

Quanex Building Products CORP  
Form 10-Q  
August 30, 2011  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended July 31, 2011

OR

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

For the transition period from            to            .

Commission File Number 1-33913

**QUANEX BUILDING PRODUCTS CORPORATION**

(Exact name of registrant as specified in its charter)

Edgar Filing: Quanex Building Products CORP - Form 10-Q

**DELAWARE**  
(State or other jurisdiction of

**26-1561397**  
(I.R.S. Employer

incorporation or organization)

Identification No.)

**1900 West Loop South, Suite 1500, Houston, Texas 77027**

(Address of principal executive offices and zip code)

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

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

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

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

Large accelerated filer  Accelerated filer

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

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

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

Class	Outstanding at August 23, 2011
Common Stock, par value \$0.01 per share	37,843,134

---

**Table of Contents**

**QUANEX BUILDING PRODUCTS CORPORATION**

**INDEX**

<b>PART I.</b>	<b><u>FINANCIAL INFORMATION</u></b>	<b>2</b>
<b>Item 1:</b>	<b><u>Financial Statements (Unaudited)</u></b>	<b>2</b>
	<u>Consolidated Balance Sheets July 31, 2011 and October 31, 2010</u>	2
	<u>Consolidated Statements of Income Three and Nine Months Ended July 31, 2011 and 2010</u>	3
	<u>Consolidated Statements of Cash Flow Nine Months Ended July 31, 2011 and 2010</u>	4
	<u>Consolidated Statement of Stockholders Equity Nine Months Ended July 31, 2011</u>	5
	<u>Notes to Consolidated Financial Statements</u>	6
<b>Item 2:</b>	<b><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	<b>24</b>
<b>Item 3:</b>	<b><u>Quantitative and Qualitative Disclosures About Market Risk</u></b>	<b>36</b>
<b>Item 4:</b>	<b><u>Controls and Procedures</u></b>	<b>37</b>
<b>PART II.</b>	<b><u>OTHER INFORMATION</u></b>	<b>38</b>
<b>Item 2:</b>	<b><u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	<b>38</b>
<b>Item 6:</b>	<b><u>Exhibits</u></b>	<b>39</b>
	Exhibit 31.1	
	Exhibit 31.2	
	Exhibit 32.1	

**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****QUANEX BUILDING PRODUCTS CORPORATION****CONSOLIDATED BALANCE SHEETS****(Unaudited)**

	<b>July 31, 2011</b>	<b>October 31, 2010</b>
	<b>(In thousands except share amounts)</b>	
<b>ASSETS</b>		
Current assets:		
Cash and equivalents	\$ 62,420	\$ 187,178
Accounts receivable, net of allowance of \$1,145 and \$1,037	100,829	87,007
Inventories	65,296	45,200
Deferred income taxes	13,210	10,547
Prepaid and other current assets	8,916	8,229
Current assets of discontinued operations		462
Total current assets	250,671	338,623
Property, plant and equipment, net	157,118	135,517
Deferred income taxes	8,512	30,563
Goodwill	69,611	25,189
Intangible assets, net	91,081	44,668
Other assets	17,340	16,690
Total assets	\$ 594,333	\$ 591,250
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 75,586	\$ 70,986
Accrued liabilities	36,856	43,447
Income taxes payable	746	
Current maturities of long-term debt	352	327
Current liabilities of discontinued operations		30
Total current liabilities	113,540	114,790
Long-term debt	1,323	1,616
Deferred pension and postretirement benefits	4,631	3,667
Non-current environmental reserves	11,322	12,027
Other liabilities	23,351	17,718
Total liabilities	154,167	149,818
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 37,854,069 and 37,862,441, respectively	379	379
Additional paid-in-capital	241,049	238,079

## Edgar Filing: Quanex Building Products CORP - Form 10-Q

Retained earnings	208,388	210,366
Accumulated other comprehensive income (loss)	(805)	(1,757)
Less treasury stock at cost, 541,537 and 351,626 shares, respectively	(8,845)	(5,635)
Total stockholders' equity	440,166	441,432
Total liabilities and stockholders' equity	\$ 594,333	\$ 591,250

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

Page 2

**Table of Contents****QUANEX BUILDING PRODUCTS CORPORATION****CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)**

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2011	2010	2011	2010
	(In thousands, except per share amounts)			
<b>Net sales</b>	\$ 252,413	\$ 225,203	\$ 615,333	\$ 576,011
Cost and expenses:				
Cost of sales (exclusive of items shown separately below)	209,667	184,799	524,834	478,559
Selling, general and administrative	18,912	17,566	61,230	52,719
Depreciation and amortization	9,197	6,639	24,583	21,008
<b>Operating income (loss)</b>	14,637	16,199	4,686	23,725
Interest expense	(110)	(106)	(341)	(333)
Other, net	(311)	997	127	2,502
Income (loss) from continuing operations before income taxes	14,216	17,090	4,472	25,894
Income tax benefit (expense)	(5,200)	(6,661)	(1,573)	(9,998)
Income (loss) from continuing operations	9,016	10,429	2,899	15,896
Income (loss) from discontinued operations, net of taxes		(148)	(12)	(1,108)
<b>Net income (loss)</b>	\$ 9,016	\$ 10,281	\$ 2,887	\$ 14,788
<b>Basic earnings per common share:</b>				
Earnings (loss) from continuing operations	\$ 0.24	\$ 0.28	\$ 0.08	\$ 0.43
Income (loss) from discontinued operations	\$	\$	\$	\$ (0.03)
Basic earnings (loss) per share	\$ 0.24	\$ 0.28	\$ 0.08	\$ 0.40
<b>Diluted earnings per common share:</b>				
Earnings (loss) from continuing operations	\$ 0.24	\$ 0.27	\$ 0.08	\$ 0.42
Income (loss) from discontinued operations	\$	\$	\$	\$ (0.03)
Diluted earnings (loss) per share	\$ 0.24	\$ 0.27	\$ 0.08	\$ 0.39
<b>Weighted-average common shares outstanding:</b>				
Basic	37,125	37,350	37,103	37,349
Diluted	37,684	37,983	37,710	37,882

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

**Table of Contents****QUANEX BUILDING PRODUCTS CORPORATION****CONSOLIDATED STATEMENTS OF CASH FLOW****(Unaudited)**

	<b>Nine Months Ended July 31,</b>	
	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>	
<b>Operating activities:</b>		
Net income (loss)	\$ 2,887	\$ 14,788
(Income) loss from discontinued operations	12	1,108
Adjustments to reconcile net income (loss) to cash provided by (used for) operating activities from continuing operations:		
Gain on bargain purchase		(1,272)
Depreciation and amortization	24,635	21,060
Deferred income taxes	(295)	6,524
Stock-based compensation	3,599	3,218
Changes in assets and liabilities, net of effects from acquisitions and dispositions:		
Decrease (increase) in accounts receivable	(4,991)	1,601
Decrease (increase) in inventory	(9,778)	(5,788)
Decrease (increase) in other current assets	244	(889)
Increase (decrease) in accounts payable	(2,801)	7,961
Increase (decrease) in accrued liabilities	(6,879)	5,084
Increase (decrease) in income taxes payable	(1,392)	11,934
Increase (decrease) in deferred pension and postretirement benefits	965	(2,706)
Other, net	3,686	1,533
Cash provided by (used for) operating activities from continuing operations	9,892	64,156
Cash provided by (used for) operating activities from discontinued operations	(68)	(415)
Cash provided by (used for) operating activities	9,824	63,741
<b>Investing activities:</b>		
Acquisitions, net of cash acquired	(110,845)	(1,590)
Capital expenditures	(16,969)	(11,779)
Proceeds from property insurance claim		392
Proceeds from executive life insurance	683	
Other, net	75	40
Cash provided by (used for) investing activities from continuing operations	(127,056)	(12,937)
Cash provided by (used for) investing activities from discontinued operations		90
Cash provided by (used for) investing activities	(127,056)	(12,847)
<b>Financing activities:</b>		
Repayments of long-term debt	(333)	(319)
Common stock dividends paid	(4,500)	(3,775)
Issuance of common stock from stock option exercises, including related tax benefits	1,089	495
Purchase of treasury stock	(4,289)	(2,169)
Other, net	392	(235)
Cash provided by (used for) financing activities from continuing operations	(7,641)	(6,003)

## Edgar Filing: Quanex Building Products CORP - Form 10-Q

Cash provided by (used for) financing activities from discontinued operations	(392)	235
Cash provided by (used for) financing activities	(8,033)	(5,768)
Effect of exchange rate changes on cash and equivalents	47	23
Less: (Increase) decrease in cash and equivalents from discontinued operations	460	90
Increase (decrease) in cash and equivalents from continuing operations	(124,758)	45,239
Cash and equivalents at beginning of period	187,178	123,499
Cash and equivalents at end of period	\$ 62,420	\$ 168,738

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

Page 4



Table of Contents

**QUANEX BUILDING PRODUCTS CORPORATION**  
**CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY**

(Unaudited)

Nine Months Ended July 31, 2011	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders Equity
(In thousands, except per share amounts)						
Balance at October 31, 2010	\$ 379	\$ 238,079	\$ 210,366	\$ (1,757)	\$ (5,635)	\$ 441,432
Net income (loss)			2,887			2,887
Foreign currency translation adjustment (net of taxes of \$157)				951		951
Common dividends (\$0.12 per share)			(4,500)			(4,500)
Treasury shares purchased, at cost					(4,289)	(4,289)
Stock-based compensation activity:						
Stock-based compensation earned		3,598				3,598
Stock options exercised		(20)	(111)		998	867
Restricted stock awards	1	(82)			81	
Stock-based compensation tax benefit		197				197
Other	(1)	(723)	(254)	1		(977)
Balance at July 31, 2011	\$ 379	\$ 241,049	\$ 208,388	\$ (805)	\$ (8,845)	\$ 440,166

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

---

**Table of Contents**

**QUANEX BUILDING PRODUCTS CORPORATION**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**1. Description of Business and Basis of Presentation**

Quanex Building Products Corporation and its subsidiaries (Quanex or the Company) are managed on a decentralized basis and operate in two business segments: Engineered Products and Aluminum Sheet Products. The Engineered Products segment produces engineered systems, products and components primarily serving the window and door industry, while the Aluminum Sheet Products segment produces mill finished and coated aluminum sheet serving the broader building products markets and secondary markets such as capital goods and transportation. The primary market drivers are residential housing starts and residential remodeling expenditures. Quanex believes it is a technological leader in the production of aluminum sheet products, flexible insulating glass spacer systems, extruded vinyl profiles, thin film solar panel sealants, and precision-formed metal and wood products which primarily serve the North American building products markets. The Company uses low-cost production processes, and engineering and metallurgical expertise to provide customers with specialized products for specific applications.

On December 12, 2007, Quanex Building Products Corporation was incorporated in the state of Delaware as a subsidiary of Quanex Corporation to facilitate the separation of Quanex Corporation's vehicular products and building products businesses. The separation occurred on April 23, 2008 through the spin-off of Quanex Corporation's building products business to its shareholders immediately followed by the merger of Quanex Corporation (consisting principally of the vehicular products business and all non-building products related corporate accounts) with a wholly-owned subsidiary of Gerda S.A. (Gerda). This is hereafter referred to as the Separation.

In January 2010, management committed to a plan to close its start-up facility in China due to the contraction of demand and the Company's inability to serve the overseas thin film solar panel market from its U.S. operation. Accordingly, the China assets and liabilities, results of operations and cash flows are reported as discontinued operations for all periods presented. Unless otherwise noted, all disclosures in the notes accompanying the consolidated financial statements reflect only continuing operations.

On March 31, 2011, the Company acquired Edgetech for \$104.4 million in an all cash transaction (net of cash acquired). Headquartered in Cambridge, Ohio, Edgetech has three manufacturing facilities (U.S., U.K. and Germany) that produce and market a full line of insulating glass spacer systems for window and door customers in North America and abroad. See Note 3 for discussion of this acquisition.

The interim unaudited consolidated financial statements of the Company include all adjustments which, in the opinion of management, are necessary for a fair presentation of the Company's financial position and results of operations. All such adjustments are of a normal recurring nature. These financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. The preparation of these financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying footnotes. 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 the Company's operating environment changes. Actual results could differ from estimates. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 2010.

**2. New Accounting Pronouncements**

In December 2010, the Financial Accounting Standards Board (FASB) issued ASC Topic No. 2010-29 *Business Combinations (ASC Topic 805) Disclosure of Supplementary Pro Forma Information for Business Combinations* which amended ASC Topic 805 *Business Combinations* to specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as

**Table of Contents**

**QUANEX BUILDING PRODUCTS CORPORATION**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

though the business combination that occurred during the year had occurred as of the beginning of the comparable prior annual reporting period only. The ASC also expands the supplemental pro forma disclosures under ASC Topic 805 to include a description of the nature and the amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The ASC is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010 (November 1, 2011 for the Company). Early adoption is permitted. The Company has disclosed information in accordance with this ASC effective March 31, 2011.

In December 2010, the FASB issued ASC Topic No. 2010-28 *Intangibles – Goodwill and Other (ASC Topic 350) – When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts* which amended ASC Topic 350 – Goodwill and Other. The ASC requires an entity with reporting units that have carrying amounts that are zero or negative to assess whether it is more likely than not that the reporting units' goodwill is impaired. If the entity determines that it is more likely than not that the goodwill of one or more of its reporting units is impaired, the entity is required to perform Step 2 of the goodwill impairment test for those reporting unit(s) and record any resulting impairment as a cumulative-effect adjustment to beginning retained earnings. The provisions of this ASC are effective for fiscal years, and interim periods within those years, beginning after December 15, 2010 (November 1, 2011 for the Company). Early adoption is not permitted. The Company does not expect the adoption of this ASC to have a material impact on the Company's consolidated financial statements.

In January 2010, the FASB issued ASC Topic No. 2010-06, *Fair Value Measurements and Disclosures (ASC Topic 820) – Improving Disclosures About Fair Value Measurements*. The ASC requires new disclosures about transfers into and out of Levels 1 (fair value determined based on quoted prices in active markets for identical assets and liabilities) and 2 (fair value determined based on significant other observable inputs) and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements. It also clarifies existing fair value disclosures about the level of disaggregation and about inputs and valuation techniques used to measure fair value. Except for the detailed Level 3 roll-forward disclosures, the new standard is effective for the Company for interim and annual reporting periods beginning after December 31, 2009 (February 1, 2010 for the Company). The requirement to provide detailed disclosures about the purchases, sales, issuances and settlements in the roll-forward activity for Level 3 fair value measurements is effective for the Company for interim and annual reporting periods beginning after December 31, 2010 (February 1, 2011 for the Company). Other than requiring additional disclosures, none that currently impact the Company, the adoption of this new guidance does not have a material impact on the Company's consolidated financial statements.

In May 2011, the FASB issued Accounting Standards Update No. 2011-04 (ASU 2011-04), *Fair Value Measurement (ASC Topic 820) Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. The amended guidance changes the wording used to describe many requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. Additionally, the amendments clarify the FASB's intent about the application of existing fair value measurement requirements. The guidance provided in ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011 (February 1, 2012 for the Company) and is applied prospectively. The Company does not expect the provisions of ASU 2011-04 to have a material effect on its consolidated financial statements.

In June 2011, the FASB issued Accounting Standards Update No. 2011-05 (ASU 2011-05), *Presentation of Comprehensive Income*. This amendment will require companies to present the components of net income and other comprehensive income either as one continuous statement or as two consecutive statements. It eliminates the option to present components of other comprehensive income as part of the statement of changes in

**Table of Contents**

**QUANEX BUILDING PRODUCTS CORPORATION**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

stockholders' equity. The amended guidance, which must be applied retroactively, is effective for interim and annual periods beginning after December 15, 2011 (February 1, 2012 for the Company), with earlier adoption permitted. ASU 2011-05 impacts presentation only and will have no effect on the Company's financial condition, results of operations or cash flows.

**3. Acquisitions**

On March 31, 2011, Quanex completed its acquisition of Edgetech I.G., Inc., an Ohio corporation (Edgetech I.G.), the United Kingdom division of Edgetech (Edgetech UK), and Edgetech Europe GmbH, a German company (Edgetech Germany) and together with Edgetech I.G. and Edgetech UK, Edgetech). Headquartered in Cambridge, Ohio, Edgetech has three manufacturing facilities located in the United States, the United Kingdom and Germany that produce a full line of warm-edge, dual seal insulating glass spacer systems for window and door customers in North America and abroad. Edgetech's products separate and seal double and triple glass within a window and act as a thermal barrier that enhances the window's energy efficiency.

Quanex acquired Edgetech by merging its wholly-owned subsidiary, QSB Inc., a Delaware corporation (QSB), with and into Lauren International, Inc. formerly known as Lauren Holdco Inc., an Ohio corporation and parent of the Edgetech Entities (Holdco), pursuant to the terms and conditions of the previously filed Agreement and Plan of Merger (the Merger Agreement), dated as of January 31, 2011, among the Company, QSB, Lauren International Ltd. fka Lauren International Inc., a privately-held Ohio corporation (Lauren), Holdco and Kevin E. Gray, as agent for the shareholders of Holdco (Agent). Holdco is now Quanex's wholly-owned subsidiary. As consideration for the acquisition of all of the issued and outstanding capital shares of Holdco, Quanex paid \$104.4 million in cash, net of \$0.8 million of cash acquired. Of the cash paid, \$7.0 million was placed into an escrow fund to satisfy certain indemnity obligations under the Merger Agreement. Additionally, Quanex is responsible for the tax liability resulting from the pre-closing reorganization of Lauren and its subsidiaries limited to \$3.5 million, of which \$2.8 million was paid during the third quarter of fiscal 2011.

Edgetech is being integrated into the Engineered Products segment. The acquisition of Edgetech complements Quanex's ongoing efforts to provide its customers with the broadest range of high quality components, products, systems and services the fenestration industry has to offer. The vast majority of windows manufactured today feature double or triple insulating glass, and with window production set to rise as the housing and remodeling markets recover, Quanex believes that the long-term outlook for the business is excellent. Acquiring Edgetech will allow the Company to better serve its growing base of national and regional customers and will further accelerate its international growth as Edgetech has a solid market presence overseas.

**Table of Contents****QUANEX BUILDING PRODUCTS CORPORATION****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

The Edgetech acquisition is being accounted for as a business combination using the acquisition method of accounting under which the total purchase price consideration is allocated to assets and liabilities assumed based upon their fair values. Fair value measurements have been applied based on assumptions that market participants would use in the pricing of the asset or liability. The excess of the purchase price over the amounts assigned to tangible or intangible assets acquired and liabilities assumed is recognized as goodwill. The following table summarizes the fair values assigned to the net assets acquired as of the March 31, 2011 acquisition date:

	<b>As of Date of Opening Balance Sheet (In thousands)</b>
<b>Current assets:</b>	
Cash and equivalents	\$ 828
Accounts receivable	9,181
Inventories	10,123
Prepaid and other current assets	2,023
<b>Total current assets</b>	<b>22,155</b>
Property, plant and equipment	21,086
Goodwill	44,052
Intangible assets	48,750
Other assets	1,378
<b>Total assets</b>	<b>\$ 137,421</b>
<b>Current liabilities:</b>	
Accounts payable	\$ 6,905
Accrued liabilities	1,316
Income taxes payable	3,780
Deferred income taxes	340
Current maturities of long-term debt	24
<b>Total current liabilities</b>	<b>12,365</b>
Long-term debt	40
Deferred income taxes	19,785
<b>Total liabilities</b>	<b>32,190</b>
Investment	105,231
<b>Total liabilities and equity</b>	<b>\$ 137,421</b>

The purchase price allocation resulted in goodwill of \$44.1 million, which is not deductible for income tax purposes. Goodwill consists of the excess of the purchase price over the fair value of the acquired assets and represents the estimated economic value attributable to future operations. The other intangible assets are being amortized over periods which reflect the pattern in which the economic benefits of the assets are expected to be realized. Specifically, the trademarks and trade names are being amortized over an average estimated useful life of 7 years, patents and other developed technology is being amortized over an average life of 10 years and customer relationships are being amortized over an average of 11 years. The weighted average useful life of intangible assets, excluding goodwill, created as a result of the acquisition is 10 years. No residual value is estimated for the intangible assets. While the Company uses its best estimates and assumptions as part of the purchase price allocation process to value assets acquired and liabilities assumed at the acquisition date, the purchase price allocation could

## Edgar Filing: Quanex Building Products CORP - Form 10-Q

change during the measurement period (not to exceed one year) if new information is obtained about facts and circumstances that existed as of the acquisition date that, if known, would have resulted in the recognition of additional assets and liabilities as of that date.

Page 9

**Table of Contents****QUANEX BUILDING PRODUCTS CORPORATION****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

The Company recorded \$0.3 million and \$2.5 million, respectively, of transaction-related costs in connection with the Edgetech acquisition within Selling, general and administrative expense in its Consolidated Statement of Income during the three and nine months ended July 31, 2011.

The Consolidated Statements of Income for the three and nine months ended July 31, 2011, include three and four months of financial results of Edgetech, respectively. For the three months ended July 31, 2011, Edgetech revenues and operating income are \$23.7 million and \$1.0 million, respectively. For the four months ended July 31, 2011, Edgetech revenues and operating income are \$30.1 million and \$0.1 million, respectively. In connection with applying the provisions of purchase accounting to state inventory at fair value, the Company increased Edgetech's inventory value by \$2.0 million, which negatively impacts Quanex's Cost of sales following the acquisition. The Edgetech results were negatively impacted by \$0.7 million and \$1.6 million of additional non-cash Cost of goods sold during the three and nine months ended July 31, 2011, respectively, due to the increased value of inventory sold from applying purchase accounting to the Edgetech inventory acquired. Additionally, Edgetech results include \$1.3 million and \$1.7 million in amortization expense from the acquired intangibles for the three and six months ended July 31, 2011, respectively.

The following table provides unaudited pro forma consolidated results of operations for the combined entity for the three and nine months ended July 31, 2011 and 2010 as if Edgetech had been acquired as of the first day of the Company's fiscal 2010 period.

	Pro forma			
	Three Months Ended July 31,		Nine Months Ended July 31,	
	2011	2010	2011	2010
	(In thousands, except per share amounts)			
Net sales	\$ 252,413	\$ 245,149	\$ 645,330	\$ 628,993
Operating income (loss)	15,670	16,495	8,470	19,353
Income (loss) from continuing operations	\$ 9,836	\$ 10,180	\$ 5,385	\$ 12,798
Diluted earnings (loss) per common share from continuing operations	\$ 0.26	\$ 0.27	\$ 0.14	\$ 0.34

The unaudited pro forma consolidated results of operations were prepared using the acquisition method of accounting and are based on the historical financial information of the Company and Edgetech. The unaudited pro forma financial information does not purport to reflect the results the combined company may achieve in future periods or the results that would have been obtained had Quanex acquired Edgetech on the first day of its fiscal 2010 period. The unaudited pro forma financial information does not include any operating efficiencies or cost savings that may be achieved or any integration expenses. Additionally, the historical Edgetech financial information has not been adjusted to remove expenses that will cease under Quanex's ownership, such as the prior parent company allocation, or to add incremental anticipated stand-alone expenses going forward. Generally, the pro forma financial information reflects the allocation of the purchase price to the appropriate assets and liabilities based upon their fair values, and related changes in depreciation and amortization expense. Accordingly, such amounts are not necessarily indicative of the results that would have occurred if the acquisition had occurred on the dates indicated or that may result in the future. The unaudited pro forma information reflects primarily the following unaudited pro forma adjustments:

Amortization expense related to the fair value of identifiable intangible assets acquired;

Additional depreciation expense related to the fair value adjustment to property, plant and equipment acquired;

Additional facility rental expense;





**Table of Contents****QUANEX BUILDING PRODUCTS CORPORATION****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

Additional cost of goods sold of \$2.0 million (\$1.9 million of which is reflected in the nine months ended July 31, 2010) to reflect the increased value of inventory sold as a result of applying purchase accounting, and a partially offsetting benefit in cost of goods sold of \$0.7 million and \$1.6 million in the three and nine months ended July 31, 2011;

Additional expense of \$2.5 million in the nine months ended July 31, 2010 to reflect the transaction-related costs incurred, and an offsetting reduction of expense of \$0.3 million and \$2.5 million in the three and nine months ended July 31, 2011;

The Edgetech historical results and all of the above adjustments were adjusted for the applicable tax impact.

In March 2011, the Company also acquired JELD-WEN's vinyl extrusion assets in Yakima, Washington (Yakima) for \$6.4 million in cash consideration. This acquisition was effected through an asset purchase of vinyl extrusion related equipment and certain other assets. Yakima was integrated into one of the Company's existing Engineered Products businesses, and the net assets acquired primarily included \$5.0 million of property, plant and equipment and \$1.4 million of intangible assets. There was no goodwill recognized in connection with the Yakima acquisition.

**4. Goodwill and Acquired Intangible Assets***Goodwill*

The changes in the carrying amount of goodwill for the periods ended July 31, 2011 and October 31, 2010 are as follows (in thousands):

	<b>Engineered Products</b>	<b>Aluminum Sheet Products</b>	<b>Consolidated</b>
<b>Balance at October 31, 2010</b>			
Goodwill, gross	\$ 175,455	\$ 20,389	\$ 195,844
Accumulated impairment losses	(150,266)	(20,389)	(170,655)
Goodwill, net	\$ 25,189	\$	\$ 25,189
<b>Acquisition</b>			
	44,052		44,052
Foreign currency translation adjustment	370		370
<b>Balance at July 31, 2011</b>			
Goodwill, gross	219,877	20,389	240,266
Accumulated impairment losses	(150,266)	(20,389)	(170,655)
Goodwill, net	\$ 69,611	\$	\$ 69,611

*Acquired Intangible Assets*

Intangible assets consist of the following (in thousands):

Edgar Filing: Quanex Building Products CORP - Form 10-Q

	As of July 31, 2011		As of October 31, 2010	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets:				
Customer relationships	\$ 44,618	\$ (7,806)	\$ 21,200	\$ (6,291)
Trademarks and trade names	45,078	(10,789)	33,530	(9,156)
Patents and other technology	25,775	(7,071)	11,560	(6,175)
Other	1,392	(116)		
Total	\$ 116,863	\$ (25,782)	\$ 66,290	\$ (21,622)

**Table of Contents****QUANEX BUILDING PRODUCTS CORPORATION****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

The aggregate amortization expense for the three and nine month period ended July 31, 2011 was \$2.1 million and \$4.2 million, respectively. The aggregate amortization expense for the three and nine month period ended July 31, 2010 was \$0.8 million and \$2.3 million, respectively. Estimated amortization expense for the next five years, based upon the amortization of pre-existing intangibles follows:

Fiscal Years Ending October 31,	Estimated Amortization (In thousands)
2011 (remaining three months)	\$ 2,138
2012	\$ 8,553
2013	\$ 8,490
2014	\$ 8,351
2015	\$ 8,212

**5. Inventories**

Inventories consist of the following:

	July 31, 2011	October 31, 2010
	(In thousands)	
Raw materials	\$ 27,117	\$ 18,823
Finished goods and work in process	34,324	23,756
	61,441	42,579
Supplies and other	3,855	2,621
<b>Total</b>	<b>\$ 65,296</b>	<b>\$ 45,200</b>

Fixed costs related to excess manufacturing capacity, if any, have been expensed in the period, and therefore, are not capitalized into inventory. The values of inventories in the consolidated balance sheets are based on the following accounting methods:

	July 31, 2011	October 31, 2010
	(In thousands)	
LIFO	\$ 23,738	\$ 20,122
FIFO	41,558	25,078
<b>Total</b>	<b>\$ 65,296</b>	<b>\$ 45,200</b>

An actual valuation of inventory under the last in, first out (LIFO) method can be made only at the end of each year based on the inventory costs and levels at that time. Accordingly, interim LIFO calculations must be based on management's estimates of expected year-end inventory costs and levels. Because these are subject to many factors beyond management's control, interim results are subject to the final year-end LIFO inventory valuation which could significantly differ from interim estimates. To estimate the effect of LIFO on interim periods, the Company

## Edgar Filing: Quanex Building Products CORP - Form 10-Q

performs a projection of the year-end LIFO reserve and considers expected year-end inventory pricing and expected inventory levels. Depending on this projection, the Company may record an interim allocation of the projected year-end LIFO calculation. This projection resulted in \$3.8 million interim LIFO expense allocation (reported in Cost of sales) for the nine months ended July 31, 2011. With respect to inventories valued using the LIFO method, replacement cost exceeded the LIFO value by approximately \$13.8 million and \$10.1 million as of July 31, 2011 and October 31, 2010, respectively.

Page 12

**Table of Contents****QUANEX BUILDING PRODUCTS CORPORATION****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)****6. Earnings and Dividends Per Share***Earnings Per Share*

The computational components of basic and diluted earnings per share from continuing operations for the three and nine months ended July 31, 2011 and 2010 are below (shares and dollars in thousands except per share amounts):

	For the Three Months Ended July 31, 2011			For the Three Months Ended July 31, 2010		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic earnings and earnings per share	\$ 9,016	37,125	\$ 0.24	\$ 10,429	37,350	\$ 0.28
Effect of dilutive securities:						
Common stock equivalents arising from stock options		366			321	
Restricted stock		193			210	
Common stock held by rabbi trust					102	
Diluted earnings and earnings per share	\$ 9,016	37,684	\$ 0.24	\$ 10,429	37,983	\$ 0.27

	For the Nine Months Ended July 31, 2011			For the Nine Months Ended July 31, 2010		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic earnings and earnings per share	\$ 2,899	37,103	\$ 0.08	\$ 15,896	37,349	\$ 0.43
Effect of dilutive securities:						
Common stock equivalents arising from stock options		380			253	
Restricted stock		227			178	
Common stock held by rabbi trust					102	
Diluted earnings and earnings per share	\$ 2,899	37,710	\$ 0.08	\$ 15,896	37,882	\$ 0.42

The computation of diluted earnings per share excludes outstanding options and other common stock equivalents in periods where inclusion of such potential common stock instruments would be anti-dilutive in the periods presented. For the nine months ended July 31, 2011 and 2010, the Company had 0.3 million and 0.3 million, respectively, of securities that are potentially dilutive in future earnings per share calculations. Such dilution will be dependent on the excess of the market price of the Company's stock over the exercise price and other components of the treasury stock method.

*Dividends Per Share*

During the three and nine months ended July 31, 2011, the Company paid \$0.04 and \$0.12, respectively, cash dividend per common share. During the three and nine months ended July 31, 2010, the Company paid \$0.04 and \$0.10, respectively, cash dividend per common share.



**Table of Contents****QUANEX BUILDING PRODUCTS CORPORATION****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)****7. Comprehensive Income**

Comprehensive income comprises net income and all other non-owner changes in equity, including foreign currency translation, pension related adjustments and realized and unrealized gains and losses on derivatives, if any. Comprehensive income for the three and nine months ended July 31, 2011 and 2010 was as follows:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2011	2010	2011	2010
	(In thousands)			
Comprehensive income (loss):				
Net income (loss)	\$ 9,016	\$ 10,281	\$ 2,887	\$ 14,788
Foreign currency translation adjustment	(1,026)	(30)	951	48
Total comprehensive income (loss), net of taxes	\$ 7,990	\$ 10,251	\$ 3,838	\$ 14,836

The 2011 foreign currency translation activity is primarily associated with Edgetech, acquired by the Company on March 31, 2011. As a result of this acquisition, Quanex now has operations in Germany and the United Kingdom whose functional currency is the Euro and the British Pound Sterling, respectively.

**8. Long-Term Debt and Capital Lease Obligations**

Long-term debt consists of the following:

	July 31, 2011	October 31, 2010
	(In thousands)	
Revolving Credit Facility	\$	\$
City of Richmond, Kentucky Industrial Building Revenue Bonds	900	1,000
Scott County, Iowa Industrial Waste Recycling Revenue Bonds	600	800
Capital lease obligations and other	175	143
Total debt	\$ 1,675	\$ 1,943
Less maturities due within one year included in current liabilities	352	327
Long-term debt	\$ 1,323	\$ 1,616

The Company's \$270.0 million Senior Unsecured Revolving Credit Facility (the Credit Facility) was executed on April 23, 2008. The Credit Facility has a five-year term and is unsecured. The Credit Facility expires April 23, 2013 and provides for up to \$50.0 million for standby letters of credit, limited to the undrawn amount available under the Credit Facility. Borrowings under the Credit Facility bear interest at a spread above LIBOR based on a combined leverage and ratings grid. Proceeds from the Credit Facility may be used to provide availability for acquisitions, working capital, capital expenditures and general corporate purposes.

Under the Credit Facility, the Company is obligated to comply with certain financial covenants requiring the Company to maintain a Consolidated Leverage Ratio of no more than 3.25 to 1 and a Consolidated Interest Coverage Ratio of no less than 3.00 to 1. As defined by the

## Edgar Filing: Quanex Building Products CORP - Form 10-Q

Credit Facility's indenture, the Consolidated Leverage Ratio is the ratio of consolidated indebtedness as of such date to consolidated EBITDA for the previous four fiscal quarters; and the Consolidated Interest Coverage Ratio is the ratio of consolidated EBITDA to consolidated interest expense for the previous four consecutive fiscal quarters. EBITDA is defined by the indenture to include proforma EBITDA of acquisitions and to exclude certain items like non-cash charges.

Page 14



Table of Contents**QUANEX BUILDING PRODUCTS CORPORATION****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

Additionally, the Credit Facility contains certain limitations on additional indebtedness, asset or equity sales, and acquisitions. Dividends and other distributions are permitted so long as after giving effect to such dividend or stock repurchase, there is no event of default.

As of July 31, 2011, the Company had no borrowings under the Credit Facility, and the Company was in compliance with all Credit Facility financial covenants. The availability under the Credit Facility is a function of both the facility amount utilized and meeting covenant requirements. Although there were no borrowings on the Credit Facility and only \$5.2 million of outstanding letters of credit under the Credit Facility, the aggregate availability under the Credit Facility was limited by the Consolidated Leverage Ratio resulting in an availability of \$204.0 million at July 31, 2011.

**9. Retirement Plans**

The Company has a number of retirement plans covering substantially all employees. The Company provides both defined benefit and defined contribution plans. In general, the plant or location of employment determines an employee's coverage for retirement benefits. Effective with the respective acquisition dates in the second fiscal quarter of 2011, the Edgetech and Yakima employees were eligible to participate in the Company's retirement plans.

*Pension Plan*

The Company has a non-contributory, single employer defined benefit pension plan that covers substantially all non-union employees. Effective January 1, 2007, the Company amended this defined benefit pension plan to include a new cash balance formula for all new salaried employees hired on or after January 1, 2007 and for any non-union employees who were not participating in a defined benefit plan prior to January 1, 2007. All new salaried employees are eligible to receive credits equivalent to 4% of their annual eligible wages, while some of the employees at the time of the plan amendment were grandfathered and are eligible to receive credits ranging up to 6.5% based upon a percentage they received in the defined contribution plan prior to the amendment of the pension plan. Additionally, every year the participants will receive an interest related credit on their respective balance equivalent to the prevailing 30-year Treasury rate. Benefits for participants in this plan prior to January 1, 2007 continue to be based on a more traditional formula for retirement benefits, where the plan pays benefits to employees upon retirement using a formula based upon years of service and pensionable compensation prior to retirement. Of the Company's participants, 99% are under the cash balance formula.

The components of net periodic pension cost are as follows:

	Three Months Ended		Nine Months Ended	
	July 31,	July 31,	July 31,	July 31,
	2011	2010	2011	2010
	(In thousands)			
<b>Pension Benefits</b>				
Service cost	\$ 1,002	\$ 839	\$ 2,884	\$ 2,490
Interest cost	213	165	614	474
Expected return on plan assets	(276)	(188)	(795)	(517)
Amortization of unrecognized net loss	24	36	69	110
Net periodic pension cost	\$ 963	\$ 852	\$ 2,772	\$ 2,557

The Company's pension funding policy generally has been to make the minimum annual contributions required by applicable regulations while considering targeted funded percentages. In fiscal 2010, the Company



**Table of Contents****QUANEX BUILDING PRODUCTS CORPORATION****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

decided to modify its funding strategy and accelerate contributions to target a 100% funding threshold. Additionally, the Company will consider funding fiscal year requirements early in the fiscal year to potentially maximize returns on assets. The Company made no contributions during the three months ended July 31, 2011 to its defined benefit plan. During the nine months ended July 31, 2011, the Company contributed \$1.9 million to its defined benefit plan. The Company does not expect to make any additional contributions for the balance of fiscal 2011. Expected contributions are dependent on many variables, including the variability of the market value of the assets as compared to the obligation and other market or regulatory conditions. In addition, the Company takes into consideration its business investment opportunities and resulting cash requirements. Accordingly, actual funding may differ greatly from current estimates.

*Defined Contribution Plans*

The Company has defined contribution plans to which both employees and the Company make contributions. Effective April 1, 2009, the Company temporarily suspended its matching contributions to the Quanex Building Products Salaried and Non-Union Employee 401(k) Plan as part of its efforts to reduce controllable spending. Effective February 1, 2010, these matching contributions were reinstated. The Company matches 50% up to the first 5% of employee deferrals.

**10. Industry Segment Information**

Quanex has two reportable segments: Engineered Products and Aluminum Sheet Products. The Engineered Products segment produces engineered systems, finished products and components serving the OEM residential window and door industry, while the Aluminum Sheet Products segment produces mill finished and coated aluminum sheet serving the broader building products markets. The main market drivers of both segments are residential repair and remodel activity (R&R) and new home construction.

The Company measures its inventory at the segment level on a FIFO or weighted-average basis; however at the consolidated Company level, approximately half of the inventory is measured on a LIFO basis. The LIFO reserve is computed on a consolidated basis as a single pool and is thus treated as a corporate expense. See Note 5 to the financial statements for more information. LIFO inventory adjustments along with corporate office charges and intersegment eliminations are reported as Corporate, Intersegment Eliminations or Other. The Company accounts for intersegment sales and transfers as though the sales or transfers were to third parties, that is, at current market prices. Intersegment sales, related cost of sales, and intercompany profit are eliminated in consolidation at Corporate. Corporate assets primarily include cash and equivalents partially offset by the Company's consolidated LIFO inventory reserve.

	Three Months Ended		Nine Months Ended	
	July 31,		July 31,	
	2011	2010	2011	2010
	(In thousands)			
<b>Net Sales:</b>				
Engineered Products	\$ 124,119	\$ 101,746	\$ 290,623	\$ 259,272
Aluminum Sheet Products	132,130	127,600	334,328	326,252
Intersegment Eliminations	(3,836)	(4,143)	(9,618)	(9,513)
Consolidated	\$ 252,413	\$ 225,203	\$ 615,333	\$ 576,011
<b>Operating Income (Loss):</b>				
Engineered Products	\$ 14,146	\$ 13,131	\$ 15,411	\$ 22,969
Aluminum Sheet Products	7,417	8,866	14,027	19,732
Corporate & Other	(6,926)	(5,798)	(24,752)	(18,976)

Edgar Filing: Quanex Building Products CORP - Form 10-Q

Consolidated	\$ 14,637	\$ 16,199	\$ 4,686	\$ 23,725
--------------	-----------	-----------	----------	-----------

Page 16

**Table of Contents****QUANEX BUILDING PRODUCTS CORPORATION****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

	July 31, 2011	October 31, 2010
	(In thousands)	
<b>Identifiable Assets:</b>		
Engineered Products <sup>1</sup>	\$ 404,191	\$ 258,919
Aluminum Sheet Products	156,373	152,113
Corporate, Intersegment Eliminations & Other <sup>2</sup>	33,769	179,756
Discontinued Operations <sup>3</sup>		462
Consolidated	\$ 594,333	\$ 591,250
<b>Goodwill:</b>		
Engineered Products	\$ 69,611	\$ 25,189
Consolidated	\$ 69,611	\$ 25,189

**11. Stock-Based Compensation**

Effective with the Separation on April 23, 2008, the Company established the Quanex Building Products Corporation 2008 Omnibus Incentive Plan (the 2008 Plan). The 2008 Plan provides for the granting of stock options, stock appreciation rights, restricted stock awards, restricted stock units (RSUs), performance stock awards, performance unit awards, annual incentive awards, other stock-based awards and cash-based awards. The 2008 Plan is administered by the Compensation and Management Development Committee of the Board of Directors and allows for immediate, graded or cliff vesting options, but options must be exercised no later than ten years from the date of grant. The aggregate number of shares of common stock authorized for grant originally under the 2008 Plan was 2,900,000. In February 2011, the 2008 Plan was amended by the Company's shareholders to increase the aggregate number of shares available for awards by an additional 2,400,000 shares. Any officer, key employee and/or non-employee director of the Company or any of its affiliates is eligible for awards under the 2008 Plan. The initial awards granted under the 2008 Plan were on April 23, 2008; service is the vesting condition.

The Company's practice is to grant options and restricted stock or RSUs to non-employee directors on October 31 of each year, with an additional grant of options to each director on the date of his or her first anniversary of service. Additionally, the Company's practice is to grant options and restricted stock or RSUs to employees at the Company's December board meeting and occasionally to key employees as deemed appropriate at other times during the year. The exercise price of the option awards is equal to the closing market price on the date granted. The Company generally issues shares from treasury stock, if available, to satisfy stock option exercises and grants of restricted stock. If there are no shares in treasury stock, the Company issues additional shares of common stock. The Company has not capitalized any stock-based compensation cost as part of inventory or fixed assets during the nine months ended July 31, 2011 and 2010.

<sup>1</sup> Increase in Engineered Products identifiable assets and goodwill are primarily attributable to the Edgetech acquisition on March 31, 2011. See note 3 for discussion of this acquisition.

<sup>2</sup> Decrease in Corporate, Intersegment Eliminations & Other identifiable assets are primarily attributable to cash paid of \$110.8 million for the Edgetech and Yakima acquisitions.

<sup>3</sup> In January 2010, management committed to a plan to shut down the operations of its start-up facility in China; therefore, the China assets are included in discontinued operations for all periods presented.

**Table of Contents****QUANEX BUILDING PRODUCTS CORPORATION****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)***Restricted Stock Awards*

Under the 2008 Plan, common stock may be awarded to key employees, officers and non-employee directors. The recipient is entitled to all of the rights of a shareholder, except that during the forfeiture period the shares are nontransferable. The awards vest over a specified time period, but typically either immediately vest or cliff vest over a three-year period with service as the vesting condition. Upon issuance of stock under the plan, fair value is measured by the grant-date price of the Company's shares. This fair value is then expensed over the restricted period with a corresponding increase to additional paid-in-capital. A summary of non-vested restricted stock award changes during the nine months ended July 31, 2011 follows:

	Shares	Weighted-Average Grant-Date Fair Value Per Share
Non-vested at October 31, 2010	378,616	\$ 13.07
Granted	69,200	17.14
Vested	(136,219)	15.28
Forfeited	(25,207)	13.62
Non-vested at July 31, 2011	286,390	\$ 12.95

The weighted-average grant-date fair value of restricted stock granted during the nine months ended July 31, 2011 and 2010 was \$17.14 and \$16.21 per share, respectively. The total fair value of restricted stock vested during the nine months ended July 31, 2011 and July 31, 2010 was \$2.1 million and \$0.1 million, respectively. Total unrecognized compensation cost related to unamortized restricted stock awards was \$1.6 million as of July 31, 2011. This cost is expected to be recognized over a weighted-average period of 1.9 years.

*Stock Options*

As described in the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 2010, the Company uses the Black-Scholes-Merton option-pricing model to estimate the fair value of its stock options. The fair value of each option was estimated on the date of grant. The following is a summary of valuation assumptions and resulting grant-date fair values for grants during the following periods:

	Nine Months Ended July 31,	
	2011	2010
Weighted-average expected volatility	53.0%	55.0%
Expected term (in years)	4.9-5.1	4.9-5.1
Risk-free interest rate	1.7%	2.1%
Expected dividend yield over expected term	1.0%	1.0%
Weighted-average grant-date fair value per share	\$ 7.59	\$ 7.32

**Table of Contents****QUANEX BUILDING PRODUCTS CORPORATION****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

Below is a table summarizing the stock option shares activity for the 2008 Plan since October 31, 2010:

	Shares	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (000s)
Outstanding at October 31, 2010	1,724,301	\$ 13.24		
Granted	425,600	17.48		
Exercised	(61,338)	14.13		
Forfeited	(2,419)	13.61		
Outstanding at July 31, 2011	2,086,144	14.07	7.4	\$ 4,384
Vested or expected to vest at July 31, 2011	2,014,596	14.02	7.4	\$ 4,281
Exercisable at July 31, 2011	1,260,707	\$ 13.38	6.7	\$ 3,093

The total intrinsic value of options (the amount by which the market price of the stock on the date of exercise exceeded the exercise price of the option) exercised during the nine months ended July 31, 2011 and 2010 was \$0.3 million and \$0.3 million, respectively. The total fair value of shares vested during the nine months ended July 31, 2011 and 2010 was \$2.4 million and \$1.6 million, respectively. Total unrecognized compensation cost related to stock options granted under the 2008 Plan was \$3.1 million as of July 31, 2011. This cost is expected to be recognized over a weighted-average period of 1.8 years.

**12. Income Taxes**

The provision for income taxes is determined by applying an estimated annual effective income tax rate to income from continuing operations before income taxes. The rate is based on the most recent annualized forecast of pretax income, permanent book versus tax differences and tax credits. The Company's estimated annual effective tax rate for the nine months ended July 31, 2011 is 35.2% compared to the estimated annual effective tax rate of 38.6% for the nine months ended July 31, 2010. The decline in the nine months ended July 31, 2011 effective rate is primarily due to additional benefit from the manufacturer's deduction and the R&D credit.

Prepaid and other current assets on the Consolidated Balance Sheets include an income tax receivable of \$2.2 million and \$2.6 million as of July 31, 2011 and October 31, 2010, respectively.

The non-current deferred income taxes asset balance decreased from \$30.6 million as of October 31, 2010 to \$8.5 million as of July 31, 2011. This large decrease primarily relates to the non-current deferred income tax liability established in the Edgetech acquisition.

The Income taxes payable balance of \$0.7 million as of July 31, 2011 relates to the reorganization taxes assumed in the acquisition of Edgetech (\$3.5 million, less payments of \$2.8 million in third quarter).

The Company's unrecognized tax benefit (UTB) is related to the Separation and state tax items regarding the interpretations of tax laws and regulations. The total UTB as of July 31, 2011 is \$18.9 million. Of this, \$8.3 million is recorded in Other liabilities and \$10.6 million is recorded in Deferred income taxes (non-current assets). The UTB includes \$1.0 million for which the disallowance of such items would not affect the annual effective tax rate.

## Edgar Filing: Quanex Building Products CORP - Form 10-Q

Judgment is required in assessing the future tax consequences of events that have been recognized in the Company's financial statements or income tax returns. The final outcome of the future tax consequences of legal

Page 19



**Table of Contents****QUANEX BUILDING PRODUCTS CORPORATION****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

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 the Company's financial statements. The Company is subject to the effects of these matters occurring in various jurisdictions. The Company believes that it is reasonably possible that a decrease of approximately \$3.5 million in the UTB may be recognized within the next twelve months as a result of a lapse in the statute of limitations.

**13. Contingencies***Environmental*

Quanex is subject to extensive laws and regulations concerning the discharge of materials into the environment and the remediation of chemical contamination. To satisfy such requirements, Quanex must make capital and other expenditures on an ongoing basis. The Company accrues its best estimates of its remediation obligations and adjusts such accruals as further information and circumstances develop. Those estimates may change substantially depending on information about the nature and extent of contamination, appropriate remediation technologies, and regulatory approvals. In accruing for environmental remediation liabilities, costs of future expenditures are not discounted to their present value, unless the amount and timing of the expenditures are fixed or reliably determinable. When environmental laws might be deemed to impose joint and several liability for the costs of responding to contamination, the Company accrues its allocable share of liability taking into account the number of parties participating, their ability to pay their shares, the volumes and nature of the wastes involved, the nature of anticipated response actions, and the nature of the Company's alleged connections. The cost of environmental matters has not had a material adverse effect on Quanex's operations or financial condition in the past, and management is not currently aware of any conditions that it believes are likely to have a material adverse effect on Quanex's operations, financial condition or cash flows.

As described below, the Company currently is engaged in remediation activities at one of its plant sites. The total associated environmental reserve and corresponding recovery as of July 31, 2011 and October 31, 2010 were as follows:

	July 31, 2011	October 31, 2010
	(In thousands)	
Current	\$ 1,700	\$ 1,564
Non-current <sup>1</sup>	11,322	12,027
<b>Total environmental reserves</b>	<b>\$ 13,022</b>	<b>\$ 13,591</b>
Receivable for recovery of remediation costs <sup>2</sup>	\$ 12,293	\$ 12,747

Approximately \$1.3 million of the July 31, 2011 reserve represents administrative costs; the balance represents estimated costs for investigation, studies, cleanup, and treatment. The reserve has not been discounted. As discussed below, an associated \$12.3 million and \$12.7 million undiscounted recovery from indemnitors of remediation costs at one plant site is recorded as of July 31, 2011 and October 31, 2010, respectively.

The Company's Nichols Aluminum-Alabama, LLC (NAA) subsidiary operates a plant in Decatur, Alabama that is subject to an Alabama Hazardous Wastes Management and Minimization Act Post-Closure Permit. Among other things, the permit requires NAA to remediate, as directed by the state, historical environmental releases of wastes and waste constituents. Consistent with the permit, NAA has undertaken various studies of site

<sup>1</sup> Reported in Accrued liabilities on the Consolidated Balance Sheets.

<sup>2</sup> Reported in Accounts receivable and Other assets on the Consolidated Balance Sheets.

---

**Table of Contents****QUANEX BUILDING PRODUCTS CORPORATION****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

conditions and, during the first quarter 2006, started a phased program to treat in-place free product petroleum that had been released underneath the plant. During the third quarter 2010, NAA submitted to the state its proposed workplan for implementing a site-wide remedy; a revised version reflecting both additional sampling data and responses to state comments was submitted during the second quarter 2011. Based on those plans, which remain subject to further state review and approval, the Company's remediation reserve at NAA's Decatur plant is \$13.0 million. NAA was acquired through a stock purchase in which the sellers agreed to indemnify Quanex and NAA for identified environmental matters related to the business and based on conditions initially created or events initially occurring prior to the acquisition. Environmental conditions are presumed to relate to the period prior to the acquisition unless proved to relate to releases occurring entirely after closing. The limit on indemnification is \$21.5 million excluding legal fees. While the Company's current estimates indicate it will not reach this limit, changing circumstances could result in additional costs or expense that are not foreseen at this time. In accordance with the indemnification, the indemnitors paid the first \$1.5 million of response costs and have been paying 90% of ongoing costs. Based on its experience to date, its estimated cleanup costs going forward, and costs incurred to date as of July 31, 2011, the Company expects to recover from the sellers shareholders an additional \$12.3 million. Of that, \$11.7 million is recorded in Other assets on the Consolidated Balance Sheets, and the balance is reflected in Accounts receivable on the Consolidated Balance Sheets.

The Company's final remediation costs and the timing of those expenditures will depend upon such factors as the nature and extent of contamination, the cleanup technologies employed, the effectiveness of the cleanup measures that are employed, and regulatory concurrences. While actual remediation costs, therefore, may be more or less than amounts accrued, the Company believes it has established adequate reserves for all probable and reasonably estimable remediation liabilities. It is not possible at this point to reasonably estimate the amount of any obligation for remediation in excess of current accruals because of uncertainties as to the extent of environmental impact, cleanup technologies, and concurrence of governmental authorities. The Company currently expects to pay the accrued remediation reserve through at least fiscal 2034, although some of the same factors discussed earlier could accelerate or extend the timing.

*Other*

From time to time, the Company and its subsidiaries are involved in various litigation matters arising in the ordinary course of their business. Although the ultimate resolution and impact of such litigation on the Company is not presently determinable, the Company's management believes that the eventual outcome of such litigation will not have a material adverse effect on the overall financial condition, results of operations or cash flows of the Company.

**14. Warranty Obligations**

The Company's estimated obligations for warranty are accrued concurrently with the revenue recognized. The Company makes provisions for its warranty obligations based upon historical experience incurred for such obligations adjusted, as necessary, for current conditions and factors. Due to the significant uncertainties and judgments involved in estimating the Company's warranty obligations, including changing product designs, variance in customer installation process and future claims experience varying from historical claims experience, the ultimate amount incurred for warranty costs could change in the near and long-term from the current estimate.

**Table of Contents****QUANEX BUILDING PRODUCTS CORPORATION****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

The following table provides a reconciliation of the activity related to the Company's accrued warranty, including both the current (reported in Accrued liabilities on the Consolidated Balance Sheets) and long-term portions (reported in Other liabilities on the Consolidated Balance Sheets), for the nine months ended July 31, 2011 (in thousands):

	<b>July 31, 2011</b>
Balance at October 31, 2010	\$ 3,697
Provision for warranty expense	2,843
Warranty costs paid	(948)
Total accrued warranty	\$ 5,592
Less long-term portion	1,512
Current accrued warranty	\$ 4,080

During the first fiscal quarter of 2011, the reserve was increased by \$2.1 million related to a rise in projected claim experience for a legacy product that was discontinued some years ago.

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

The Company holds Money Market Fund investments that are classified as cash equivalents and are measured at fair value on a recurring basis, based on quoted prices in active markets for identical assets (Level 1). The Company had cash equivalent investments totaling approximately \$36.0 million and \$180.6 million at July 31, 2011 and October 31, 2010, respectively. The decrease is primarily related to the \$104.4 million cash paid for the acquisition of Edgetech, net of cash acquired of \$0.8 million. Inputs and valuation techniques used to measure the fair value of the Company's pension plan assets vary according to the type of security being valued. All of the equity and debt securities held directly by the plans are actively traded and fair values are determined based on quoted market prices. As of July 31, 2011 and October 31, 2010, the fair value of pension plan assets was \$14.9 million and \$12.9 million, respectively. As of July 31, 2011, the Company did not have any assets or liabilities obtained from readily available pricing sources for comparable instruments (Level 2) or requiring measurement at fair value without observable market values that would require a high level of judgment to determine fair value (Level 3).

**16. Stock Repurchase Program and Treasury Stock**

On May 27, 2010, the Board of Directors approved a stock repurchase program of 1.0 million shares, and on August 25, 2011, the Board of Directors authorized an additional 1.0 million shares to this program. The objectives of this program are to manage the dilution created by shares issued under stock-based compensation plans and to repurchase shares opportunistically. The Company records treasury stock purchases under the cost method whereby the entire cost of the acquired stock is recorded as treasury stock. The Company uses a moving-average method on the subsequent reissuance of shares, and any resulting proceeds in excess of cost are credited to additional paid in capital while any deficiency is charged to retained earnings.

As of October 31, 2010, the number of shares in treasury stock was 351,626. During the nine months ended July 31, 2011, the Company purchased 256,249 shares at a cost of \$4.3 million partially offset by shares issued for stock option exercises and restricted stock grants for a net increase to the number of shares in treasury stock to 541,537 as of July 31, 2011. Since inception of the program, Quanex has purchased 506,249 shares through July 31, 2011 and purchased 745,299 shares through August 29, 2011. The remaining shares authorized for repurchase in the program was 1,254,701 as of August 29, 2011.



**Table of Contents**

**QUANEX BUILDING PRODUCTS CORPORATION**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**17. Other Income (Expense)**

During the three and nine months ended July 31, 2011, the Company incurred \$0.4 million and \$0.2 million of transaction losses which are included in determining net income primarily related to Edgetech's international operations and foreign currency denominated receivables. There are no transaction gains or losses during the three and nine months ended July 31, 2010.

In February 2010, the Company completed a small acquisition for approximately \$1.6 million in consideration. This operation was integrated into one of its existing Engineered Products businesses. ASC 805 *Business Combinations* requires that a gain be recorded when the fair value of the net assets acquired is greater than the fair value of the consideration transferred. Though uncommon, bargain purchases can occur because of underpayments for the business acquired due to a forced liquidation or distress sale. These assets were acquired at auction due to the business being in Wisconsin receivership proceedings. As such, the Company obtained the assets at a bargain and recognized a gain of approximately \$1.3 million in Other, net.

---

## **Table of Contents**

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

The discussion and analysis of Quanex Building Products Corporation and its subsidiaries' financial condition and results of operations should be read in conjunction with the July 31, 2011 Consolidated Financial Statements of the Company and the accompanying notes and in conjunction with the Consolidated Financial Statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 2010. References made to the Company or Quanex include Quanex Building Products Corporation and its subsidiaries and Quanex Corporation (Predecessor to Quanex Building Products Corporation) unless the context indicates otherwise.

#### **Private Securities Litigation Reform Act**

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. All statements which address future operating performance, events or developments that the Company expects or anticipates will occur in the future, including statements relating to volume, sales, operating income and earnings per share, and statements expressing general outlook about future operating results, are forward-looking statements. Forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from the Company's historical experience and the present projections or expectations. As and when made, management believes 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. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Factors exist that could cause the Company's actual results to differ materially from the expected results described in or underlying the Company's forward-looking statements. Such factors include domestic and international economic activity, prevailing prices of aluminum scrap and other raw material costs, the rate of change in prices for aluminum scrap, fluctuations in foreign currency exchange rates, energy costs, interest rates, construction delays, market conditions, particularly in the home building and remodeling markets, any material changes in purchases by the Company's principal customers, labor supply and relations, environmental regulations, changes in estimates of costs for known environmental remediation projects and situations, world-wide political stability and economic growth, warranty obligations, the Company's successful implementation of its internal operating plans, acquisition strategies and integration, performance issues with key customers, suppliers and subcontractors, and regulatory changes and legal proceedings. Accordingly, there can be no assurance that the forward-looking statements contained herein will occur or that objectives will be achieved. All written and verbal forward-looking statements attributable to the Company or persons acting on its behalf are expressly qualified in their entirety by such factors. For more information, see Part I, Item 1A, Risk Factors in the Company's Annual Report on Form 10-K, for the year ended October 31, 2010.

#### **About Third-Party Information**

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

**Table of Contents****Description of Business**

On December 12, 2007, Quanex Building Products Corporation was incorporated in the state of Delaware as a subsidiary of Quanex Corporation to facilitate the separation of Quanex Corporation's vehicular products and building products businesses. The separation occurred on April 23, 2008 through the spin-off of Quanex Corporation's building products business to its shareholders immediately followed by the merger of Quanex Corporation (consisting principally of the vehicular products business and all non-building products related corporate accounts) with a wholly-owned subsidiary of Gerdau S.A. (Gerdau).

The spin-off and subsequent merger is hereafter referred to as the Separation. For purposes of describing the events related to the Separation, as well as other events, transactions and financial results of Quanex Corporation and its subsidiaries related to periods prior to April 23, 2008, the term the Company refers to Quanex Building Products Corporation's accounting predecessor, Quanex Corporation.

In January 2010, management committed to a plan to close its start-up facility in China due to the contraction of demand and the Company's ability to serve the overseas thin film solar panel market from its North American operations. Accordingly, the China assets and liabilities, results of operations and cash flows are reported as discontinued operations for all periods presented. Unless otherwise noted, all discussions reflect only continuing operations.

On March 31, 2011, the Company acquired Edgetech for \$104.4 million in an all cash transaction (net of cash acquired). Headquartered in Cambridge, Ohio, Edgetech has three manufacturing facilities located in the United States, the United Kingdom and Germany that produce a full line of warm-edge, dual seal insulating glass spacer systems for window and door customers in North America and abroad. Edgetech's products separate and seal double and triple pane glass within a window and act as a thermal barrier that enhances the window's energy efficiency. Edgetech is being integrated into the Engineered Products segment. Acquiring Edgetech will allow the Company to better serve its growing base of national and regional customers and will further accelerate its international growth as Edgetech has a solid market presence overseas.

**Consolidated Results of Operations***Summary Information*

	Three Months Ended July 31,				Nine Months Ended July 31,			
	2011	2010	Change	%	2011	2010	Change	%
	(Dollars in millions)							
Net sales	\$ 252.4	\$ 225.2	\$ 27.2	12.1	\$ 615.3	\$ 576.0	\$ 39.3	6.8
Cost of sales <sup>1</sup>	209.7	184.8	24.9	13.5	524.8	478.6	46.2	9.7
Selling, general and administrative	18.9	17.6	1.3	7.4	61.2	52.7	8.5	16.1
Depreciation and amortization	9.2	6.6	2.6	39.4	24.6	21.0	3.6	17.1
Operating income (loss)	14.6	16.2	(1.6)	(9.9)	4.7	23.7	(19.0)	(80.2)
Interest expense	(0.1)	(0.1)			(0.3)	(0.3)		
Other, net	(0.3)	1.0	(1.3)	(130.0)	0.1	2.5	(2.4)	(96.0)
Income tax (expense) benefit	(5.2)	(6.7)	1.5	(22.4)	(1.6)	(10.0)	8.4	(84.0)
Income (loss) from continuing operations	\$ 9.0	\$ 10.4	\$ (1.4)	(13.5)	\$ 2.9	\$ 15.9	\$ (13.0)	(81.8)

<sup>1</sup> Exclusive of items shown separately below.



---

**Table of Contents***Overview*

Quanex continues to face difficult end markets and prime window demand has dropped to new lows. The first quarter of 2011 experienced demand pull-forward in advance of the \$1,500 window tax credit that expired on December 31, 2010, while the second fiscal quarter experienced an expected drop due to demand being pulled ahead into the first fiscal quarter. As expected by the Company, customer demand in the third fiscal quarter of 2011 did not experience a meaningful Spring bounce as is typical for this time of the year. The three and nine months ended July 31, 2011 figures include financial results from the Edgetech acquisition beginning in April 2011. Net sales, excluding Edgetech, increased \$3.5 million or 1.6% for the three months ended July 31, 2011 compared to the same 2010 period. Edgetech added \$23.7 million of Net sales for the third quarter of fiscal 2011. Of the \$39.3 million increase, Net sales for the nine months ended July 31, 2011 were up \$30.1 million compared to the same period of last year driven by the Edgetech acquisition. Despite weak end markets, same store 2011 revenues from Engineered Products were generally flat compared to 2010, supported by price increases and surcharges. Operating income in the third quarter of 2011 included \$1.0 million of operating income from Edgetech, but was \$1.6 million lower than the year ago quarter due to lower shipments coupled with higher maintenance costs at Aluminum Sheet Products, acquisition related costs and higher Engineered Products sales and marketing costs as the Company invested in long-term organic growth initiatives. Operating income for the nine months ended July 31, 2011 was \$19.0 million lower than the same period last year due to the same factors described for the third quarter, coupled with costs at Engineered Products associated with rationalizing operations, acquisition related costs, higher raw material costs and warranty expense.

The Company believes that consumer demand for more energy efficient products and its ability to provide innovative window and door systems in addition to stand-alone components, along with its new sales and marketing efforts targeted at regional OEM customers, will help fuel long-term organic growth even as the housing market continues to experience hardship. Demographics for long-term housing demand in the U.S. remain favorable when factoring the projected population increase and continuing immigration. The Company believes taking a disciplined approach to the way it seeks new business opportunities will make it a more successful company and a stronger competitor by offering a broader range of customers a more robust slate of systems, products and services. Additionally, the Company is elevating its programs to develop more energy efficient products. These programs and initiatives, coupled with an eventual return to a more normal housing market, will benefit Quanex over the long term.

*Business Segments*

Quanex has two reportable segments: Engineered Products and Aluminum Sheet Products. The Engineered Products segment produces systems, finished products, and components serving the OEM residential window and door industry, while the Aluminum Sheet Products segment produces mill finished and coated aluminum sheet serving the broader building products markets. The primary market drivers of both segments are residential repair and remodel activity (R&R) and new home construction.

For financial reporting purposes, four of the Company's five operating segments, Homeshield, Truseal, Edgetech and Mikron, have been aggregated into the Engineered Products reportable segment. The remaining operating segment, Aluminum Sheet Products (Nichols Aluminum), is reported as a separate reportable segment. Corporate & Other is comprised of corporate office expenses and certain inter-division eliminations. The sale of products between segments is recognized at market prices. The financial performance of the operations is based upon operating income. The segments follow the accounting principles described in Item 1, Note 1 to the consolidated financial statements of the Company's 2010 Form 10-K. The two reportable segments value inventory on a FIFO or weighted-average basis while the LIFO reserve relating to those operations accounted for under the LIFO method of inventory valuation is computed on a consolidated basis in a single pool and treated as a corporate item.

**Table of Contents****Three and Nine Months Ended July 31, 2011 Compared to Three and Nine Months Ended July 31, 2010***Engineered Products*

	Three Months Ended July 31,				Nine Months Ended July 31,			
	2011	2010	Change	%	2011	2010	Change	%
	(Dollars in millions)							
Net sales	\$ 124.1	\$ 101.7	\$ 22.4	22.0	\$ 290.6	\$ 259.3	\$ 31.3	12.1
Cost of sales <sup>1</sup>	90.5	74.5	16.0	21.5	222.1	193.1	29.0	15.0
Selling, general and administrative	12.4	9.5	2.9	30.5	35.0	28.5	6.5	22.8
Depreciation and amortization	7.1	4.6	2.5	54.3	18.1	14.7	3.4	23.1
Operating income (loss)	\$ 14.1	\$ 13.1	\$ 1.0	7.6	\$ 15.4	\$ 23.0	\$ (7.6)	(33.0)

Engineered Products is focused on providing window and door OEM customers with fenestration components, products and systems. Key end markets are residential remodel and repair (R&R) and new home construction. Net sales for the three months ended July 31, 2011, excluding Edgetech, were \$1.3 million or 1.3% compared to the same period of 2010. Edgetech added \$23.7 million of Net sales for the third fiscal quarter of 2011. The third quarter year-over-year comparison was negatively impacted by the higher than normal demand realized in the third quarter of 2010 which had the benefit of a \$1,500 energy efficient window tax credit program. There were no similar tax credits in the third quarter of 2011. Since Quanex's acquisition of Edgetech on March 31, 2011, Edgetech generated \$30.1 million in Net sales and is the primary reason Net sales for the nine months ended July 31, 2011 exceeded the prior year 2010 period. Engineered Products' Net sales before considering acquisitions were nearly flat despite headwinds in its end markets. Engineered Products compares its sales to US window shipments as reported by Ducker Worldwide, a market intelligence firm. For the twelve months ended July 31, 2011, Engineered Products' Net sales before contributions from acquisitions were down 0.8% compared to the previous twelve months, versus US window shipments that were down approximately 6%. Quanex believes there is value in measuring its sales performance against industry indexes. As expected, the seasonal volume pickup in demand during the third quarter 2011 was lower than traditionally experienced in prior years; uncertainty remains as to what level the demand will be during the remainder of 2011.

Net sales less Cost of sales (Contribution margin) at Engineered Products for the three and nine months ended July 31, 2011 compared to the same periods of last year improved by \$6.4 million and \$2.3 million, respectively, including Edgetech's contribution of \$6.8 million and \$7.7 million, respectively. Net sales less Cost of sales as a percent of Net sales for the quarter ended July 31, 2011 is above the same 2010 periods (with and without acquisitions) even with the weak market and negative pressure on volume. Although Engineered Products experienced higher raw material costs in the third quarter of 2011, these higher costs were generally offset by higher prices, surcharges, cost controls and productivity improvements, which strengthened margins. Truseal, one of the Company's warm edge, insulating glass spacer divisions, initiated an oil based raw material surcharge effective May 1, 2011. The surcharge helped Truseal offset the rising cost of butyl, a key raw material of the business and highly correlated to the price of oil. Third quarter 2011 margins also benefited from Edgetech's results. Net sales less Cost of sales as a percent of Net sales for the nine months ended July 31, 2011 are below the same 2010 period due to higher raw material costs and temporary increases in labor expense as the Company used overtime to meet a hike in orders in November and December; additionally, the first fiscal quarter of 2010 benefited from hourly labor savings associated with the strike at the segment's Barbourville, Kentucky facility in mid-December 2009. Further reducing margins during the nine months ended July 31, 2011 was \$3.1 million of costs associated with plant consolidations and closings as the Company rationalized production facilities. The Company finished the building consolidation project at its facility in Kent, Washington where four buildings have been consolidated to one, and the Company closed a facility in The Dalles, Oregon. Of the \$3.1 million in plant consolidation costs, \$1.3 million is recognized in Cost of sales. During the nine months ended July 31, 2011, \$2.1 million of expense was recognized in Cost of sales to increase the warranty reserve.

<sup>1</sup> Exclusive of items shown separately below.

---

**Table of Contents**

associated with a legacy product that was discontinued some years ago. Because the establishment of the warranty reserve is an inherently uncertain process involving estimates of the number of future claims and the cost to settle claims, the Company's ultimate losses may differ from the warranty reserve and future adjustments to the reserve may be necessary. Finally, 2011 results were negatively impacted by \$0.7 million and \$1.6 million of additional non-cash Cost of goods sold during the three and nine months ended July 31, 2011, respectively, due to the increased value of inventory sold from applying purchase accounting to the Edgetech inventory acquired. Of the initial \$2.0 million increase in inventory value from applying purchase accounting, the Company expects the majority of the \$0.4 million balance to be recognized during the remainder of 2011.

Selling, general and administrative costs increased for the 2011 quarter and year from the acquisition of Edgetech which reported \$3.7 million and \$4.9 million of Selling, general and administrative costs for the three and nine months ended July 31, 2011. Additionally, the increase in Selling, general and administrative costs for the year were attributable to \$1.4 million (included in the total \$3.1 million discussed above) of costs associated with the aforementioned plant consolidations and closing during the first fiscal quarter of 2011. The majority of the \$1.4 million represents an estimated liability to terminate a facility operating lease; if the associated sublease differs from assumptions inherent in the estimate used to derive the reserve, additional expense or a recovery of expense could be recognized in future periods. Furthermore, Engineered Products incurred additional sales and marketing expenses of \$1.4 million in 2011 associated with the roll out of new products and programs and increasing resources necessary to achieve long-term organic growth, with a focus on expanding further into the regional segment of the residential market. Benefiting the comparative 2011 results is \$1.0 million of costs associated with the aforementioned strike in mid December 2009 (partially offset by the direct labor savings in Cost of sales) as well as reduced incentives corresponding to lower earnings.

Depreciation and amortization has increased for the quarter and the year in 2011 compared to 2010 primarily due to the acquisition of Edgetech on March 31, 2011. Depreciation and amortization associated with Edgetech was \$2.1 million (three months) and \$2.7 million (four months) for the three and nine months ended July 31, 2011, respectively. In addition, depreciation and amortization increased for the year in 2011 by \$0.3 million (included in the total \$3.1 million discussed above) for accelerated depreciation related to the plant consolidations. Depreciation and amortization for the full fiscal year of 2012 is expected to increase over fiscal 2011 as a full twelve months of expense associated with the recognition of Edgetech intangible assets and the step-up in Edgetech's tangible assets is realized going forward.

Operating income for the third fiscal quarter of 2011 was up by \$1.0 million from Edgetech while the operating income from the remaining Engineered Products businesses was flat compared to the same period of 2010. Operating income for the nine months ended July 31, 2011 was below prior year levels primarily due to weak end markets and rising material costs as well as negative impacts from current year costs to consolidate facilities, warranty expense associated with legacy products and incremental sales and marketing investment to support Engineered Products' organic growth initiatives.

Engineered Products' long-term organic growth programs are focused on driving profitable growth through one sales and marketing team, coupled with the engineering collaboration of its family of businesses: Mikron, Truseal and Homeshield (and as of March 31, 2011, Edgetech). The Company believes these programs will drive profitable growth at Engineered Products by furthering the goal of becoming the leading energy efficient expert in the market by offering customers state-of-the-art engineering, design and marketing support. The organic growth programs were formalized and launched in March 2010 and are comprised of related initiatives to execute this strategy; the sales, marketing and engineering efforts of these divisions operated independently in the past. Today, Engineered Products' sales and marketing employees have been organized into a single team to better utilize their combined capabilities to expand sales opportunities to the existing customer base. Additionally, the new sales and marketing structure is focused on developing and capturing more regional OEM business. Regional OEMs, a customer class Engineered Products has historically underserved, are believed to comprise about 60% of the market. The engineering resources across Engineered Products are also working together to develop products and systems that provide customers with the latest innovations in technology and energy efficiency. Engineered Products is in the early stages of this long-term organic growth initiative but believes it

**Table of Contents**

will have a meaningful impact on its long-term growth and profitability. The Company will continue to incur expenses and to invest in additional resources at Engineered Products to support this organic growth effort.

*Aluminum Sheet Products*

	Three Months Ended July 31,				Nine Months Ended July 31,			
	2011	2010	Change	%	2011	2010	Change	%
	(Dollars in millions)							
Net sales	\$ 132.1	\$ 127.6	\$ 4.5	3.5	\$ 334.3	\$ 326.2	\$ 8.1	2.5
Cost of sales <sup>1</sup>	120.8	113.3	7.5	6.6	307.9	292.4	15.5	5.3
Selling, general and administrative	1.8	3.4	(1.6)	(47.1)	5.9	7.9	(2.0)	(25.3)
Depreciation and amortization	2.1	2.0	0.1	5.0	6.4	6.2	0.2	3.2
Operating income (loss)	\$ 7.4	\$ 8.9	\$ (1.5)	(16.9)	\$ 14.1	\$ 19.7	\$ (5.6)	(28.4)
Shipped pounds	79.9	90.3	(10.4)	(11.5)	211.8	234.6	(22.8)	(9.7)

The primary market drivers for the Aluminum Sheet Products segment are residential repair and remodel activity and new home construction (together approximately 70% of the segment's sales) and transportation (approximately 20% of the segment's sales) markets.

The increase in net sales at the Aluminum Sheet Products segment for the three and nine months ended July 31, 2011 was the result of a 16.9% and 13.5% increase in average selling price per pound, respectively, compared to the same periods of 2010. Average selling price increased primarily due to higher London Metal Exchange (LME) aluminum prices in the comparative periods as well as an increase during the quarter in the percent of value added painted mix. LME aluminum prices are the most commonly used index for correlating aluminum sheet prices. However, net sales was negatively impacted by a decline in shipped pounds of 11.5% for the quarter and 9.7% for the nine months compared to the same periods of 2010 due to weaker demand for residential building and construction sheet. The Aluminum Association, which tracks aluminum industry shipments of sheet products, reported non-can sheet aluminum shipments in the third quarter and year-to-date July up 4% from a year ago, while Aluminum Sheet Products' shipments were down. Part of the Company's underperformance versus the industry can be attributed to relatively weaker building and construction demand, where Quanex has a sizable presence, compared to stronger distribution and transportation demand, where Quanex has a relatively smaller presence. Compared to the Company's sequential second quarter, shipped pounds were flat at the same 80 million pounds, further indication of a weak Spring bounce.

Selling, general and administrative costs decreased by \$1.6 million and \$2.0 million for the three and nine months ended July 31, 2011, respectively, compared to the same 2010 periods. The decrease in the three and six months expense is primarily due to a \$1.0 million expense in 2010 associated with the discontinuation of a new Microsoft Dynamics AX enterprise resource planning system for the segment and to a lesser extent a decrease in variable pay incentives associated with a lower level of earnings. Additionally, the decrease in year-to-date expense was due to \$1.1 million of environmental reserve expense in fiscal 2010.

Operating income decreased at the Aluminum Sheet Products segment for the three and nine months ended July 31, 2011, compared to prior year due to lower shipped pounds. Operating income was further impacted by high repair and maintenance expenses and to a lesser extent by higher energy costs and higher freight costs. Repair and maintenance expense for the nine months ended July 31, 2011 increased by \$3.1 million over the same 2010 period in part due to projects that were previously deferred in prior years. The Company believes that repairs and maintenance will not remain at the 2011 levels, and expects future repair and maintenance expenditures to be more in line with 2010. This decline in operating income was partially offset by an increase in

<sup>1</sup> Exclusive of items shown separately below.

**Table of Contents**

spread (sales price less material costs). Third quarter and year-to-date fiscal 2011 spreads increased by 12.8% and 8.2% over the same 2010 periods, respectively. Spread for the third quarter of fiscal 2011 increased 4.0% from the sequential second quarter of fiscal 2011. The higher spread compared to the previous year was generally a result of higher aluminum prices that rose faster than material costs. The segment's operating income and margins are impacted by changes in LME aluminum prices as its spread is correlated with aluminum prices over time. Declines in aluminum prices generally result in spread compression; however, as aluminum prices rebound, spread and profits generally expand. Aluminum prices have drifted down since July 31, 2011, potentially putting some pressure on margins if there is not a corresponding decline in scrap costs.

*Corporate and Other*

	Three Months Ended July 31,				Nine Months Ended July 31,			
	2011	2010	Change	%	2011	2010	Change	%
	(Dollars in millions)							
Net sales	\$ (3.8)	\$ (4.1)	\$ 0.3	(7.3)	\$ (9.6)	\$ (9.5)	\$ (0.1)	1.1
Cost of sales <sup>1</sup>	(1.6)	(3.0)	1.4	(46.7)	(5.2)	(6.9)	1.7	(24.6)
Selling, general and administrative	4.7	4.7			20.3	16.3	4.0	24.5
Depreciation and amortization					0.1	0.1		
Operating income (loss)	\$ (6.9)	\$ (5.8)	\$ (1.1)	19.0	\$ (24.8)	\$ (19.0)	\$ (5.8)	30.5

Corporate and Other operating expenses, which are not in the segments mentioned above, include intersegment eliminations, the consolidated LIFO inventory adjustments (calculated on a combined pool basis), if any, and corporate office expenses. Net sales amounts represent intersegment eliminations between the Engineered Products segment and the Aluminum Sheet Products segment with an equal and offsetting elimination in Cost of sales. Included in Cost of sales for the three and nine months ended July 31, 2011 was \$1.8 million and \$3.8 million of LIFO expense, respectively, compared to \$1.0 million and \$2.3 million of LIFO expense for the same 2010 periods. LIFO related expense/income is derived from management's estimate of year-end inventory volume and pricing. Management is currently estimating that aluminum scrap values held by the Company will be higher at October 31, 2011 compared to October 31, 2010. Accordingly, 75% of the projected 2011 year-end LIFO adjustment was recorded during the nine months ended July 31, 2011. Management updates this estimate each quarter in an effort to determine what amount, if any, should be recorded in the period. The actual adjustment is trued-up in the fourth quarter once the year-end volume levels and pricing are known.

Selling, general and administrative costs was flat for the three months ended July 31, 2011 and increased by \$4.0 million for the nine months ended July 31, 2011. The single largest reason for the increase is the transaction and integration related costs associated with the acquisition of Edgetech of \$1.2 million and \$3.4 million during the three and nine months ended July 31, 2011, respectively. While the transaction closed in March 2011, the Company expects to incur additional related costs as it conducts integration activities. Also increasing Selling, general and administrative costs are those costs associated with the development and rollout of a company-wide ERP system. The Company initiated this ERP project (Project Quest) in March 2011 to support the drive for long-term organic growth by bringing the myriad of disparate systems currently existing throughout the Company together into a single standard system supported by a common set of processes. During the three and nine months ended July 31, 2011, the Company recognized \$0.3 million and \$0.9 million, respectively, of Project Quest expense. The current plan anticipates the conversion of all of the Company's disparate systems to a single system over a period of at least three years. Selling, general and administrative costs in 2011 also reflect various other programs including lean six sigma employee training that the Company believes will result in future cost savings. Partially offsetting these increases was a \$0.9 million and \$1.2 million decline during the three and nine months July 31, 2011, respectively, in mark-to-market expense associated with the deferred compensation plan.

<sup>1</sup> Exclusive of items shown separately below.

**Table of Contents**

reflecting the decrease in the Company's stock price as well as the market value of other investments held by the deferred compensation plan during the 2011 period. Approximately 48% of the deferred compensation plan balance is indexed to the Company's stock price, and the Quanex stock price decreased by \$2.35 per share through July of fiscal 2011 compared to an increase of \$2.72 per share through July of fiscal 2010. Additionally, Selling, general and administrative costs have declined in 2011 from lower estimated variable pay incentive costs corresponding to the Company's lower earnings.

*Other items*

Other, net typically includes interest income earned on the Company's cash and equivalents and beginning with the acquisition of Edgetech in April 2011 foreign currency transaction gains and losses. Other income decreased by \$1.3 million and \$2.4 million during the three and nine months ended July 31, 2011 compared to the respective 2010 periods. The quarter and year-to-date July 2011 results include foreign currency transaction losses of \$0.4 million and \$0.2 million, respectively. The quarter and year-to-date July 2010 results include the recognition of a \$0.9 million gain on involuntary conversion of a non-monetary asset related to the May 2009 tornado that struck and damaged the Company's Mikron facility in Richmond, Kentucky. Additionally, the nine months ended July 31, 2010 includes a \$1.3 million bargain purchase gain related to an acquisition during the second fiscal quarter of 2010.

The Company's estimated annual effective tax rate for the three and nine months ended July 31, 2011 is 36.6% and 35.2%, respectively, compared to 39.0% and 38.6% for the three and nine months ended July 31, 2010. The decline in the 2011 nine months effective rate is primarily due to additional benefit from the manufacturer's deduction and the R&D credit.

*Outlook*

Stagnant home construction and R&R activity, high levels of homes available for sale, high unemployment and a tight credit market continues to create a difficult business environment for Quanex. A case for a lack of recovery in the housing market in 2012 continues to build, and the Company now anticipates flat to reduced customer demand in the coming quarters. In light of these new expectations, 2011 segment guidance has been reduced at the Aluminum Sheet Products Group.

For 2011, operating income guidance for the Aluminum Sheet Products Group is estimated at about \$22 million, compared to previous guidance of about \$25 million. The Group earned \$30 million in 2010. Operating income in 2011 is down from 2010 due to reduced mill-finished shipments, reduced painted shipments and higher costs, offset somewhat by a higher spread.

For 2011, operating income guidance for the Engineered Products Group is unchanged at about \$30 million (excludes an estimated \$2 million from Edgetech's results). The Group earned \$34 million in 2010. Operating income in 2011 is down from 2010 due to expenses associated with the group's long term growth initiatives, and higher raw material costs.

Segment guidance excludes certain 2011 expenses that are detailed in the table below:

	Quaenx (excluding Edgetech)	Acquisition Related Items (in millions)	Total Quanex
Corporate expenses	\$ 24	\$ 4	\$ 28
LIFO charge (income)	\$ 5	\$	\$ 5
Capital expenditures	\$ 25	\$ 2	\$ 27

---

## **Table of Contents**

Corporate expenses and capital expenditures include \$2 million and \$6 million, respectively, of costs associated with the launch of Quanex's \$30 million, multi-year ERP program.

### **Liquidity and Capital Resources**

The Company's principal sources of funds are cash on hand, cash flow from operations, and borrowings under its \$270.0 million Senior Unsecured Revolving Credit Facility (the Credit Facility). As of July 31, 2011, the Company has a solid liquidity position, comprised of cash and equivalents and adequate availability under the Company's Credit Facility. The Company has \$62.4 million of cash and equivalents, \$204.0 million of current availability under the revolving credit facility and minimal debt of \$1.7 million as of July 31, 2011. The Company grew its cash and equivalents balance steadily since its spin-off from Quanex Corporation in April 2008, throughout 2009 and 2010 from \$40.5 million as of April 30, 2008 to \$123.5 million at October 31, 2009 and to \$187.2 million at October 31, 2010. In a very weak year, Quanex was able to grow its cash balance in 2010 ending the year with \$187.2 million, a \$63.7 million increase over 2009. Cash equivalents during the nine months ended July 31, 2011 was reduced primarily due to \$110.8 million of cash paid (net of cash acquired) for the acquisition of Edgetech and JELD-WEN's vinyl extrusion assets in Yakima, Washington (Yakima). The Company's strategy for cash uses is to make strategic acquisitions that fit its fenestration vision, invest in organic growth opportunities, fund the cash dividend and make ongoing purchases of Quanex stock.

The Company's excess cash and equivalents are invested only in large, overnight money market funds due to the conditions of the financial market. The funds are diversified by security type across Treasuries, Government Agencies and Prime Corporate. These funds are all AAA-rated, approved by the NAIC and compliant with Rule 2A-7 of the Investment Company Act of 1940. The Company's current investments are diversified across multiple institutions that the Company believes to be financially sound. The Company intends to remain in 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, the Company may temporarily move funds into operating bank accounts of highly-rated financial institutions to meet on-going operational liquidity requirements. The Company had no material losses on its cash and marketable securities investments.

The Credit Facility was executed on April 23, 2008 and has a five-year term. Proceeds from the Credit Facility may be used to provide availability for acquisitions, working capital, capital expenditures, and general corporate purposes. Borrowings under the Credit Facility bear interest at a spread above LIBOR based on a combined leverage and ratings grid. There are certain limitations on additional indebtedness, asset or equity sales, and acquisitions. Dividends and other distributions are permitted so long as after giving effect to such dividend or stock repurchase, there is no event of default. Under the Credit Facility, the Company is obligated to comply with certain financial covenants requiring the Company to maintain a Consolidated Leverage Ratio of no more than 3.25 to 1 and a Consolidated Interest Coverage Ratio of no less than 3.00 to 1. As defined by the indenture, the Consolidated Leverage Ratio is the ratio of consolidated indebtedness as of such date to consolidated EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) for the previous four fiscal quarters, and the Consolidated Interest Coverage Ratio is the ratio of consolidated EBITDA to consolidated interest expense, in each case for the previous four consecutive fiscal quarters. EBITDA is defined by the indenture to include proforma EBITDA of acquisitions and to exclude certain items like goodwill and intangible asset impairments and certain other non-cash charges and non-recurring items. The availability under the Credit Facility is a function of both the facility amount utilized and meeting covenant requirements. Additionally, the availability of the Credit Facility is dependent upon the financial viability of the Company's lenders. The Credit Facility is funded by a syndicate of nine banks, with three banks comprising over 55% of the commitment. If any of the banks in the syndicate were unable to perform on their commitments to fund the facility, the availability under the Credit Facility could be reduced; however, the Company has no reason to believe that such liquidity will be unavailable or decreased.

**Table of Contents**

As of July 31, 2011, the Company had no borrowings under the Credit Facility, and the Company was in compliance with all Credit Facility covenants as seen by the table below:

<b>At July 31, 2011</b>	<b>Required</b>	<b>Actual</b>
Consolidated Interest Coverage Ratio	No less than 3.00 to 1	145.54 to 1
Consolidated Leverage Ratio	No more than 3.25 to 1	0.12 to 1

Although there were no borrowings on the Credit Facility and only \$5.2 million of outstanding letters of credit under the Credit Facility, the aggregate availability under the Credit Facility was limited by the Consolidated Leverage Ratio resulting in an availability of \$204.0 million at July 31, 2011. Because the Consolidated Leverage Ratio is based on a rolling twelve months of EBITDA, a change in future earnings will impact the amount available under the Credit Facility in future quarters, absent any pro-forma EBITDA benefit from any potential acquisitions. To have access to the full availability of the \$270.0 million Credit Facility, the Company must have a minimum rolling EBITDA of approximately \$84 million for the previous four fiscal quarters. Actual rolling EBITDA for the previous four fiscal quarters was \$65.2 million as of July 31, 2011. Increased earnings for any future periods could increase availability under the Credit Facility; conversely, reduced earnings for any future periods could adversely impact the amount available under the Credit Facility in future quarters, absent any pro-forma EBITDA benefit from any potential acquisitions.

The Company believes that it has sufficient funds and adequate financial resources available to meet its anticipated liquidity needs. The Company also believes that cash balances and cash flow from operations will be sufficient in the next twelve months and foreseeable future to finance anticipated working capital requirements, capital expenditures, debt service requirements, environmental expenditures, and dividends.

The Company's working capital was \$137.1 million on July 31, 2011 compared to \$223.8 million on October 31, 2010. Working capital declined by \$86.7 million from the impact of the acquisitions of Edgetech and Yakima, of which \$110.8 million represents the cash paid for these acquisitions (net of cash acquired). Partially offsetting this decline was a \$16.8 million increase in conversion capital (accounts receivable plus inventory less accounts payable) during the nine months ended July 31, 2011. Conversion capital increased primarily due to an increase in inventory reflecting a rise in raw material costs and an increase in levels of raw materials and finished goods held. The Company increased inventory levels partly to enhance customer service.

The following table summarizes the Company's cash flow results from continuing operations for the nine months ended July 31, 2011 and 2010:

	<b>July 31,</b>	
	<b>2011</b>	<b>2010</b>
	<b>(In millions)</b>	
Cash flows from operating activities	\$ 9.9	\$ 64.2
Cash flows from investing activities	\$ (127.1)	\$ (12.9)
Cash flows from financing activities	\$ (7.6)	\$ (6.0)

Highlights from the Company's cash flow results for the nine months ended July 31, 2011 and 2010 are as follows:

*Operating Activities – Continuing Operations*

Cash provided by operating activities from continuing operations for the first nine months of fiscal 2011 compared to the same period last year declined by \$54.3 million. This decline is primarily attributable to reduced income and an increase in conversion capital during the nine months ended July 31, 2011 compared to the same 2010 period. Conversion capital during the nine months ended July 2011 used \$17.6 million of cash (compared to a \$3.8 million source of cash in the same 2010 period) primarily attributable to an increase in inventory from a



---

**Table of Contents**

rise in raw material costs and increases in raw and finished goods on hand. The Company increased inventory levels partly to enhance customer service. Additionally, during the nine months ended July 31, 2010, the Company received a federal income tax refund of \$11.4 million; the Company did not receive a tax refund in 2011. Quanex expects to remit an estimated \$3.5 million in fiscal 2011 relating to reorganization taxes assumed in the Edgetech acquisition, of which \$2.8 million was remitted in third quarter. Despite the winding down of the building and construction season coupled with the continued overall weak condition of the end markets, the Company expects to generate additional operating cash flow during the balance of fiscal 2011.

*Investing Activities   Continuing Operations*

Cash spending from investing activities from continuing operations during the nine months ended July 31, 2011, increased \$114.2 million compared to spending during the same prior year period. The increase in investing cash spending is attributable to the Company's acquisition activity during the second fiscal quarter of 2011. On March 31, 2011, the Company used \$104.4 million in an all cash transaction (net of cash acquired) to acquire Edgetech. Edgetech is headquartered in Cambridge, Ohio, and has three manufacturing facilities (U.S., U.K. and Germany) that produce and market a full line of insulating glass spacer systems for window and door customers in North America and abroad. In March, 2011, the Company also acquired JELD-WEN's vinyl extrusion assets in Yakima, Washington (integrated into one of its existing Engineered Products businesses) for \$6.4 million in cash consideration. This acquisition was effected through an asset purchase of vinyl extrusion related equipment and certain other assets. During the first nine months of fiscal 2010, the Company spent approximately \$1.6 million on a small acquisition. The Company remains interested in acquisitions that fit its fenestration vision.

Capital expenditures increased by \$5.2 million during the nine months ended July 31, 2011 compared to spending during the same prior year period. In the first nine months of fiscal 2011, the Company incurred \$2.7 million associated with the rollout of its company-wide ERP system (Project Quest) initiated in March 2011. The current plan anticipates the conversion of all of the Company's disparate systems to a single system over a period of at least three years. The Company expects 2011 capital expenditures to approximate \$27.0 million, including approximately \$2.0 million associated with Edgetech and \$6.0 million associated with Project Quest. The increase in spending from prior year levels relate to Project Quest, Edgetech and organic growth initiatives including capital to support new product development as well as spending on previously deferred projects. At July 31, 2011, the Company had commitments of approximately \$7.1 million for the purchase or construction of capital assets. The Company plans to fund these capital expenditures through cash flow from operations.

*Financing Activities   Continuing Operations*

The Company used \$7.6 million for financing activities from continuing operations during the nine months ended July 31, 2011, compared to \$6.0 million in the same prior year period. The \$1.6 million increase in cash spending from financing activities was primarily the result of the Company's stock repurchase program and to a lesser extent an increase in the cash dividend in mid fiscal 2010. This increase in spending was partially offset by more proceeds from stock option exercises of \$0.6 million. The Board of Directors approved a stock repurchase program of 1.0 million shares in May 2010, and authorized an additional 1.0 million shares to the program in August 2011. During the nine months ended July 31, 2011, the Company purchased 256,249 shares of common stock at a cost of \$4.3 million compared to 125,000 shares at a cost of \$2.2 million in during the nine months ended July 31, 2010. From August 1, 2011 through August 29, 2011, the Company purchased an additional 239,050 shares, and if the Quanex stock price remains around its current range, the Company expects to continue to be buyers. In the first nine months of fiscal 2011 and 2010, the Company paid quarterly dividends of \$0.12 per common share and \$0.10 per common share, respectively, with shares outstanding remaining relatively flat. The Company increased its quarterly cash dividend in May 2010 by 33% to \$0.04 per share from \$0.03 per share.

## **Table of Contents**

### *Discontinued Operations*

Cash flows from discontinued operations represent results related to the Company's start-up facility in China that was closed in fiscal year 2010. Residual 2011 cash flows represent wind-up activities, including repayment by the China facility (discontinued cash outflow) to its Quanex parent (offsetting financing cash inflow in continuing operations).

### **Critical Accounting Estimates**

In preparing the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, the Company's management must make decisions which impact the reported amounts and the related disclosures. Such decisions include the selection of the appropriate accounting principles to be applied and assumptions on which to base estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to revenue recognition, allowances for doubtful accounts, inventory, long-lived assets, environmental contingencies, insurance, U.S. pension and other post-employment benefits, litigation and contingent liabilities, warranty obligations and income taxes. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The Company's management believes the critical accounting estimates listed and described in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations of the Company's 2010 Annual Report on Form 10-K are the most important to the fair presentation of the Company's financial condition and results. These policies require management's significant judgments and estimates in the preparation of the Company's consolidated financial statements. There have been no significant changes to the Company's critical accounting estimates since October 31, 2010.

### **New Accounting Pronouncements**

In December 2010, the Financial Accounting Standards Board (FASB) issued ASC Topic No. 2010-29 *Business Combinations (ASC Topic 805) Disclosure of Supplementary Pro Forma Information for Business Combinations* which amended ASC Topic 805 Business Combinations to specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination that occurred during the year had occurred as of the beginning of the comparable prior annual reporting period only. The ASC also expands the supplemental pro forma disclosures under ASC Topic 805 to include a description of the nature and the amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The ASC is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010 (November 1, 2011 for the Company). Early adoption is permitted. The Company has disclosed information in accordance with this ASC effective March 31, 2011.

In June 2011, the FASB issued Accounting Standards Update No. 2011-05 (ASU 2011-05), *Presentation of Comprehensive Income*. This amendment will require companies to present the components of net income and other comprehensive income either as one continuous statement or as two consecutive statements. It eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The amended guidance, which must be applied retroactively, is effective for interim and annual periods beginning after December 15, 2011, with earlier adoption permitted. ASU 2011-05 impacts presentation only and will have no effect on the Company's financial condition, results of operations or cash flows.

---

**Table of Contents****Item 3. Quantitative and Qualitative Disclosures About Market Risk**

The following discussion of the Company and its subsidiaries' exposure to various market risks contains forward looking statements that involve risks and uncertainties. These projected results have been prepared utilizing certain assumptions considered reasonable in light of information currently available to the Company. Nevertheless, because of the inherent unpredictability of interest rates, foreign currency rates and metal commodity prices as well as other factors, actual results could differ materially from those projected in such forward looking information. The Company does not use derivative financial instruments for speculative or trading purposes.

**Interest Rate Risk**

The Company and its subsidiaries have a Credit Facility and other long-term debt which subject the Company to the risk of loss associated with movements in market interest rates.

At July 31, 2011, the Company had fixed-rate debt totaling \$0.2 million or 10% of total debt, which does not expose the Company to the risk of earnings loss due to changes in market interest rates. The Company and certain of its subsidiaries' floating-rate obligations totaled \$1.5 million, or 90% of total debt at July 31, 2011. Based on the floating-rate obligations outstanding at July 31, 2011, a one percent increase or decrease in the average interest rate would result in a change to pre-tax interest expense of approximately \$15 thousand.

**Commodity Price Risk**

Within the Aluminum Sheet Products segment, the Company uses various grades of aluminum scrap as well as minimal amounts of prime aluminum ingot as raw materials for its manufacturing processes. The price of this raw material is subject to fluctuations due to many factors in the aluminum market. In the normal course of business, Nichols Aluminum enters into firm price sales commitments with its customers. In an effort to reduce the risk of fluctuating raw material prices, Nichols Aluminum enters into firm price raw material purchase commitments (which are designated as normal purchases under ASC Topic 815 *Derivatives and Hedging* (ASC 815)) as well as option contracts on the London Metal Exchange (LME). The Company's risk management policy as it relates to these LME contracts is to enter into contracts to cover the raw material needs of the Company's committed sales orders, to the extent not covered by fixed price purchase commitments.

Nichols Aluminum maintains a balanced metals book position which excludes a normal operational inventory level. This operating inventory level as a matter of practice is currently not hedged against material price (LME) movements. This practice reflects that over the commodity price cycle, no gain or loss is incurred on this inventory. Through the use of firm price raw material purchase commitments and LME contracts, the Company intends to protect cost of sales from the effects of changing prices of aluminum. To the extent that the raw material costs factored into the firm price sales commitments are matched with firm price raw material purchase commitments, changes in aluminum prices should have no effect. During fiscal 2011 and 2010, the Company primarily relied upon firm price raw material purchase commitments to protect cost of sales tied to firm price sales commitments. At July 31, 2011, there were 23 open LME forward contracts associated with metal exchange derivatives covering notional volumes of 1.3 million pounds with a fair value mark-to-market net gain of approximately \$0.1 million. At July 31, 2011 there were no open LME short sale contracts associated with metal exchange derivatives. These contracts were not designated as hedging instruments, and any mark-to-market net gain or loss was recorded in Cost of sales with the offsetting amount reflected as a current asset or liability on the balance sheet. At October 31, 2010, there were 22 open LME forward contracts associated with metal exchange derivatives covering notional volumes of 1.2 million pounds with a fair value mark-to-market net gain of approximately \$0.2 million. In addition, at October 31, 2010, there were 116 open LME short sale contracts associated with metal exchange derivatives covering notional volumes of 6.4 million pounds with a fair value mark-to-market net loss of approximately \$0.4 million.

## **Table of Contents**

Within the Engineered Products segment, polyvinyl resin (PVC) is the significant raw material consumed during the manufacture of vinyl extrusions. The Company has a monthly resin adjuster in place with the majority of its customers and resin supplier that is adjusted based upon published industry resin prices for the prior month. This adjuster effectively shares the base pass-through price changes of PVC with the Company's customers commensurate with the market at large. The Company's long-term exposure to changes in PVC prices is thus significantly reduced due to the contractual component of the resin adjuster program; however, there is a level of exposure to short-term volatility due to the one month lag.

Effective May 1, 2011, one of the Company's warm edge, insulating glass spacer divisions initiated an oil-based materials surcharge. The surcharge helps offset the rising cost of butyl and other oil-based raw materials, pricing of which are highly correlated to the price of oil. The surcharge is in place with the majority of its customers and is adjusted monthly based upon the 90 day average published price for Brent crude. The oil-based raw materials purchased by the company are subject to similar pricing schemes. Therefore, the Company's long-term exposure to changes in oil-based raw materials prices is significantly reduced due to the contractual component of the surcharge program.

### ***Item 4. Controls and Procedures***

#### **Evaluation of Disclosure Controls and Procedures**

Under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, the Company has evaluated the effectiveness of its disclosure controls and procedures pursuant to Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (1934 Act) as of July 31, 2011. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of July 31, 2011, the disclosure controls and procedures are effective.

#### **Changes in Internal Control over Financial Reporting**

As a result of the acquisition of Edgetech on March 31, 2011, certain information included in the Company's consolidated financial statements for the quarter ended July 31, 2011, was obtained from accounting and information systems utilized by Edgetech that have not yet been fully integrated in the Company's systems and procedures. In connection with the integration, the Company implemented certain compensating manual procedures and controls at Edgetech to ensure the effectiveness of the Company's internal control over financial reporting.

There have been no other 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 the Company's internal control over financial reporting.

**Table of Contents****PART II. OTHER INFORMATION****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

On May 27, 2010, the Board of Directors approved a stock repurchase program that authorized the repurchase of 1.0 million shares of the Company's common stock, and on August 25, 2011, the Board of Directors authorized an additional 1.0 million shares to the program. Set forth below is a table summarizing the program and the repurchase of shares during the quarter ended July 31, 2011.

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs <sup>(1)</sup>	(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs <sup>(1)</sup>
May 1, 2011 thru May 31, 2011		\$		663,351
June 1, 2011 thru June 30, 2011 <sup>(2)</sup>	72,508	\$ 16.48	69,600	593,751
July 1, 2011 thru July 31, 2011 <sup>(2)</sup>	117,618	\$ 16.40	100,000	493,751
<b>Total</b>	190,126	\$ 16.43	169,600	493,751

<sup>(1)</sup> On May 27, 2010, the Board of Directors approved a stock repurchase program of 1.0 million shares, and on August 25, 2011, the Board of Directors authorized an additional 1.0 million shares to the program. The table above reflects the original May 2010 shares authorized and activity through July 31, 2011. From August 1, 2011 through August 29, 2011, the Company purchased 239,050 shares at an average price of \$12.21 per share; the remaining shares that may be purchased on the program is 1,254,701 as of August 29, 2011. The program does not have a dollar limit or an expiration date.

<sup>(2)</sup> In June and July 2011, shares of 2,908 and 17,618, respectively, were surrendered to the Company by employees to satisfy individual tax withholding obligations upon vesting of previously issued shares of restricted stock awards. Average price paid per share reflects the closing price of Quanex stock on the business day the shares were surrendered by the employee stockholder to satisfy individual tax withholding.

**Table of Contents**

**Item 6. Exhibits**

<b>Exhibit Number</b>	<b>Description of Exhibits</b>
3.1	Certificate of Incorporation of the Registrant dated as of December 12, 2007, filed as Exhibit 3.1 of the Registrant's Registration Statement on Form 10 (Reg. No. 001-33913) as filed with the Securities and Exchange Commission on January 11, 2008, and incorporated herein by reference.
3.2	Amended and Restated Bylaws of the Registrant dated as of August 25, 2011, filed as Exhibit 3.1 of the Registrant's Current Report on Form 8-K (Reg. No. 001-33913) filed with the Securities and Exchange Commission on August 29, 2011, 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 April 23, 2008, among the Company, certain of its subsidiaries as guarantors, Wells Fargo Bank, National Association, in its capacity as administrative agent, and certain lender parties, filed as Exhibit 10.1 of the Registrant's Current Report on Form 8-K (Reg. No. 001-33913) dated April 23, 2008, 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.

\* 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.

**Table of Contents**

**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**

/s/ Brent L. Korb  
Brent L. Korb  
Senior Vice President Finance and Chief Financial Officer

Date: August 30, 2011

(Principal Financial Officer)

Page 40

---

**Table of Contents**

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description of Exhibits</b>
3.1	Certificate of Incorporation of the Registrant dated as of December 12, 2007, filed as Exhibit 3.1 of the Registrant's Registration Statement on Form 10 (Reg. No. 001-33913) as filed with the Securities and Exchange Commission on January 11, 2008, and incorporated herein by reference.
3.2	Amended and Restated Bylaws of the Registrant dated as of August 25, 2011, filed as Exhibit 3.1 of the Registrant's Current Report on Form 8-K (Reg. No. 001-33913) filed with the Securities and Exchange Commission on August 29, 2011, 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 April 23, 2008, among the Company, certain of its subsidiaries as guarantors, Wells Fargo Bank, National Association, in its capacity as administrative agent, and certain lender parties, filed as Exhibit 10.1 of the Registrant's Current Report on Form 8-K (Reg. No. 001-33913) dated April 23, 2008, 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.

\* Filed herewith