net of cash acquired, subject to a working capital true-up and including certain holdbacks with regard to potential indemnity claims, as more fully described in the accompanying notes to condensed consolidated financial statements (Note 2, "Acquisitions").

In order to fund this acquisition, we entered into senior secured credit facilities of \$410.0 million consisting of an asset-based lending (ABL) revolving credit facility of \$100.0 million (for which the borrowing base is determined monthly) and a term loan facility of \$310.0 million (collectively the "New Credit Facilities"). The New Credit Facilities were syndicated in October 2015, and a consortium of banks and investors provided the funding for this credit facility, with Wells Fargo as Administrative Agent. On November 2, 2015, we borrowed \$310.0 million under the term loan facility and \$10.5 million under the ABL facility to fund the Woodcraft acquisition, to refinance and retire outstanding debt of \$50.0 million under the Retired Facility and to pay fees associated with the New Credit Facilities. The proceeds from this borrowing were reduced by a debt discount of \$6.2 million, which is being recognized on the effective interest method over the term of the facility. We may borrow funds under this facility in the future to fund other general working capital needs. We recorded expense of \$0.5 million in November 2015 to write off the unamortized deferred financing fees associated with the Retired Facility.

We are evaluating whether to refinance the New Credit Facilities which may result in the write-off of unamortized deferred financing fees and the original issuers discount. The unamortized amounts of such fees were \$8.4 million and \$5.7 million at April 30, 2016.

As of April 30, 2016, we had \$29.0 million of cash and equivalents, \$309.2 million outstanding under the term loan facility (reduced by unamortized loan discount of \$5.7 million), no borrowings outstanding under the ABL facility, \$5.9 million of outstanding letters of credit and \$5.9 million outstanding under capital leases and other debt vehicles. We had \$82.8 million available under the New Credit Facilities at April 30, 2016.

Cash and cash equivalents increased by \$5.9 million during the six months ended April 30, 2016, of which \$24.6 million was provided by operating activities, partially offset by increased capital expenditures of \$17.4 million, less amounts used from net borrowings under our credit facilities to acquire Woodcraft, to invest in capital for our manufacturing facilities, and to retire debt.

## Analysis of Cash Flow

The following table summarizes our cash flow results for the six months ended April 30, 2016 and 2015:

|  | Six Months<br>Ended<br>April 30,<br>2016      2015 |          |
|--|--|----------|
|  | (In millions)                                      |          |
| Cash provided by operating activities            | \$24.6   | \$3.3    |
| Cash used for investing activities               | \$(262.4)  | \$(12.7) |
| Cash provided by (used for) financing activities | \$243.5  | \$(51.4) |

Operating Activities. Cash provided by operating activities for the six-month period ended April 30, 2016 improved by approximately \$21.3 million compared to the six-month period ended April 30, 2015. A portion of this increase is attributable to the activities of HLP and Woodcraft, acquired in June 2015 and November 2015, respectively.

Excluding these acquisitions, our cash receipts increased due to an increase in sales, year-over-year, and more timely collection of receivables. In addition, our inventory levels are down year-over-year, as we invested more in an



inventory build in 2015 than in 2016 and we are managing our inventory levels more efficiently in 2016. Partially offsetting the favorable operating cash flow derived from these items is a

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cash outflow to service our debt. Working capital was \$119.4 million, \$70.0 million and \$139.8 million at April 30, 2016, October 31, 2015 and April 30, 2015, respectively. Contributing to the relatively larger working capital balance at April 30, 2015 was a greater amount of cash on hand, primarily from the sale of Nichols in April 2014.

**Investing Activities.** Cash used for investing activities increased \$249.7 million when comparing the six months ended April 30, 2016 to the same period in 2015. Of the increase, \$245.9 million was used to purchase Woodcraft on November 2, 2015, and an incremental \$4.0 million was invested in capital expenditures, largely associated with HLP and Woodcraft projects.

**Financing Activities.** Cash provided by financing activities was \$243.5 million for the six-month period ended April 30, 2016, primarily attributable to borrowings under the new Term Loan B and ABL facilities during 2016 totaling \$332.8 million, of which \$79.8 million had been repaid as of April 30, 2016. Additionally, we paid \$8.7 million in debt issuance costs related to the new credit facilities, and used \$2.7 million to pay dividends to our shareholders. These uses of cash were partially offset by \$3.0 million of proceeds received from stock option exercises. For the six months ended April 30, 2015, we used \$51.4 million for financing activities, of which \$52.7 million was used to purchase treasury stock and \$2.8 million was used to pay dividends, partially offset by an in-flow of \$4.2 million associated with issuances of common stock related to stock option exercises.

### 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 six-month periods ended April 30, 2016 and 2015. We maintain cash balances in foreign countries which total \$11.2 million as of April 30, 2016. 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.

### Credit Facility

On November 2, 2015, we refinanced and retired our existing credit facility by entering into a \$310.0 Million Term Loan Credit Agreement and a \$100.0 million ABL Credit Agreement (collectively the "New Credit Facilities"). The term loan portion of the New Credit Facilities matures on November 2, 2022, and requires quarterly principal payments equal to 0.25% of the aggregate borrowings. The ABL portion of the New Credit Facilities matures on November 2, 2020 with no stated principal repayment terms prior to maturity. Interest is computed, at our election, on a grid as the Base Rate plus an Applicable Margin, as defined in the agreement, or LIBOR plus an Applicable Margin. For additional details of the New Credit Facilities, see "Item 1A. Risk Factors" included in our Annual Report on Form 10-K as of October 31, 2015.

The weighted average interest rate for the six-month periods ended April 30, 2016 and 2015 was 6.23% and 1.09%, respectively. As of and for the six-month period ended April 30, 2015, we had no outstanding borrowings under the Retired Facility. We were in compliance with our debt covenants as of April 30, 2016.

### 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.

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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, 2015. Our critical accounting policies and estimates have not changed materially during the six months ended April 30, 2016.

**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 six months ended April 30, 2016, we adopted Accounting Standards Update (ASU) No. 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes. See Note 16, "New Accounting Guidance Adopted", contained elsewhere herein, for further details.

In May 2016, the FASB issued ASU No. 2016-12, Revenue from Contracts with Customers (Topic 606), Narrow-Scope Improvements and Practical Expedients. This ASU is an update to ASU 2014-09, Revenue from Contracts with Customers. This update does not change the core revenue recognition principle included within ASU 2014-09, but rather provides clarifying guidance in certain narrow areas and adds some practical expedients. We anticipate adopting ASU 2016-12 concurrently with ASU 2014-09 in fiscal 2019 and are currently evaluating the impact on our consolidated financial statements.

In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606), Identifying Performance Obligations and Licensing. This amendment is intended to clarify the identification of performance obligations and the licensing implementation guidance included within ASU No. 2014-09. We anticipate adopting ASU 2016-08 concurrently with ASU 2014-09 in fiscal 2019 and are currently evaluating the impact on our consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. This amendment simplifies the accounting for share-based payment transactions, including income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This guidance becomes effective for fiscal years beginning after December 15, 2016, and, therefore, we will adopt this pronouncement in fiscal 2018. We are currently evaluating the impact of this pronouncement on our consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations. This amendment is intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations included within ASU No. 2014-09. We anticipate adopting ASU 2016-08 concurrently with ASU 2014-09 in fiscal 2019 and are currently evaluating the impact on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842): Amendments to the Accounting Standards Codification. The amendments replace current guidance and require the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous U.S. GAAP. The amendments apply to any entity that enters into leasing arrangements. This guidance becomes effective for fiscal years beginning after December 15, 2018, and, therefore, we will adopt this pronouncement in fiscal 2020. We are currently evaluating the impact of this pronouncement on our consolidated financial statements.

Refer to our Annual Report on Form 10-K for the year ended October 31, 2015 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 April 30, 2016, a hypothetical 1.0% increase or decrease in interest rates could result in approximately \$3.1 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, the Mexican peso 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 April 30, 2016 and October 31, 2015, were as follows (in thousands):

|                               | Notional as indicated |                  | Fair Value in \$ |                  |
|-------------------------------|-----------------------|------------------|------------------|------------------|
|                               | April 30, 2016        | October 31, 2015 | April 30, 2016   | October 31, 2015 |
| Foreign currency derivatives: |                       |                  |                  |                  |
| Sell EUR, buy USD             | EUR \$7,235           | \$ 8,076         | \$(174)          | \$ 37            |
| Sell CAD, buy USD             | CAD 279               | 280              | (3)              | ) 1              |
| Sell GBP, buy USD             | GBP 317               | 226              | (6)              | ) 3              |
| Buy EUR, sell USD             | EUR —                 | 807              | —                | 3                |
| Buy EUR, sell GBP             | EUR 86                | 2                | 1                | —                |
| Buy USD, sell EUR             | USD 251               | —                | (5)              | ) —              |
| Buy GBP, sell EUR             | GBP 8                 | —                | —                | —                |

At April 30, 2016 and October 31, 2015, 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 remeasurement of the underlying foreign currency balance, changes in exchange rates should have no effect. See Note 10, "Derivative Instruments", 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 and six months ended April 30, 2016, we recorded an unrealized gain of \$0.5 million and an unrealized loss of \$1.5 million, respectively, associated with this foreign currency exposure.

In addition, our functional currency in Mexico is the United States dollar. As such, changes in the value of the Mexican peso relative to the United States dollar will result in foreign currency gains and losses. We have recorded a gain of \$0.5 million for the three months ended April 30, 2016 and a loss of less than \$0.1 million for the period November 2, 2015 to April 30, 2016 related to this operation.

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### 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.

We also charge our 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.

From time to time, in the normal course of business, we may enter into firm price sales commitments with customers in which aluminum is an integral fabrication input. In an effort to protect cost of sales from the effects of changing prices of aluminum, we enter into firm price raw material purchase commitments, which are designated as "normal purchases" under Accounting Standards Codification Topic 815 "Derivatives and Hedging." As a result, firm price sales commitments are matched with firm price raw material purchase commitments so that changes in aluminum prices should have no effect. While we consider the derivative contracts to provide an economic hedge against changes in aluminum prices, the derivatives have not been designated as hedges in accordance with ASC 815 for accounting purposes. As such, any mark-to-market net gain or loss is recorded as a period cost with the offsetting amount reflected as an asset or liability on the balance sheet. As of April 30, 2016, we had a forward purchase contract with a notional amount of approximately 1.4 million pounds of aluminum with a fair value of less than \$0.1 million. There were no such contracts utilized during the year ended October 31, 2015. For additional details, see Note 10, "Derivative Instruments," contained elsewhere herein.

### 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 April 30, 2016. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of April 30, 2016, 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, except with regard to the internal controls of HLP and Woodcraft which were acquired by us on June 15, 2015 and November 2, 2015, respectively. Prior to the acquisition, HLP was a privately-held company incorporated in the United Kingdom, which reported financial results pursuant to accounting principles generally accepted in the United Kingdom, and Woodcraft was a privately-held company incorporated in the United States, reporting financial results pursuant to accounting principles generally accepted in the United States. Therefore, neither HLP nor Woodcraft were previously required to comply with the Sarbanes-Oxley Act of 2002. Management is currently evaluating internal control procedures and implementing changes in internal control over financial reporting with regard to HLP and Woodcraft, in order to fully comply with the requirements of the Sarbanes-Oxley Act of 2002 as of October 31, 2016.



PART II. OTHER INFORMATION

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: June 1, 2016 /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   |
|----------------|---|
| 3.1            | 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.  |
| 3.2            | Third Amended and Restated Bylaws of the Registrant dated as of March 4, 2016, filed as Exhibit 3.2 of the Registrant's Current Report on Form 8-K (Reg. No. 001-33913) filed with the Securities and Exchange Commission on March 7, 2016, and incorporated herein by reference.   |
| 4.1            | 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.  |
| 4.2            | Credit Agreement dated as of November 2, 2015, among the Company; certain of its subsidiaries as guarantors; Wells Fargo Bank, National Association, as administrative agent; Bank of America, N.A., as lead arranger and syndication agent; and the lenders parties 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 November 3, 2015, and incorporated herein by reference.           |
| 4.3            | Term Loan Credit Agreement dated as of November 2, 2015, among the Company; certain of its subsidiaries as guarantors; Wells Fargo Bank, National Association, as administrative agent; Bank of America, N.A., as lead arranger and syndication agent; and the lenders parties thereto, 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 November 3, 2015, and incorporated herein by reference. |
| *31.1          | Certification by chief executive officer pursuant to Rule 13a-14(a)/15d-14(a).  |
| *31.2          | Certification by chief financial officer pursuant to Rule 13a-14(a)/15d-14(a).  |
| *32.1          | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| *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.