

Edgar Filing: AZZ INC - Form 10-Q

AZZ INC  
Form 10-Q  
January 08, 2019  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended November 30, 2018

OR

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

Commission file number 1-12777

AZZ Inc.

(Exact name of registrant as specified in its charter)

TEXAS

(State or other jurisdiction of incorporation or organization)

75-0948250

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

One Museum Place, Suite 500

3100 West 7th Street

Fort Worth, Texas 76107

(Address of principal executive offices, including zip code)

(817) 810-0095

(Registrant's telephone number, including area code)

NONE

(Former name, former address and former fiscal year, if changed since last report)

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 (§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, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Smaller reporting company  Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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

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Title of each class:	Outstanding at November 30, 2018:
Common Stock, \$1.00 par value per share	26,087,191

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## AZZ INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

(Unaudited)

	November 30, 2018	February 28, 2018
Assets		
Current assets:		
Cash and cash equivalents	\$ 17,413	\$ 20,853
Accounts receivable (net of allowance for doubtful accounts of \$2,348 as of November 30, 2018 and \$569 as of February 28, 2018)	159,395	141,488
Inventories:		
Raw material	100,594	98,475
Work-in-process	1,694	2,544
Finished goods	12,688	9,742
Contract assets	70,419	51,787
Prepaid expenses and other	5,171	4,265
Total current assets	367,374	329,154
Property, plant and equipment, net	207,090	216,855
Goodwill	323,541	321,307
Intangibles and other assets, net	134,374	160,893
Total assets	\$ 1,032,379	\$ 1,028,209
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$ 45,072	\$ 54,162
Income tax payable	3,120	144
Accrued salaries and wages	22,606	19,011
Other accrued liabilities	23,532	19,622
Customer deposits	741	1,816
Contract liabilities	32,744	22,698
Debt due within one year	—	14,286
Total current liabilities	127,815	131,739
Debt due after one year, net	272,712	286,609
Other long-term liabilities	1,564	11,696
Deferred income taxes	34,410	32,962
Total liabilities	436,501	463,006
Commitments and contingencies		
Shareholders' equity:		
Common stock, \$1 par, shares authorized 100,000; 26,087 shares issued and outstanding at November 30, 2018 and 25,959 shares issued and outstanding at February 28, 2018	26,087	25,959
Capital in excess of par value	43,944	38,446
Retained earnings	555,096	526,018
Accumulated other comprehensive loss	(29,249	) (25,220 )
Total shareholders' equity	595,878	565,203
Total liabilities and shareholders' equity	\$ 1,032,379	\$ 1,028,209

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



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AZZ INC.

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME (LOSS)

(In thousands, except per share data)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	November 30,		November 30,	
	2018	2017	2018	2017
Net sales	\$239,516	\$208,158	\$724,539	\$609,770
Cost of sales	189,761	177,041	569,175	487,471
Gross margin	49,755	31,117	155,364	122,299
Selling, general and administrative	26,986	29,563	91,794	83,335
Operating income	22,769	1,554	63,570	38,964
Interest expense	3,723	3,507	11,541	10,267
Other (income) expense, net	309	15	(839)	) 90
Income (loss) before income taxes	18,737	(1,968)	) 52,868	28,607
Income tax expense (benefit)	3,342	(1,802)	) 10,511	6,925
Net income (loss)	\$15,395	\$(166)	) \$42,357	\$21,682
Earnings (loss) per common share				
Basic earnings (loss) per share	\$0.59	\$(0.01)	) \$1.63	\$0.83
Diluted earnings (loss) per share	\$0.59	\$(0.01)	) \$1.62	\$0.83
Cash dividends declared per common share	\$0.17	\$0.17	\$0.51	\$0.51

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

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AZZ INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands)

(Unaudited)

	Three Months Ended November 30, 2018		Nine Months Ended November 30, 2018	
	2017		2017	
Net income (loss)	\$15,395	\$(166 )	\$42,357	\$21,682
Other comprehensive income (loss):				
Foreign currency translation adjustments, net of income tax of \$0	(2,187 )	(1,453 )	(3,988 )	2,876
Interest rate swap, net of income tax of \$7, \$7, \$22 and \$22, respectively.	(14 )	(13 )	(41 )	(41 )
Other comprehensive income (loss)	(2,201 )	(1,466 )	(4,029 )	2,835
Comprehensive income (loss)	\$13,194	\$(1,632)	\$38,328	\$24,517

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

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AZZ INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended November 30,	
	2018	2017
<b>Cash Flows From Operating Activities</b>		
Net income	\$42,357	\$21,682
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for doubtful accounts	2,039	2,940
Amortization and depreciation	38,068	37,840
Deferred income taxes	1,533	2,362
Net loss on property, plant and equipment due to impairment	810	8,285
Net loss (gain) on sale of property, plant and equipment	(191 )	576
Amortization of deferred borrowing costs	407	450
Share-based compensation expense	3,335	4,810
Effects of changes in assets and liabilities:		
Accounts receivable	(13,955 )	(15,754 )
Inventories	1,564	(11,744 )
Prepaid expenses and other	(953 )	(2,518 )
Other assets	(1,006 )	(57 )
Net change in contract assets and liabilities	(9,496 )	4,896
Accounts payable	(8,037 )	(5,867 )
Other accrued liabilities and income taxes payable	3,920	(9,191 )
Net cash provided by operating activities	60,395	38,710
<b>Cash Flows From Investing Activities</b>		
Proceeds from sale of property, plant and equipment	362	200
Purchase of property, plant and equipment	(13,691 )	(21,533 )
Acquisition of subsidiaries, net of cash acquired	(8,000 )	(32,841 )
Net cash used in investing activities	(21,329 )	(54,174 )
<b>Cash Flows From Financing Activities</b>		
Proceeds from revolving loan	212,000	273,000
Payments on revolving loan	(226,000)	(174,500)
Payments on long term debt	(14,286 )	(63,505 )
Purchases of treasury shares	—	(7,518 )
Payments of dividends	(13,279 )	(13,266 )
Net cash provided by (used in) financing activities	(41,565 )	14,211
Effect of exchange rate changes on cash	(941 )	602
Net decrease in cash and cash equivalents	(3,440 )	(651 )
Cash and cash equivalents at beginning of period	20,853	11,302
Cash and cash equivalents at end of period	\$17,413	\$10,651
<b>Supplemental disclosures</b>		
Cash paid for interest	\$9,957	\$8,948
Cash paid for income taxes	\$2,398	\$8,416

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





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AZZ INC.

## CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(In thousands)

(Unaudited)

	Nine Months Ended November 30, 2018					
	Common Stock		Capital	Retained	Accumulated	Total
	Shares	Amount	in Excess of Par Value	Earnings	Other Comprehensive Loss	
Balance at February 28, 2018	25,959	\$25,959	\$38,446	\$526,018	\$ (25,220 )	\$565,203
Share-based compensation	—	—	1,358	—	—	1,358
Restricted stock units	30	30	(549 )	—	—	(519 )
Stock issued for SARs	1	1	—	—	—	1
Employee stock purchase plan	37	37	1,290	—	—	1,327
Cash dividends paid	—	—	—	(4,418 )	—	(4,418 )
Net income	—	—	—	15,718	—	15,718
Foreign currency translation	—	—	—	—	(2,256 )	(2,256 )
Interest rate swap	—	—	—	—	(14 )	(14 )
Balance at May 31, 2018	26,027	\$26,027	\$40,545	\$537,318	\$ (27,490 )	\$576,400
Share-based compensation	15	15	2,286	—	—	2,301
Restricted stock units	—	—	(14 )	—	—	(14 )
Stock issued for SARs	8	8	(30 )	—	—	(22 )
Cash dividends paid	—	—	—	(4,426 )	—	(4,426 )
Net income	—	—	—	11,244	—	11,244
Foreign currency translation	—	—	—	—	455	455
Interest rate swap	—	—	—	—	(13 )	(13 )
Balance at August 31, 2018	26,050	\$26,050	\$42,787	\$544,136	\$ (27,048 )	\$585,925
Share-based compensation	—	—	(324 )	—	—	(324 )
Employee stock purchase plan	37	37	1,481	—	—	1,518
Cash dividends paid	—	—	—	(4,435 )	—	(4,435 )
Net income	—	—	—	15,395	—	15,395
Foreign currency translation	—	—	—	—	(2,187 )	(2,187 )
Interest rate swap	—	—	—	—	(14 )	(14 )
Balance at November 30, 2018	26,087	\$26,087	\$43,944	\$555,096	\$ (29,249 )	\$595,878

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

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AZZ INC.

## CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(In thousands)

(Unaudited)

	Nine Months Ended November 30, 2017					
	Common Stock		Capital	Retained	Accumulated	Total
	Shares	Amount	in Excess of Par Value	Earnings	Other Comprehensive Loss	
Balance at February 28, 2017	25,964	\$25,964	\$37,739	\$498,527	\$ (29,094 )	\$533,136
Share-based compensation	—	—	1,194	—	—	1,194
Restricted stock units	42	42	(1,240 )	—	—	(1,198 )
Employee stock purchase plan	35	35	1,597	—	—	1,632
Retirement of treasury shares	(47 )	(47 )	(2,636 )	—	—	(2,683 )
Cash dividends paid	—	—	—	(4,423 )	—	(4,423 )
Net income	—	—	—	12,062	—	12,062
Foreign currency translation	—	—	—	—	(997 )	(997 )
Interest rate swap	—	—	—	—	(14 )	(14 )
Balance at May 31, 2017	25,994	\$25,994	\$36,654	\$506,166	\$ (30,105 )	\$538,709
Share-based compensation	16	16	2,190	—	—	2,206
Stock issued for SARs	1	1	(1 )	—	—	—
Retirement of treasury shares	(50 )	(50 )	(2,452 )	—	—	(2,502 )
Cash dividends paid	—	—	—	(4,422 )	—	(4,422 )
Net income	—	—	—	9,786	—	9,786
Foreign currency translation	—	—	—	—	5,325	5,325
Interest rate swap	—	—	—	—	(13 )	(13 )
Balance at August 31, 2017	25,961	\$25,961	\$36,391	\$511,530	\$ (24,793 )	\$549,089
Share-based compensation	—	—	1,410	—	—	1,410
Restricted stock units	1	1	(19 )	—	—	(18 )
Stock issued for SARs	—	—	(4 )	—	—	(4 )
Employee stock purchase plan	42	42	1,643	—	—	1,685
Retirement of treasury shares	(50 )	(50 )	(2,283 )	—	—	(2,333 )
Cash dividends paid	—	—	—	(4,421 )	—	(4,421 )
Net loss	—	—	—	(166 )	—	(166 )
Foreign currency translation	—	—	—	—	(1,453 )	(1,453 )
Interest rate swap	—	—	—	—	(13 )	(13 )
Balance at November 30, 2017	25,954	\$25,954	\$37,138	\$506,943	\$ (26,259 )	\$543,776

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

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AZZ INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. The Company and Basis of Presentation

AZZ Inc. (“AZZ”, the “Company”, “our” or “we”) was established in 1956 and incorporated under the laws of the state of Texas. The Company is a global provider of metal coating services, welding solutions, specialty electrical equipment and highly engineered services to the power generation, transmission, distribution, refining and industrial markets. The Company has two distinct operating segments: the Energy segment and the Metal Coatings segment. AZZ Energy is dedicated to delivering safe and reliable transmission of power from generation sources to end customers, and automated weld overlay solutions for corrosion and erosion mitigation to critical infrastructure in the energy markets worldwide. AZZ Metal Coatings is a leading provider of metal finishing solutions for corrosion protection, including hot dip galvanizing to the North American steel fabrication industry.

Presentation

The accompanying condensed consolidated balance sheet as of February 28, 2018, which was derived from audited financial statements, and the unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete consolidated financial statements. These financial statements should be read in conjunction with the audited financial statements and related notes for the fiscal year ended February 28, 2018, included in the Company’s Annual Report on Form 10-K covering such period.

Our fiscal year ends on the last day of February and is identified as the fiscal year for the calendar year in which it ends. For example, the fiscal year ended February 28, 2019 is referred to as fiscal 2019.

In the opinion of management, the accompanying unaudited consolidated financial statements include all adjustments, consisting only of normal recurring adjustments, which are necessary to present fairly the financial position of the Company as of November 30, 2018, the results of its operations for the three and nine months ended November 30, 2018 and 2017, and cash flows for the nine months ended November 30, 2018 and 2017. These interim results are not necessarily indicative of results for a full year.

Accounting Standards Recently Adopted

On March 1, 2018, the Company adopted Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers (Topic 606) and the related amendments (“ASC 606”) using the modified retrospective method applied to those contracts which were not completed as of February 28, 2018. Results for operating periods beginning on or after March 1, 2018 are presented under ASC 606, while prior period amounts have not been adjusted and continue to be reported in accordance with the accounting standards in effect for those periods. However, for the three and nine months ended November 30, 2018, the impact of applying ASC 606 as opposed to applying legacy accounting guidance did not result in a significant change to reported revenues or costs of revenues. Accordingly, no reconciliation has been provided to show the difference between applying ASC 606 and legacy guidance for the three and nine months ended November 30, 2018. In addition, there was no cumulative effect adjustment to the beginning retained earnings on March 1, 2018 related to the adoption. See Note 2 for a description of the Company's accounting policy resulting from the adoption of ASC 606.

On March 1, 2018, the Company adopted ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which clarifies the presentation and classification of certain cash receipts and cash payments in the statement of cash flows. The adoption did not have a material impact on the Company's consolidated statements of cash flows.

Recently Issued Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (“FASB”) issued ASU 2016-02, Leases (Topic 842). Under the new guidance, a lessee will be required to recognize assets and liabilities for all leases with lease terms of more than 12 months. Consistent with current GAAP, the recognition, measurement, and presentation of expenses and

cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. The Company expects to early adopt this standard in the fourth quarter of fiscal year 2019, which will be retrospectively applied to the beginning of fiscal year 2019. The standard, as subsequently amended, does not require full retrospective adoption,

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thus periods prior to fiscal year 2019 will not be adjusted and any impacts of transitioning to the new standard will be reflected with a cumulative effect adjustment to the opening balance of retained earnings in the year of adoption. In preparing for the adoption of this standard, the Company is substantially complete in assessing its portfolio of leases for accounting and disclosure purposes. The Company is also progressing with the design of the future lease accounting procedures, policies and related internal controls and with the implementation of lease accounting software. While the Company has not yet completed its evaluation of the financial statement impact of the new lease accounting standard, the Company expects that the adoption will result in a significant increase in assets and liabilities related to operating leases in its consolidated balance sheets. However, the Company does not expect to record a significant cumulative effect adjustment as a result of adopting the standard.

### 2. Summary of Significant Accounting Policies

The Company's significant accounting policies are detailed in Note 1 of its Annual Report on Form 10-K for the year ended February 28, 2018. The following section includes revised accounting policies related to the adoption of ASC 606.

#### Revenue recognition

The Company determines revenue recognition through the following steps:

- 1) Identification of the contract with a customer,
- 2) Identification of the performance obligations in the contract,
- 3) Determination of the transaction price,
- 4) Allocation of the transaction price to performance obligations in the contract, and
- 5) Recognition of revenue when, or as, the Company satisfies a performance obligation

Revenue is recognized when control of the promised goods or services is transferred to the Company's customers, in an amount that reflects the consideration that it expects to be entitled to in exchange for those goods or services. The amount and timing of revenue recognition varies by segment based on the nature of the goods or services provided and the terms and conditions of the customer contract.

#### Energy Segment

AZZ's Energy segment is a provider of specialized products and services designed to support industrial, nuclear and electrical applications. Within this segment, the contract is governed by a customer purchase order and an executed product or services agreement. The contract generally specifies the delivery of what constitutes a single performance obligation consisting of either custom built products, custom services, or off-the-shelf products. When the Company does enter into an arrangement with multiple performance obligations, the transaction price is allocated to each performance obligation based on the relative standalone selling prices of the goods or services being provided to the customer and revenue is recognized upon the satisfaction of each performance obligation. The Company combines contracts for revenue recognition purposes that are executed with the same customer within a short timeframe from each other and that purport to be for a single commercial objective.

For custom built products, the Company recognizes revenues over time provided that the goods do not have an alternative use to the Company and the Company has an unconditional right to payment for work completed to date plus a reasonable margin. For custom services, which consist of specialized welding and other professional services, the Company recognizes revenues over time as the services are rendered due to the fact that the services enhance a customer owned asset. For off-the-shelf products, which consist of tubing and lighting products, the Company recognizes revenue at a point-in-time upon the transfer of the goods to the customer.

For services and custom built products, the Company recognizes revenues over time using a cost-to-cost input measure. This requires the Company to estimate the total contract revenues, costs and margin, which can involve significant management judgment. As a significant change in one or more of these estimates could affect the profitability of the Company's contracts, management reviews and updates its contract related estimates regularly. The Company recognizes adjustments in estimated margin on contracts under a cumulative catch-up basis and subsequent revenues are recognized using the adjusted estimate. If the estimate of contract margin indicates an anticipated loss on the contract, the Company recognizes the total estimated loss in the period it is identified.

Due to the custom nature of the goods and services provided, contracts within the Energy segment are often modified to account for changes in contract specifications and requirements. A contract modification exists when the modification either creates new, or changes the existing, enforceable rights and obligations in the contract. For the Company, most contract modifications are related to goods or services that are not distinct from those in the original contract due to the significant interrelationship or interdependencies between the deliverables. Such modifications are accounted for as if they were part of the original contract. As

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a result, the transaction price and the measure of progress for the performance obligation to which it relates, is recognized as an adjustment to revenue on a cumulative catch-up basis.

In addition to fixed consideration, the Company's contracts within its Energy segment can include variable consideration, including claims, incentive fees, liquidated damages or other penalties. The Company recognizes revenue for variable consideration when it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur. The Company estimates the amount of revenue to be recognized on variable consideration using the expected value or the most likely amount method, whichever is expected to better predict the amount.

**Metal Coatings Segment**

AZZ's Metal Coatings segment is a provider of hot dip galvanizing, powder coating and other metal coating applications to the steel fabrication industry. Within this segment, the contract is governed by a customer purchase order or work order. The contract generally specifies the delivery of what constitutes a single performance obligation consisting of metal coating services. The Company combines contracts for revenue recognition purposes that are executed with the same customer within a short timeframe from each other and that purport to be for a single commercial objective.

The Company recognizes revenue over time as the metal coating is applied to the customer provided material as the process enhances a customer controlled asset. Contract modifications are rare within this segment and most contracts are on a fixed price basis with no variable consideration.

**Contract Assets and Liabilities**

The timing of revenue recognition, billings and cash collections results in accounts receivable, contract assets (unbilled receivables), and contract liabilities (customer advances and deposits) on the consolidated balance sheet, primarily related to the Company's Energy segment. Amounts are billed as work progresses in accordance with agreed upon contractual terms, either at periodic intervals (e.g., weekly or monthly) or upon achievement of contractual milestones. Billing can occur subsequent to revenue recognition, resulting in contract assets. In addition, the Company can receive advances or deposits from its customers, before revenue is recognized, resulting in contract liabilities. These assets and liabilities are reported on the consolidated balance sheet on a contract-by-contract basis at the end of each reporting period.

For the nine months ended November 30, 2018, the Company recognized \$20.1 million of revenues from amounts that were included in contract liabilities at February 28, 2018. The Company did not record any revenues for the three or nine months ended November 30, 2018 related to performance obligations satisfied in prior periods. The Company expects to recognize revenues of approximately \$13.8 million, \$16.1 million, \$1.5 million and \$1.3 million in fiscal 2019, 2020, 2021 and 2022, respectively, related to the \$32.7 million balance of contract liabilities as of November 30, 2018.

The increases or decreases in accounts receivable, contract assets and contract liabilities during the three and nine months ended November 30, 2018 were due primarily to normal timing differences between the Company's performance and customer payments. The Lectrus acquisition described in Note 8 had no impact on contract assets or liabilities as of the date of acquisition.

**Other**

No general rights of return exist for customers and the Company establishes provisions for estimated warranties. The Company generally does not sell extended warranties. Revenue is recognized net of applicable sales and other taxes. The Company does not adjust the contract price for the effects of a significant financing component if the Company expects, at contract inception, that the period between when the Company transfers a good or service to a customer and when the customer pays for that good or service will be one year or less, which is generally the case. Sales commissions are deferred and recognized over the same period as the related revenues. Shipping and handling is treated as a fulfillment obligation instead of a separate performance obligation and such costs are expensed as incurred.



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## Disaggregated Revenue

Revenue by segment and geography is disclosed in Note 5. In addition, the following table presents disaggregated revenue by customer industry (in thousands):

	Three Months Ended November 30,		Nine Months Ended November 30,	
	2018	2017	2018	2017
Net sales:				
Industrial - oil and gas, construction, and general	\$143,710	\$126,976	\$415,323	\$355,895
Transmission and distribution	35,927	45,795	162,033	130,134
Power generation	59,879	35,387	147,183	123,741
Total net sales	\$239,516	\$208,158	\$724,539	\$609,770

## 3. Earnings (Loss) Per Share

Earnings (loss) per share is based on the weighted average number of shares outstanding during each period, adjusted for the dilutive effect of stock awards.

The following table sets forth the computation of basic and diluted earnings (loss) per share (in thousands, except per share data):

	Three Months Ended November 30,		Nine Months Ended November 30,	
	2018	2017	2018	2017
Numerator:				
Net income (loss) for basic and diluted earnings per common share	\$15,395	\$(166)	\$42,357	\$21,682
Denominator:				
Denominator for basic earnings per common share—weighted average shares	26,064	25,965	26,022	25,982
Effect of dilutive securities:				
Employee and director stock awards	87	—	70	67
Denominator for diluted earnings per common share	26,151	25,965	26,092	26,049
Earnings (loss) per share basic and diluted:				
Basic earnings (loss) per common share	\$0.59	\$(0.01)	\$1.63	\$0.83
Diluted earnings (loss) per common share	\$0.59	\$(0.01)	\$1.62	\$0.83

For the three months ended November 30, 2017, approximately 0.1 million shares related to employee and director stock awards were excluded from the diluted shares outstanding count as the effect was anti-dilutive.

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## 4. Share-based Compensation

The Company has one share-based compensation plan, the 2014 Long Term Incentive Plan (the "Plan"). The purpose of the Plan is to promote the growth and prosperity of the Company by permitting the Company to grant to its employees, directors and advisors various types of restricted stock unit awards, performance share units, stock options, and stock appreciation rights to purchase common stock of the Company. The maximum number of shares that may be issued under the Plan is 1,500,000 shares. As of November 30, 2018, the Company had approximately 1,248,775 shares available for future issuance under the Plan.

## Restricted Stock Unit Awards

Restricted stock unit awards are valued at the market price of our common stock on the grant date. Awards generally vest ratably over a period of three years but these awards may vest earlier in accordance with the Plan's accelerated vesting provisions.

A summary of the Company's non-vested restricted stock unit award activity for the nine month period ended November 30, 2018 is as follows:

	Restricted Stock Units	Weighted Average Grant Date Fair Value
Non-vested balance as of February 28, 2018	109,777	\$ 56.62
Granted	84,023	42.01
Vested	(37,670 )	54.63
Forfeited	(7,290 )	55.27
Non-vested balance as of November 30, 2018	148,840	\$ 48.94

## Performance Share Unit Awards

The Company also grants performance share units ("PSU") awards to certain employees. These PSU awards have a three year performance cycle and will vest and become payable, if at all, on the third anniversary of the award date. The PSU awards are subject to the Company's degree of achievement of a target annual average adjusted return on assets during these three-year periods and, in certain circumstances, vesting is based on the relative performance of a predetermined group of peer companies. In addition, these PSU awards may have vesting conditions or certain vesting multipliers, which are based on the Company's total shareholder return during such three-year period in comparison to a defined specific industry peer group. The Company estimates the fair value of PSU awards with performance and service conditions using the value of the Company's common stock on the date of grant. The Company estimates the fair value of PSU awards with market conditions using a Monte Carlo simulation model on the date of grant.

A summary of the Company's non-vested performance share unit award activity for the nine month period ended November 30, 2018 is as follows:

	Performance Stock Units	Weighted Average Grant Date Fair Value
Non-vested balance as of February 28, 2018	70,030	\$ 54.59
Granted	46,183	42.00
Vested	(3,378 )	46.65
Forfeited	(29,710 )	49.51
Non-vested balance as of November 30, 2018	83,125	\$ 49.74

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## Stock Appreciation Rights

Stock appreciation rights are granted with an exercise price equal to the market value of our common stock on the date of grant. These awards generally have a contractual term of 7 years and vest ratably over a period of three years although some may vest immediately on issuance. These awards are valued using the Black-Scholes option-pricing model.

A summary of the Company's stock appreciation rights activity for the nine month period ended November 30, 2018 is as follows:

	SARs	Weighted Average Exercise Price
Outstanding as of February 28, 2018	148,513	\$ 43.29
Granted	—	—
Exercised	(47,484 )	40.84
Forfeited	(2,845 )	43.92
Outstanding as of November 30, 2018	98,184	\$ 44.46
Exercisable as of November 30, 2018	98,184	\$ 44.46

The average remaining contractual term for those stock appreciation rights outstanding and those stock appreciation rights that were exercisable as of November 30, 2018 was 2.09 years, with an aggregate intrinsic value of \$0.3 million.

## Employee Stock Purchase Plan

The Company also has an Employee Stock Purchase Plan, which allows employees of the Company to purchase common stock of the Company through accumulated payroll deductions. Offerings under this plan have a duration of 24 months (the "offering period"). On the first day of an offering period (the "enrollment date") the participant is granted the option to purchase shares on each exercise date at the lower of 85% of the market value of a share of our common stock on the enrollment date or the exercise date. The participant's right to purchase common stock under the plan is restricted to no more than \$25,000 per calendar year and the participant may not purchase more than 5,000 shares during any offering period. Participants may terminate their interest in a given offering or a given exercise period by withdrawing all of their accumulated payroll deductions at any time prior to the end of the offering period. The fair value of the estimated number of shares to be issued under each offering is determined using the Black-Scholes option-pricing model. For the nine month period ended November 30, 2018, the Company issued 73,702 shares under the Company's Employee Stock Purchase Plan.

## Share-based Compensation Expense

Share-based compensation expense and related income tax benefits related to all the plans listed above were as follows (in thousands):

	Nine Months Ended November 30,	
	2018	2017
Compensation expense	\$3,335	\$4,810
Income tax benefits	\$700	\$1,684

Unrecognized compensation cost related to restricted stock units, performance share unit awards, stock appreciation rights, and the Company's Employee Stock Purchase Plan at November 30, 2018 totals \$8.0 million.

The Company's policy is to issue shares required under these plans from the Company's authorized but unissued shares.

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## 5. Segments

## Segment Information

Net sales and operating income by segment for each period were as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	November 30,		November 30,	
	2018	2017	2018	2017
Net sales:				
Energy	\$ 132,025	\$ 107,021	\$ 385,526	\$ 317,526
Metal Coatings	107,491	101,137	339,013	292,244
Total net sales	\$ 239,516	\$ 208,158	\$ 724,539	\$ 609,770
Operating income (loss):				
Energy	\$ 11,532	\$ (12,103 )	\$ 25,763	\$ (3,029 )
Metal Coatings	18,321	21,681	65,581	66,332
Corporate	(7,084 )	(8,024 )	(27,774 )	(24,339 )
Total operating income	\$ 22,769	\$ 1,554	\$ 63,570	\$ 38,964

Asset balances by segment for each period were as follows (in thousands):

	November 30,	February 28,
	2018	2018
Total assets:		
Energy	\$ 585,807	\$ 554,866
Metal Coatings	436,873	460,575
Corporate	9,699	12,768
Total	\$ 1,032,379	\$ 1,028,209

In the second quarter of fiscal 2019, the Company recognized impairment charges of \$0.8 million, which were classified within cost of sales in the consolidated statement of income and were related to property, plant and equipment in the Metal Coatings segment that was vacated or abandoned upon the consolidation of two galvanizing facilities in the Gulf Coast region of the United States. As part of the consolidation of facilities, the Company also recognized \$0.5 million in employee severance and other disposal costs in the second quarter of fiscal 2019, which were also classified within cost of sales in the consolidated statement of income.

## Financial Information About Geographical Areas

The following table presents revenues by geographic region for each period (in thousands):

	Three Months		Nine Months Ended	
	Ended November		November 30,	
	30,		2018	2017
	2018	2017	2018	2017
Net sales:				
United States	\$ 203,788	\$ 175,803	\$ 605,672	\$ 505,023
International	35,728	32,355	118,867	104,747
Total	\$ 239,516	\$ 208,158	\$ 724,539	\$ 609,770



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The following table presents fixed assets by geographic region for each period (in thousands):

	November 30, 2018	February 28, 2018
Property, plant and equipment, net:		
United States	\$ 186,696	\$ 194,418
Canada	16,619	18,254
Other countries	3,775	4,183
Total	\$ 207,090	\$ 216,855

## 6. Warranty Reserves

A reserve has been established to provide for the estimated future cost of warranties on a portion of the Company's delivered products and is classified within other accrued liabilities on the consolidated balance sheets. Management periodically reviews the reserves and makes adjustments accordingly. Warranties cover such factors as non-conformance to specifications and defects in material and workmanship.

The following table shows the changes in the warranty reserves for the nine month period ended November 30, 2018 (in thousands):

	Warranty Reserve
Balance at February 28, 2018	\$ 2,013
Warranty costs incurred	(1,674 )
Additions charged to income	1,561
Balance at November 30, 2018	\$ 1,900

## 7. Debt

The Company's debt consisted of the following for each of the periods presented (in thousands):

	November 30, 2018	February 28, 2018
2011 Senior Notes	\$ 125,000	\$ 125,000
2008 Senior Notes	—	14,286
2017 Revolving Credit Facility	148,000	162,000
Total debt	273,000	301,286
Unamortized debt issuance costs for Senior Notes	(288 )	(391 )
Total debt, net	272,712	300,895
Less amount due within one year	—	(14,286 )
Debt due after one year, net	\$ 272,712	\$ 286,609

On March 31, 2018, the Company made the final principal payment of \$14.3 million to fully settle the 2008 Senior Notes on the scheduled maturity date.

## 8. Acquisitions

On March 22, 2018, the Company purchased certain assets through a bankruptcy sales process from Lectrus Corporation, a privately-held corporation based in Chattanooga, Tennessee. Lectrus designs and manufactures custom metal enclosures and provides electrical and mechanical integration. The acquisition will complement AZZ's current metal enclosure and switchgear businesses.

This acquisition was not significant. Accordingly, disclosures of the purchase price allocation and unaudited pro forma results of operations have not been provided.

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

## Forward Looking Statements

Certain statements herein about our expectations of future events or results constitute forward-looking statements for purposes of the safe harbor provisions of The Private Securities Litigation Reform Act of 1995. You can identify forward-looking statements by terminology such as "may," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "potential," "continue," or the negative of these terms or other comparable terminology. Such forward-looking statements are based on currently available competitive, financial and economic data and management's views and assumptions regarding future events. Such forward-looking statements are inherently uncertain, and investors must recognize that actual results may differ from those expressed or implied in the forward-looking statements. In addition, certain factors could affect the outcome of the matters described herein. This Quarterly Report on Form 10-Q may contain forward-looking statements that involve risks and uncertainties including, but not limited to, changes in customer demand and response to products and services offered by AZZ, including demand by the power generation markets, electrical transmission and distribution markets, the industrial markets, and the hot dip galvanizing markets; prices and raw material cost, including zinc and natural gas which are used in the hot dip galvanizing process; changes in the political stability and economic conditions of the various markets that AZZ serves, foreign and domestic, customer requested delays of shipments, acquisition opportunities, currency exchange rates, adequacy of financing, and availability of experienced management and employees to implement AZZ's continued growth strategy; a downturn in market conditions in any industry relating to the products we inventory or sell or the services that we provide; the continuing economic volatility in the U.S. and other markets in which we operate; acts of war or terrorism inside the United States or abroad; natural disasters in the countries in which we operate; and other changes in economic and financial conditions. AZZ has provided additional information regarding risks associated with the business in AZZ's Annual Report on Form 10-K for the fiscal year ended February 28, 2018 and other filings with the SEC, available for viewing on AZZ's website at [www.azz.com](http://www.azz.com) and on the SEC's website at [www.sec.gov](http://www.sec.gov). You are urged to consider these factors carefully in evaluating the forward-looking statements herein and are cautioned not to place undue reliance on such forward-looking statements, which are qualified in their entirety by this cautionary statement. These statements are based on information as of the date hereof and AZZ assumes no obligation to update any forward-looking statements, whether as a result of new information, future events, or otherwise. The following discussion should be read in conjunction with management's discussion and analysis contained in our Annual Report on Form 10-K for the fiscal year ended February 28, 2018, and with the condensed consolidated financial statements and notes thereto included in this Quarterly Report on Form 10-Q.

## Adoption of Revenue Recognition Standard

On March 1, 2018, we adopted Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606) and the related amendments ("ASC 606") using the modified retrospective method applied to those contracts which were not completed as of February 28, 2018. Results for operating periods beginning on or after March 1, 2018 are presented under ASC 606, while prior period amounts have not been adjusted and continue to be reported in accordance with the accounting standards in effect for those periods. However, for the three and nine months ended November 30, 2018, the impact of applying ASC 606 as opposed to applying legacy accounting guidance did not result in a significant change to reported revenues or costs of revenues. Accordingly, no reconciliation has been provided to show the difference between applying ASC 606 and legacy guidance for the three and nine months ended November 30, 2018. In addition, there was no cumulative effect adjustment to the beginning retained earnings on March 1, 2018 related to the adoption. See Note 2 to the condensed consolidated financial statements included herein for a description of our accounting policy resulting from the adoption of ASC 606.

## Results of Operations

We have two distinct operating segments, the Energy segment and the Metal Coatings segment, as defined in our Annual Report on Form 10-K for the fiscal year ended February 28, 2018. Management believes that the most meaningful analysis of our results of operations is to analyze our performance by segment. We use revenue and operating income by segment to evaluate our segments. Segment operating income consists of net sales less cost of sales and selling, general and administrative expenses that are specifically identifiable to a segment. For a reconciliation of segment operating income to consolidated operating income, see Note 5 to our quarterly consolidated

financial statements included in this Quarterly Report on Form 10-Q.

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## Orders and Backlog

Our entire backlog relates to our Energy Segment and was \$307.8 million as of November 30, 2018, an increase of \$42.4 million, or 16.0%, as compared to \$265.4 million as of February 28, 2018. Our backlog increased \$24.6 million, or 8.7%, as compared to the same period in the prior fiscal year. Both of these increases were primarily the result of several large international orders, higher overall activity within the Energy Segment and incremental business generated from our acquisitions completed during the previous twelve months. For the three months ended November 30, 2018, our book-to-revenue ratio increased slightly to 0.88 to 1 from 0.86 to 1 when compared to same period of fiscal 2018 and our incoming net orders increased by \$31.5 million, or 17.5%.

The table below includes the progression of the backlog (in thousands):

	Period Ended		Period Ended	
Backlog	2/28/2018	\$265,417	2/28/2017	\$317,922
Net bookings		295,738		193,754
Acquired backlog		6,006		—
Revenues recognized		(262,236 )		(205,283 )
Backlog	5/31/2018	304,925	5/31/2017	306,393
Book to revenue ratio		1.13		0.94
Net bookings		253,882		190,055
Revenues recognized		(222,787 )		(196,329 )
Backlog	8/31/2018	336,020	8/31/2017	300,119
Book to revenue ratio		1.14		0.97
Net bookings		211,273		179,783
Acquired backlog		—		11,417
Revenues recognized		(239,516 )		(208,158 )
Backlog	11/30/2018	307,777	11/30/2017	283,161
Book to revenue ratio		0.88		0.86

## Segment Revenues

For the three and nine months ended November 30, 2018, consolidated revenues increased \$31.4 million, or 15.1%, and \$114.8 million or 18.8%, respectively, as compared to the same periods in fiscal 2018.

The following table reflects the breakdown of revenue by segment (in thousands):

	Three Months Ended November 30,		Nine Months Ended November 30,	
	2018	2017	2018	2017
Net sales:				
Energy	\$132,025	\$107,021	\$385,526	\$317,526
Metal Coatings	107,491	101,137	339,013	292,244
Total net sales	\$239,516	\$208,158	\$724,539	\$609,770

Revenues for the Energy segment increased \$25.0 million or 23.4%, and \$68.0 million or 21.4%, respectively, for the three and nine months ended November 30, 2018 as compared to the same periods in fiscal 2018. These increases in revenues were caused by several positive factors including improved turnarounds in the U.S. refinery market, increased international projects and an uptick in our electrical business. These increases were also attributable to incremental revenues from our acquisitions completed during the past twelve months and were partially offset by continued softness in the nuclear market, which is due in part to the Westinghouse Bankruptcy discussed below. Revenues for the Metal Coatings segment increased \$6.4 million or 6.3%, and \$46.8 million or 16.0%, respectively, for the three and nine months ended November 30, 2018 as compared to the same periods in fiscal 2018. These increases were a result of higher selling prices and higher volumes of steel processed during the periods driven primarily by improvements in various markets. These increases were also attributable to incremental revenues from

our acquisitions completed during the past twelve months.

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## Segment Operating Income

The following table reflects the breakdown of operating income by segment (in thousands):

	Three Months		Nine Months	
	Ended November		Ended November	
	30,	30,	30,	30,
	2018	2017	2018	2017
Operating income (loss):				
Energy	\$ 11,532	\$(12,103)	\$ 25,763	\$(3,029)
Metal Coatings	18,321	21,681	65,581	66,332
Corporate	(7,084 )	(8,024 )	(27,774 )	(24,339 )
Total operating income	\$ 22,769	\$ 1,554	\$ 63,570	\$ 38,964

Operating income for the Energy segment increased by \$23.6 million or 195.0%, and \$28.8 million or 950.8%, respectively, for the three and nine months ended November 30, 2018 as compared to the same periods in fiscal 2018. Operating margins were 8.7% and (11.3)%, for the three months ended November 30, 2018 and 2017, respectively, and 6.7% and (1.0)% for the nine months ended November 30, 2018 and 2017, respectively. These increases were primarily attributable to the positive factors noted above and improvements in project margins. In addition, for the three and nine months ended November 30, 2017, the Company recognized an impairment charge of \$8.3 million, classified within cost of sales, related to property, plant and equipment that was retired and a provision for doubtful accounts of \$2.9 million, classified within selling, general and administrative, resulting from an adverse court decision related to certain outstanding accounts receivables. No such charges were recorded in the current fiscal year.

Operating income for the Metal Coatings segment decreased by \$3.4 million or 15.7% and \$0.8 million or 1.2%, respectively, for the three and nine months ended November 30, 2018 as compared to the same periods in fiscal 2018. These decreases were primarily attributable to higher zinc and labor costs and a one-time charge of \$1.3 million incurred during the second quarter of fiscal 2019 for asset impairments, employee severance and other disposal costs related to the consolidation of two galvanizing facilities in the Gulf Coast region of the United States. These unfavorable trends were partially offset by increased volumes and selling prices. Operating margins were 17.0% and 21.4%, for the three months ended November 30, 2018 and 2017, respectively and 19.3% and 22.7% for the nine months ended November 30, 2018 and 2017, respectively. These declines were attributable to higher zinc and labor costs, which were not fully offset by increased selling prices, and the one-time charge for the consolidation of facilities.

## Corporate Expenses

Corporate expenses decreased by \$0.9 million or 11.2%, and increased \$3.4 million or 14.0%, respectively, for the three and nine months ended November 30, 2018 as compared to the prior year comparable periods. During the three and nine months ended November 30, 2018, we recorded lower share-based compensation expense as a result of certain employee performance share unit grants that were forfeited when various vesting conditions were not satisfied during the fiscal year. For the nine months ended November 30, 2018 as compared to the prior year comparable period, the decline in share-based compensation expense was more than offset by increased employee compensation, outside professional services and general corporate marketing activities.

## Interest Expense

Interest expense for the three and nine months ended November 30, 2018 was \$3.7 million and \$11.5 million, respectively, as compared to \$3.5 million and \$10.3 million for the prior year comparable periods. These increases were the result of higher interest rates on variable rate debt and slightly higher average outstanding debt balances. Our gross debt to equity ratio was 0.46 to 1 as of November 30, 2018, compared to 0.57 to 1 as of November 30, 2017.

## Income Taxes

The provision for (benefit from) income taxes reflects an effective tax rate of 17.8% and (91.6)% for the three months ended November 30, 2018 and 2017, respectively, and the change was primarily attributable to the net loss incurred and various tax benefits received during the prior year period. The provision for income taxes reflects an effective rate of 19.9% and 24.2%, for the nine months ended November 30, 2018 and 2017, respectively, and the decrease was primarily attributable to the Tax Cuts and Jobs Act of 2017.

Westinghouse Electric Company Bankruptcy Case

We had existing contracts with subsidiaries of Westinghouse Electric Company (“WEC”). WEC and the relevant subsidiaries (the "Debtors") filed relief under Chapter 11 of the Bankruptcy Code on March 29, 2017 in the United States Bankruptcy Court

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for the Southern District of New York, jointly administered as In re Westinghouse Electric Company, et al., Case No. 17-10751 (the "Bankruptcy Case"). To date, WEC has continued to operate under a Debtor-in-Possession Financing Facility and we continue to honor their executory contracts. The Company has been collecting on post-petition amounts due and owed. On February 22, 2018, the United States Bankruptcy Court for the Southern District of New York approved the Debtors' Modified First Amended Disclosure Statement for the Joint Chapter 11 Plan of Reorganization. In the Disclosure Statement, the Debtors estimated a 98.9% to 100% distribution on Allowed General Unsecured Claims. We have approximately \$12 million of such claims filed with the court, which includes 100% of our pre-petition claims. The total claims filed exceed the book value of our exposure.

Liquidity and Capital Resources

We have historically met our cash needs through a combination of cash flows from operating activities along with bank and bond market debt. Our cash requirements are generally for operating activities, cash dividend payments, capital improvements, debt repayment, acquisitions and share repurchases. We believe that our cash position, cash flows from operating activities and our expectation of continuing availability to draw upon our credit facilities are sufficient to meet our cash flow needs for the foreseeable future.

Cash Flows

The following table summarizes our cash flows by category for the periods presented (in thousands):

	Nine Months Ended November 30,	
	2018	2017
Net cash provided by operating activities	\$60,395	\$38,710
Net cash used in investing activities	(21,329 )	(54,174 )
Net cash provided by (used in) financing activities	(41,565 )	14,211

For the nine month period ended November 30, 2018, net cash provided by operating activities was \$60.4 million, net cash used in investing activities was \$21.3 million, net cash used in financing activities was \$41.6 million, and a decrease of \$0.9 million from the net effect of exchange rate changes on cash resulting in a net decrease in cash and cash equivalents of \$3.4 million. In comparison to the comparable period in fiscal 2018, the results in the statement of cash flows for operating activities for the nine month period ended November 30, 2018, are primarily attributable to the increase in net income and more favorable impacts of changes in working capital. The Company's use of cash for investing activities was lower due to decreased capital expenditures and lower spending for acquisitions. Net cash used in financing activities was higher during the nine month period ended November 30, 2018 due primarily to net payments made on outstanding borrowings.

Our working capital was \$239.6 million as of November 30, 2018, as compared to \$197.4 million at February 28, 2018.

Financing and Capital

As of November 30, 2018, the Company had \$273.0 million of floating and fixed rate notes outstanding with varying maturities through fiscal 2023 and the Company was in compliance with all of the covenants related to these outstanding borrowings. During the first quarter of fiscal 2019, the Company repaid \$14.3 million of outstanding principal related to its outstanding notes on the scheduled maturity date. As of November 30, 2018, the Company had approximately \$282.9 million of additional credit available for future draws or letters of credit.

For additional information on the Company's outstanding borrowings see Note 7 to the condensed consolidated financial statements and further below under Contractual Commitments.

Share Repurchase Program

In January of 2012, our Board authorized the repurchase of up to ten percent of the outstanding shares of our Common Stock. The share repurchase authorization does not have an expiration date, and the amount and prices paid for any future share purchases under the authorization will be based on market conditions and other factors at the time of the purchase. Repurchases under this share repurchase authorization would be made through open market purchases or private transactions in accordance with applicable federal securities laws, including Rule 10b-18 under the Exchange Act. The Company did not make any repurchases of its common shares during the nine months ended November 30,

2018.

Other Exposures

We have exposure to commodity price increases in both segments of our business, primarily copper, aluminum, steel and nickel based alloys in the Energy segment and zinc and natural gas in the Metal Coatings segment. We attempt to minimize these

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increases through escalation clauses in customer contracts for copper, aluminum, steel and nickel based alloys, when market conditions allow and through fixed cost contract purchases on zinc. In addition to these measures, we attempt to recover other cost increases through improvements to our manufacturing process, supply chain management, and through increases in prices where competitively feasible.

**Off Balance Sheet Arrangements and Contractual Obligations**

As of November 30, 2018, the Company did not have any off-balance sheet arrangements as defined under SEC rules. Specifically, there were no off-balance sheet transactions, arrangements, obligations (including contingent obligations), or other relationships with unconsolidated entities or other persons that have, or may have, a material effect on the financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources of the Company.

The following summarizes our operating lease obligations, debt principal payments, and interest payments (based on current interest rates for variable rate debt) for the remainder of the next five years and beyond (in thousands):

	Operating Leases	Long-Term Debt	Interest	Total
Fiscal:				
2019	\$2,294	\$ —	\$5,037	\$7,331
2020	8,076	—	13,373	21,449
2021	6,160	125,000	13,373	144,533
2022	5,932	—	6,598	12,530
2023	5,666	148,000	668	154,334
Thereafter	26,189	—	—	26,189
Total	\$54,317	\$273,000	\$39,049	\$366,366

As of November 30, 2018, we had outstanding letters of credit in the amount of \$39.4 million. These letters of credit are issued for a number of reasons, but are most commonly issued in lieu of customer retention withholding payments covering warranty or performance periods.

**Critical Accounting Policies and Estimates**

The preparation of financial statements and related disclosures in conformity with U.S. GAAP requires us to make judgments, assumptions, and estimates that affect the amounts reported in the condensed consolidated financial statements and the accompanying notes. On an ongoing basis, we evaluate our estimates and assumptions. These estimates and assumptions are based on current facts, historical experience, and various other factors that we believe are reasonable under the circumstances to determine reported amounts of assets, liabilities, revenue and expenses that are not readily apparent from other sources.

During the nine month period ended November 30, 2018, with the exception of the adoption of ASC 606, there were no significant changes to our critical accounting policies and estimates as compared to the critical accounting policies and estimates disclosed in Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, of our Annual Report on Form 10-K for the year ended February 28, 2018. See Note 2 to the condensed consolidated financial statements included herein for our updated critical accounting policy and estimates related to revenue recognition upon the adoption of ASC 606.

**Recent Accounting Pronouncements**

See Note 1 to the condensed consolidated financial statements, included herein, for a full description of recent accounting pronouncements, including the actual and expected dates of adoption and estimated effects on our consolidated results of operations and financial condition, which is incorporated herein by reference.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes to the Company's market risk disclosures during the first nine months of fiscal 2019. For a discussion of the Company's exposure to market risk, refer to the Company's market risk disclosures set forth in Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk, of our Annual Report on Form 10-K for the year ended February 28, 2018.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, management of the Company has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that, due to the material weakness described below, the Company's disclosure controls and procedures were not effective as of the end of the period covered by this Form 10-Q to provide reasonable assurance that information required to be disclosed by us in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and were not effective as of the end of the period covered by this Form 10-Q to provide reasonable assurance that such information is accumulated and communicated to our management, including our principal executive and financial officers, as appropriate to allow timely discussions regarding required disclosure.

Changes in Internal Controls Over Financial Reporting

As previously disclosed, after filing our Form 10-Q for the quarter ended August 31, 2017, an error was discovered related to the Company's historical revenue recognition policies and procedures. In particular, the Company determined that for certain contracts within its Energy segment for which revenue was historically recognized upon contract completion and transfer of title, the Company instead should have applied the percentage-of-completion method in accordance with the FASB's Accounting Standards Codification No. 605-35, Construction-Type and Production-Type Contracts. This error resulted in a material misstatement of the financial statements and required restatement of the financial statements included in the Company's Form 10-K for the fiscal year ended February 28, 2017 and in the Company's Form 10-Q for the quarterly periods ended May 31, 2017 and August 31, 2017. This error, which was not detected timely by management, was the result of inadequate design of controls pertaining to the Company's review and ongoing monitoring of its revenue recognition policies. The deficiency represents a material weakness in the Company's internal control over financial reporting.

Management is actively engaged in the implementation of remediation efforts to address the material weakness identified above. The remediation plan includes i) the implementation of new controls designed to evaluate the appropriateness of revenue recognition policies and procedures, ii) new controls over recording revenue transactions, and iii) additional training.

Management believes the measures described above and others that may be implemented will remediate the material weaknesses that we have identified. As management continues to evaluate and improve internal control over financial reporting, we may decide to take additional measures to address control deficiencies or determine to modify, or in appropriate circumstances not to complete, certain of the remediation measures identified. Procedures are in place, but subsequent testing of the operational effectiveness of the new controls is necessary to validate that the material weakness is fully remediated.

Subject to these remediation efforts, there have been no significant changes in the Company's internal control over financial reporting during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



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**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

On January 11, 2018, Logan Mullins, acting on behalf of himself and a putative class of persons who purchased or otherwise acquired the Company's securities between April 22, 2015 and January 8, 2018, filed a class action complaint in the U.S. District Court for the Northern District of Texas against the Company and two of its executive officers, Thomas E. Ferguson and Paul W. Fehlman. Logan Mullins v. AZZ, Inc., et al., Case No. 4:18-cv-00025-Y. The complaint alleges, among other things, that the Company's SEC filings contained statements that were rendered materially false and misleading by the Company's alleged failure to properly recognize revenue related to certain contracts in its Energy Segment in purported violation of (1) Section 10(b) of the Exchange Act and Rule 10b-5 and (2) Section 20(a) of the Exchange Act. The plaintiffs seek an award of compensatory and punitive damages, interests, attorneys' fees and costs. The Company denies the allegations and believes it has strong defenses to vigorously contest them. The Company cannot predict the outcome of this action nor when it will be resolved. If the plaintiffs were to prevail in this matter, the Company could be liable for damages, which could potentially be material and could adversely affect its financial condition or results of operations.

In addition, the Company and its subsidiaries are named defendants in various routine lawsuits incidental to our business. These proceedings include labor and employment claims, use of the Company's intellectual property, worker's compensation and various environmental matters, all arising in the normal course of business. Although the outcome of these lawsuits or other proceedings cannot be predicted with certainty, and the amount of any potential liability that could arise with respect to such lawsuits or other matters cannot be predicted at this time, management, after consultation with legal counsel, does not expect liabilities, if any, from these claims or proceedings, either individually or in the aggregate, to have a material effect on the Company's financial position, results of operations or cash flows.

**Item 1A. Risk Factors**

There have been no material changes in the risk factors disclosed under Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended February 28, 2018.

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

In January of 2012, our Board authorized the repurchase of up to ten percent of the outstanding shares of our Common Stock. The share repurchase authorization does not have an expiration date, and the amount and prices paid for any future share purchases under the authorization will be based on market conditions and other factors at the time of the purchase. Repurchases under this share repurchase authorization would be made through open market purchases or private transactions in accordance with applicable federal securities laws, including Rule 10b-18 under the Exchange Act. The Company did not make any repurchases of its common shares during the three months ended November 30, 2018.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

None.

**Item 5. Other Information**

None.

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Item 6. Exhibits

- 3.1 Amended and Restated Certificate of Formation of AZZ Inc. (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K filed by the Registrant on July 14, 2015)
- 3.2 Amended and Restated Bylaws of AZZ Inc. (incorporated by reference to Exhibit 3.2 to the Current Report on Form 8-K filed by the Registrant on January 23, 2017)
- 10.1 Note Purchase Agreement dated March 31, 2008, by and among AZZ incorporated and the purchasers listed therein (incorporated by reference to Exhibit 10(1) to the Current Report on Form 8-K filed by the Registrant on April 2, 2008).
- 10.2\* AZZ Inc. 2018 Employee Stock Purchase Plan (incorporated by reference to Appendix A to the Registrant's Definitive Proxy Statement on Form DEFA filed on May 25, 2018.).
- 10.3 Note Purchase Agreement, dated as of January 20, 2011, by and among AZZ incorporated and the purchasers identified therein (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed by the Registrant on January 21, 2011).
- 10.4 Amended and Restated Credit Agreement by and between AZZ Inc. as borrower, Bank of America N.A. as Administrative Agent, Swing Line Lender and L/C Issuer, and the other Lender's party thereto (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed by the Registrant on March 24, 2017).
- 10.5\* AZZ incorporated 2014 Long Term Incentive Plan (incorporated by reference to Appendix A to the Registrant's Definitive Proxy Statement on Form DEFA filed May 29, 2014).
- 10.6\* First Amendment to AZZ Inc. 2014 Long Term Incentive Plan (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed by the Registrant on January 21, 2016).
- 31.1 Certification of Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. Filed Herewith.
- 31.2 Certification of Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. Filed Herewith.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. Filed Herewith.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. Filed Herewith.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase
- 101.DEF XBRL Taxonomy Definition Linkbase

101.LAB XBRL Taxonomy Extension Label Linkbase

101.PRE XBRL Taxonomy Extension Presentation Linkbase

\* Management contract, compensatory plan or arrangement

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SIGNATURES

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

AZZ Inc.  
(Registrant)

Date: January 8, 2019 By: /s/ Paul W. Fehlman  
Paul W. Fehlman  
Senior Vice President and  
Chief Financial Officer