Quanex Building Products CORP
Form 10-Q
September 04, 2013

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended July 31, 2013

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)

DELAWARE	26-1561397
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1800 West Loop South, Suite 1500, Houston, Texas 77027
(Address of principal executive offices and zip code)
Registrant's telephone number, including area code: (713) 961-4600

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 x 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 x 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	x	Accelerated filer	¨

Non-accelerated filer o (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 x

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 29, 2013
Common Stock, par value $0.01 per share	37,064,965

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

QUANEX BUILDING PRODUCTS CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	July 31, 2013	October 31, 2012
	(In thousands, except share amounts)	
ASSETS		
Current assets:		
Cash and equivalents	$16,073	$71,255
Accounts receivable, net of allowance of $795 and $1,026	99,051	85,644
Inventories, net (Note 3)	67,839	65,904
Deferred income taxes	24,497	20,439
Prepaid and other current assets	6,592	7,628
Total current assets	214,052	250,870
Property, plant and equipment, net of accumulated depreciation of $346,135 and $333,898	176,033	168,877
Deferred income taxes	12,381	8,911
Goodwill (Note 4)	71,302	68,331
Intangible assets, net (Note 4)	80,757	78,380
Other assets	17,036	14,169
Total assets	$571,561	$589,538
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$78,479	$80,985
Accrued liabilities	45,357	46,459
Current maturities of long-term debt (Note 5)	375	368
Total current liabilities	124,211	127,812
Long-term debt (Note 5)	753	1,033
Deferred pension and postretirement benefits (Note 6)	5,862	6,873
Liability for uncertain tax positions (Note 8)	5,416	6,736
Non-current environmental reserves (Note 9)	9,037	9,827
Other liabilities	13,008	15,430
Total liabilities	158,287	167,711
Commitments and contingencies (Note 9)		
Stockholders’ equity:		
Preferred stock, no par value, shares authorized 1,000,000; issued and outstanding - none	—	—
Common stock, $0.01 par value, shares authorized 125,000,000; issued 37,653,639 and 37,788,804, respectively	377	378
Additional paid-in-capital	246,631	245,144

Retained earnings	180,147	193,105
Accumulated other comprehensive loss	(5,370)	(5,299)
Less treasury stock at cost, 604,088 and 816,302 shares, respectively	(8,511)	(11,501)
Total stockholders’ equity	413,274	421,827
Total liabilities and stockholders' equity	$571,561	$589,538

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

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

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2013	2012	2013	2012
	(In thousands, except per share amounts)			
Net sales	$259,174	$237,905	$677,345	$593,928
Cost and expenses:				
Cost of sales	215,182	200,663	576,835	510,542
Selling, general and administrative	24,683	26,659	83,063	80,936
Depreciation and amortization	12,193	9,131	33,389	28,381
Operating income (loss)	7,116	1,452	(15,942)	(25,931)
Non-operating income (expense):				
Interest expense	(182)	(108)	(495)	(348)
Other, net	(46)	21	(128)	199
Income (loss) before income taxes	6,888	1,365	(16,565)	(26,080)
Income tax expense (benefit)	1,919	(166)	(6,068)	(8,578)
Net income (loss)	$4,969	$1,531	$(10,497)	$(17,502)
Earnings (loss) per common share:				
Basic	$0.13	$0.04	$(0.28)	$(0.48)
Diluted	$0.13	$0.04	$(0.28)	$(0.48)
Weighted-average common shares outstanding:				
Basic	36,856	36,637	36,838	36,584
Diluted	37,413	37,163	36,838	36,584
Cash dividends per share	$0.04	$0.04	$0.12	$0.12

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

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

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2013	2012	2013	2012
	(In thousands)			
Net income (loss)	$4,969	$1,531	$(10,497)	$(17,502)
Other comprehensive loss - foreign currency translation adjustments (pretax)	(168)	(2,526)	(494)	(3,621)
Other comprehensive loss - foreign currency translation adjustments tax benefit	150	242	423	176
Other comprehensive loss, net of tax	(18)	(2,284)	(71)	(3,445)
Comprehensive income (loss)	$4,951	$(753)	$(10,568)	$(20,947)

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

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

	Nine Months Ended July 31,	
	2013	2012
	(In thousands)	
Operating activities:		
Net loss	$(10,497)	$(17,502)
Adjustments to reconcile net loss to cash provided by operating activities:		
Depreciation and amortization	33,389	28,381
Stock-based compensation	3,856	3,180
Deferred income tax benefit	(6,862)	(9,437)
Excess tax benefit from share-based compensation	(172)	(413)
Restructuring charges	—	1,206
Other, net	698	2,133
Changes in assets and liabilities, net of effects from acquisitions and dispositions:		
Increase in accounts receivable	(9,642)	(7,114)
Decrease (increase) in inventory	3,095	(7,515)
Decrease (increase) in other current assets	241	(757)
Increase (decrease) in accounts payable	(2,990)	10,242
Increase (decrease) in accrued liabilities	(6,883)	5,789
Increase (decrease) in income taxes	1,622	(771)
Decrease in deferred pension and postretirement benefits	(1,011)	(1,572)
Increase in other long-term liabilities	1,229	488
Other, net	504	(351)
Cash provided by operating activities	6,577	5,987
Investing activities:		
Acquisitions, net of cash acquired	(22,096)	—
Capital expenditures	(34,517)	(31,710)
Proceeds from disposition of capital assets	335	36
Proceeds from property insurance claim	—	479
Cash used for investing activities	(56,278)	(31,195)
Financing activities:		
Borrowings under credit facility	23,500	—
Repayments of credit facility borrowings	(23,500)	—
Repayments of other long-term debt	(364)	(339)
Common stock dividends paid	(4,446)	(4,413)
Issuance of common stock	909	2,501
Excess tax benefit from share-based compensation	172	413
Debt issuance costs	(1,163)	—
Purchase of treasury stock	—	(1,284)
Cash used for financing activities	(4,892)	(3,122)

Effect of exchange rate changes on cash and equivalents	(589)	1,003
Decrease in cash and equivalents	(55,182)	(27,327)
Cash and equivalents at beginning of period	71,255	89,619
Cash and equivalents at end of period	$16,073	$62,292

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

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

Nine Months Ended July 31, 2013	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Stockholders' Equity
	(In thousands, no per share amounts shown except in verbiage)					
Balance at October 31, 2012	$378	$245,144	$193,105	$(5,299)	$(11,501)	$421,827
Net loss	—	—	(10,497)	—	—	(10,497)
Foreign currency translation adjustment (net of tax benefit of $423)	—	—	—	(71)	—	(71)
Common dividends ($0.12 per share)	—	—	(4,446)	—	—	(4,446)
Stock-based compensation activity:						
Expense related to stock-based compensation	—	3,856	—	—	—	3,856
Stock options exercised	—	10	—	—	899	909
Tax benefit from share-based compensation	—	113	—	—	—	113
Restricted stock awards granted	—	(2,091)	—	—	2,091	—
Recognition of unrecognized tax benefit (Note 8)	—	—	2,102	—	—	2,102
Other	(1)	(401)	(117)	—	—	(519)
Balance at July 31, 2013	$377	$246,631	$180,147	$(5,370)	$(8,511)	$413,274

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

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QUANEX BUILDING PRODUCTS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Nature of Operations and Basis of Presentation

Quanex Building Products Corporation is a technological leader in the production of engineered materials and aluminum sheet products for original equipment manufacturers (OEMs) through two business segments: (1) Engineered Products and (2) Aluminum Sheet Products. Quanex Building Products Corporation produces energy efficient engineered products that include flexible insulating glass spacers, extruded vinyl profiles, and thin film solar panel sealants, as well as window and door screens and precision-formed metal and wood products. Aluminum sheet products include high quality mill finished and coated aluminum sheet that is tailored toward customers' specifications. Quanex Building Products Corporation serves a primary customer base in North America and also serves customers in international markets through operating plants in the United Kingdom and Germany, as well as through sales and marketing efforts in other countries.

Unless the context indicates otherwise, references to "Quanex", the "Company", "we", "us" and "our" refer to the consolidated business operations of Quanex Building Products Corporation and its subsidiaries.

The accompanying interim condensed consolidated financial statements include the accounts of Quanex Building Products Corporation. All intercompany accounts and transactions have been eliminated in consolidation. These financial statements have been prepared by us, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) have been condensed or omitted pursuant to such rules and regulations. The condensed consolidated balance sheet as of October 31, 2012 was derived from audited financial information, but does not include all disclosures required by U.S. GAAP. The accompanying financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto, included in our Annual Report on Form 10-K for the fiscal year ended October 31, 2012. In our opinion, the accompanying financial statements contain all adjustments (which consist of normal recurring adjustments, except as disclosed herein) necessary to fairly present our financial position, results of operations and cash flows for the interim periods. The results of operations for the periods presented are not necessarily indicative of the results to be expected for the full year or for any future periods.

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

2. Acquisitions

On December 31, 2012, we acquired substantially all of the assets of Alumco, Inc. and its subsidiaries (Alumco), including its aluminum screen business, for $22.4 million in cash. The purchase agreement contains (1) a working capital clause that provides for an adjustment to the purchase price based on the working capital balance as of the acquisition date and (2) an earn-out clause that provides for the payment of an additional $0.5 million to Alumco contingent upon the achievement of certain financial targets. We received $0.4 million from the prior owner of Alumco pursuant to the working capital clause. We recorded contingent consideration of $0.3 million as the fair value of the earn-out included in the purchase price.

The purchase price has been allocated to the fair value of the assets acquired and liabilities assumed, as indicated in the table below. This allocation is preliminary and based on estimates and assumptions that are subject to change within the purchase price allocation period (generally one year from the acquisition date). During the period from the acquisition date to July 31, 2013, we recorded an adjustment to goodwill of $0.1 million to recognize a derivative liability and $0.2 million for obsolete inventory reserve write-off, that existed as of the opening balance sheet date.

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QUANEX BUILDING PRODUCTS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

	As of Date of Opening Balance Sheet (In thousands)
Net assets acquired:	
Accounts receivable	$ 3,638
Inventories	5,062
Prepaid and other current assets	140
Property, plant and equipment	4,702
Intangible assets	8,939
Accounts payable	(2,066)
Accrued liabilities	(993)
Current maturities of long-term debt	(14)
Long-term debt	(77)
Goodwill	2,765
Net assets acquired	$ 22,096
Consideration:	
Cash, net of cash and cash equivalents acquired	$ 22,096

We used recognized valuation techniques to determine the fair value of the assets and liabilities, including the income approach for customer relationships, with a discount rate that reflects the risk of the expected future cash flows. The goodwill balance, which is deductible for tax purposes, was allocated entirely to the Engineered Products business segment. We expect that this acquisition will expand our product portfolio and geographic distribution capabilities particularly in the vinyl window segment in the screen market.

Pro forma results of operations were not presented because the Alumco acquisition was not deemed material to our results of operations.

3. Inventories

Inventories consist of the following:

	July 31, 2013	October 31, 2012
	(In thousands)	
Raw materials	$37,350	$34,392
Finished goods and work in process	42,412	43,915
Supplies and other	2,462	2,567
Total	82,224	80,874
Less inventory reserves	14,385	14,970
Inventories, net	$67,839	$65,904

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

	July 31, 2013	October 31, 2012
	(In thousands)	
LIFO	$20,962	$28,224
FIFO	46,877	37,680
Total	$67,839	$65,904

During interim periods, we estimate a LIFO reserve based on our expectations of year-end inventory levels and costs. If our calculations indicate that an adjustment at year-end will be required, we record a proportionate share of this amount during the period. At year-end, we calculate the actual LIFO reserve and record an adjustment for the difference between the annual calculation and any estimates recognized during the interim periods. Because the interim projections are subject to many factors beyond our control, the results could differ significantly from the year-end LIFO calculation. We recorded no interim LIFO allocation for the nine-month periods ended July 31, 2013 and 2012.

For inventories valued under the LIFO method, replacement cost exceeded the LIFO value by approximately $10.7 million as of July 31, 2013 and October 31, 2012.

4. Goodwill and Intangible Assets

Goodwill

All of our goodwill is recorded in the Engineered Products business segment. The change in the carrying amount of goodwill was as follows (in thousands):

	Nine Months Ended July 31, 2013	Year Ended October 31, 2012
Beginning balance as of November 1, 2012 and 2011, respectively	$68,331	$69,432
Alumco acquisition	2,765	—
Foreign currency translation adjustment	206	(1,101)
Balance as of the end of the period	$71,302	$68,331

Intangible Assets

Intangible assets consisted of the following (in thousands):

	July 31, 2013		October 31, 2012	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets:				
Customer relationships	$52,525	$14,552	$43,737	$11,675
Trademarks and trade names	44,534	16,704	44,519	14,520
Patents and other technology	25,029	10,794	24,773	9,382
Other	1,392	673	1,392	464
Total	$123,480	$42,723	$114,421	$36,041

Intangible assets as of July 31, 2013 include customer relationships of $8.7 million and technology of $0.2 million related to the Alumco acquisition. These assets have estimated useful lives of 10 and 3 years, respectively. (See Note 2 "Acquisitions").

The aggregate amortization expense for the three and nine months ended July 31, 2013 was $2.3 million and $6.6 million, respectively. The aggregate amortization expense for the three and nine months ended July 31, 2012 was $2.0 million and $6.2 million, respectively.

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

	Estimated Amortization Expense
2013 (remaining three months)	$2,272
2014	8,986
2015	8,852
2016	8,581
2017	8,475
Thereafter	43,591
Total	$80,757

5. Long-Term Debt and Capital Lease Obligations

Long-term debt consisted of the following:

	July 31, 2013	October 31, 2012
	(In thousands)	
Revolving Credit Facility	$—	$—
City of Richmond, Kentucky Industrial Building Revenue Bonds	700	800
Scott County, Iowa Industrial Waste Recycling Revenue Bonds	200	400
Capital lease obligations and other	228	201
Total debt	1,128	1,401
Less current maturities	375	368
Long-term debt	$753	$1,033

On January 28, 2013, we entered into a Senior Unsecured Revolving Credit Facility (the Credit Facility) that has a five-year term and permits aggregate borrowings at any time of up to $150 million, with a letter of credit sub-facility, a swing line sub-facility and a multi-currency sub-facility. Borrowings denominated in U.S. dollars bear interest at a spread above the London Interbank Borrowing Rate (LIBOR) or a base rate derived from the prime rate. Foreign denominated borrowings bear interest at a spread above the LIBOR applicable to such currencies. Subject to customary conditions, we may request that the aggregate commitments under the Credit Facility be increased by up to $100 million, with total commitments not to exceed $250 million. The Credit Facility replaces our previous senior unsecured revolving credit facility (the Retired Facility) that was scheduled to expire on April 23, 2013.

The Credit Facility requires us to comply with certain financial covenants, the terms of which are defined therein. Specifically, we must not permit, on a quarterly basis, our ratio of consolidated EBITDA to consolidated interest expense as defined (Consolidated Interest Coverage Ratio), to exceed 3.00 to 1 or our ratio of consolidated funded debt to consolidated EBITDA, as defined (Consolidated Leverage Ratio), to exceed 3.25 to 1. The Consolidated Leverage 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. Subject to our compliance with the covenant requirements, the amount available under the Credit Facility is a function of: (1) our trailing twelve month EBITDA; (2) the maximum Consolidated Leverage Ratio allowed under the Credit Facility; and (3) the aggregate amount of our outstanding debt and letters of credit. As of

July 31, 2013, we were in compliance with the financial covenants set forth in the Credit Facility.

For the nine-month period ended July 31, 2013, we borrowed and repaid $23.5 million under the Credit Facility, and thus had no outstanding borrowings at July 31, 2013. The weighted average interest rate for the nine months ended July 31, 2013 was 1.33%. Our current borrowing rate under the Credit Facility was 3.25% and 1.2% for the swing line sub facility and the revolver, respectively, at July 31, 2013.

As of July 31, 2013, the amount available to us for use under the Credit Facility was limited to $82.5 million and we had outstanding letters of credit of $5.7 million.

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QUANEX BUILDING PRODUCTS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

6. Retirement Plans

Pension Plan

We have a non-contributory, single employer defined benefit pension plan that covers substantially all non-union employees.

The net periodic pension cost for this plan includes the following components:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2013	2012	2013	2012
	(In thousands)			
Net periodic benefit cost:				
Service cost	$955	$884	$2,865	$2,710
Interest cost	197	184	590	592
Expected return on plan assets	(350)	(250)	(1,050)	(831)
Amortization of net loss	92	45	277	118
Net periodic benefit cost	$894	$863	$2,682	$2,589

In February 2013, we contributed $3.3 million to fund our plan and currently expect to make a minimal contribution during the fourth quarter of fiscal 2013.

7. Warranty Obligations

We accrue warranty obligations concurrently as revenues are recognized. We make provisions for our 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 our warranty obligations, including changing product designs, variance in customer installation processes 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.

A reconciliation of the activity related to our accrued warranty, including both the current and long-term portions (reported in accrued liabilities and other liabilities, respectively, on the accompanying condensed consolidated balance sheets) is presented below (in thousands):

	Nine Months Ended July 31, 2013	Year Ended October 31, 2012
Beginning balance as of November 1, 2012 and 2011, respectively	$4,781	$5,262
Provision for warranty expense	548	652
Change in accrual for preexisting warranties	(337)	(838)
Warranty costs paid	(376)	(295)
Total accrued warranty as of the end of the period	4,616	4,781
Less current accrued warranty	1,887	2,045
Long-term accrued warranty	$2,729	$2,736

8. Income Taxes

To determine our income tax expense for interim periods, consistent with accounting standards, we apply the estimated annual effective income tax rate to year-to-date results except when this method does not result in a reliable estimate of year-to-date income tax expense. For the three and nine months ended July 31, 2013, we used the discrete or cut-off method, which allows for the use of a year-to-date effective income tax rate that is more applicable to the results. This approach is appropriate where a small change in estimated income could produce a large change in the estimated annual effective tax rate. Our estimated annual effective tax rates for the three and nine months ended July 31, 2013 and 2012, were 27.9% and a benefit of 12.2%, respectively, and 36.6% and 32.9%, respectively.

We continue to record a valuation allowance for certain state net operating losses in fiscal 2013. In assessing the need for a valuation allowance, we consider both positive and negative evidence related to the likelihood of realization of the deferred tax assets.

Prepaid and other current assets on the condensed consolidated balance sheets include an income tax receivable of $0.2 million and $1.3 million as of July 31, 2013 and October 31, 2012, respectively.

Our unrecognized tax benefit (UTB) is related to the 2008 spin-off of Quanex from its parent and certain state tax items regarding the interpretation of tax laws and regulations. The total UTB at October 31, 2012 was $15.8 million. Of this amount, $6.7 million was recorded as a liability for uncertain tax positions and $8.9 million was recorded as deferred income taxes (non-current assets) on the accompanying condensed consolidated balance sheet. During the nine months ended July 31, 2013, we reduced the liability for uncertain tax positions related to the spin-off by $2.7 million due to the lapse in the statute of limitations, which resulted in a non-cash increase in retained earnings of $2.1 million and a decrease in income tax expense of $0.6 million. At July 31, 2013, $5.4 million is recorded as a liability for uncertain tax positions and $7.9 million is recorded in deferred income taxes. The total UTB at July 31, 2013 of $13.3 million includes $12.4 million for which the disallowance of such items would not affect the annual effective tax rate.

Judgment is required in assessing the future tax consequences of events that have been recognized in our financial statements or income tax returns. The final outcome of the future tax consequences of legal proceedings, if any, as well as the outcome of competent authority proceedings, changes in regulatory tax laws, or interpretation of those tax laws could impact our financial statements. We are subject to the effect of these matters occuring in various jurisdictions. We believe it is reasonably possible that a decrease of approximately $2.0 million in the UTB may be recognized within the next twelve months as a result of a lapse in the statute of limitations.

9. Contingencies

Environmental

We are subject to extensive laws and regulations concerning the discharge of materials into the environment and the remediation of chemical contamination. To satisfy such requirements, we must make capital and other expenditures on an on-going basis. We accrue for remediation obligations and adjust our accruals as information becomes available and circumstances develop. Those estimates may change substantially depending on various factors, including the nature and extent of contamination, appropriate remediation technologies, and regulatory approvals. When we accrue 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, information indicates that it is probable we have incurred a loss, and such amount is estimable, we accrue our allocable share of liability taking into account the number of parties participating, the ability of such counter-parties to pay their shares of the costs, the volumes and nature of the wastes involved, the nature of anticipated response actions, and the nature of our alleged connection to the contamination. The cost of environmental matters has not had a material adverse effect on our operations or financial condition in the past, and we are not currently aware of any conditions that, we believe, are likely to have a material adverse effect on our operations, financial condition or cash flows.

The table below indicates the total environmental reserve and corresponding recovery balances as well as where these balances are reported in the accompanying condensed consolidated balance sheets as of July 31, 2013 and October 31, 2012:

	July 31, 2013	October 31, 2012
	(In thousands)	
Accrued liabilities	$1,700	$1,700
Non-current environmental reserves	9,037	9,827
Total environmental reserves	$10,737	$11,527
Accounts receivable	$929	$821
Other assets (non-current)	9,663	10,374
Total receivable for recovery of remediation costs	$10,592	$11,195

Currently, our on-going remediation activities are associated with one of our subsidiaries, Nichols Aluminum-Alabama, LLC (NAA). NAA operates a plant in Decatur, Alabama that is subject to an Alabama Hazardous Wastes Management and Minimization Act Post-Closure Permit. Among other things, the permit requires NAA to remediate, as directed by the state, historical environmental releases of wastes and waste constituents. Consistent with the permit, NAA has undertaken various studies of site conditions and, during the first quarter of 2006, started a phased program to treat in-place free product petroleum that had been released underneath the plant. During the second quarter 2010, NAA submitted to the state the first component of its proposed workplan for implementing a site-wide remedy. The full workplan was submitted to the state during the third quarter 2010, revised during the second quarter 2011 to reflect both additional sampling data and responses to state comments, and revised again in the fourth quarter 2011 in response to another round of state comments. Based on those plans, which remain subject to further comment, revision, and state approval, our remediation reserve at NAA's Decatur plant is $10.7 million as of July 31, 2013. Approximately $0.3 million of the July 31, 2013 reserve represents administrative costs; the balance of $10.4 million represents estimated costs for investigation, studies, cleanup, and treatment. The reserve has not been discounted. NAA was acquired through a stock purchase in which the sellers agreed to indemnify us 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 our current estimates indicate we will not reach this limit, changing circumstances could result in additional costs or expenses 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 on-going costs. Based on our experience to date, the estimated cleanup costs going forward, and costs incurred to date as of July 31, 2013, we expect to recover from the sellers' shareholders an additional $10.6 million which has not been discounted.

Our 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, we believe that we have 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. Currently, we expect to pay the accrued remediation reserve through fiscal year 2035, although some of the same factors discussed earlier could accelerate or extend the timing.

Other

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

10. Derivative Instruments and Fair Value Measurement of Assets and Liabilities

Derivative Instruments

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

The nature of our business activities requires the management of various financial and market risks, including those related to changes in foreign currency exchange rates and aluminum scrap prices. We use foreign currency forwards and options and aluminum forward and swap contracts to mitigate or eliminate certain of those risks. Specifically, the foreign currency contracts are used to offset fluctuations in the value of accounts receivable and payable balances that are denominated in currencies other than the U.S. dollar, including the Euro, British Pound and Canadian Dollar. We use aluminum contracts to minimize the price risk related to customer sales contracts. Historically, we have entered 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 certain forward purchase and sale contracts and a swap contract with the commodity price based on published amounts from the London Metal Exchange (LME). Our risk management policy, as it relates to these LME contracts, is to enter into contracts as needed so that raw material purchase levels, including both fixed price purchase commitments as well as LME contracts, match our needs to meet the committed sales orders. Currently, we do not enter into derivative transactions for speculative or trading purposes. We are exposed to credit loss in the event of nonperformance by the counterparties to our derivative transactions. We attempt to mitigate this risk by monitoring the creditworthiness of our counterparties and limiting our exposure to individual counterparties. In addition, we have established master netting agreements in certain cases to facilitate the settlement of gains and losses on specific

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derivative contracts.

We have not designated any of our derivative contracts as hedges for accounting purposes. Therefore, changes in the fair value of these contracts and the realized gains and losses are recorded in the condensed consolidated statements of income as follows:

Derivatives Not Designated as Hedging Instruments	Location of Gain or (Loss) Recognized in Earnings	Three Months Ended July 31, 2013	Three Months Ended July 31, 2012	Nine Months Ended July 31, 2013	Nine Months Ended July 31, 2012
		(In thousands)			
Aluminum derivatives	Cost of sales	$(49)	$(734)	$(233)	$(637)
Foreign currency derivatives	Other, net	$(231)	$700	$(613)	$1,326

The fair value of outstanding derivative contracts were recorded as assets and liabilities on the accompanying condensed consolidated balance sheets as indicated in the table below:

	July 31, 2013	October 31, 2012
	(In thousands)	
Asset Derivatives		
Prepaid and other current assets:		
Aluminum derivatives	$4	$10
Foreign currency derivatives	2	6
Other assets:		
Aluminum derivatives	8	—
Liability Derivatives		
Accrued liabilities:		
Aluminum derivatives	259	170
Foreign currency derivatives	111	23
Other liabilities (non-current):		
Aluminum derivatives	$—	$4

The following table summarizes the notional amounts and fair value of outstanding derivative contracts:

		Notional as indicated July 31, 2013	Notional as indicated October 31, 2012	Fair Value in $ July 31, 2013	Fair Value in $ October 31, 2012
		(In thousands)			
Aluminum derivatives:					
Aluminum forward purchase contracts	LBS	3,638	2,370	$(28)	$(164)
Aluminum swap contracts	LBS	991	—	(219)	—
Foreign currency exchange derivatives:					
Sell EUR, buy USD	EUR	7,687	7,663	(85)	(23)
Buy GBP, sell USD	GBP	2,781	1,934	(24)	5

Sell CAD, buy USD	CAD	637	608	(2)	1
Buy EUR, sell GBP	EUR	96	—	2	—
Sell EUR, buy GBP	EUR	—	545	$—	$—

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Fair Value Measurement

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

- Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
- Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly or indirectly including quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability (e.g., interest rates) and inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- Level 3 - Inputs that are both significant to the fair value measurement and unobservable.

We hold investments in money market funds, pension plan assets and derivative contracts that are measured at fair value on a recurring basis. The investments in money market funds and the pension plan assets are measured at fair value based on active market quotations and are therefore classified as Level 1. All of our derivative contracts are valued using quoted market prices from brokers or exchanges and are classified within Level 2 of the fair value hierarchy.

We have classified the investments in money market funds as cash and equivalents and the pension plan assets were classified as deferred pension and postretirement benefits in the accompanying condensed consolidated balance sheets.

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

	July 31, 2013				October 31, 2012			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	(In thousands)							
Assets								
Investments in money market fund	$8,503	$—	$—	$8,503	$67,819	$—	$—	$67,819
Pension plan assets	23,171	—	—	23,171	18,562	—	—	18,562
Aluminum derivatives	—	12	—	12	—	10	—	10
Foreign currency exchange derivatives	—	2	—	2	—	6	—	6
Total assets	$31,674	$14	$—	$31,688	$86,381	$16	$—	$86,397
Liabilities								
Aluminum derivatives	$—	$(259)	$—	$(259)	$—	$(174)	$—	$(174)
Foreign currency exchange derivatives	—	(111)	—	(111)	—	(23)	—	(23)
Contingent consideration	—	—	(250)	(250)	—	—	—	—

Total liabilities	$—	$(370)	$(250)	$(620)	$—	$(197)	$—	$(197)
Net assets (liabilities)	$31,674	$(356)	$(250)	$31,068	$86,381	$(181)	$—	$86,200

In connection with the Alumco asset purchase transaction (See Note 2 "Acquisitions"), we recognized a contingent liability of $0.3 million that is classified as Level 3 and measured at fair value on a recurring basis. The fair value is based on management's assessment of the probability that the acquired business will achieve the financial targets necessary to receive the earn out payment specified in the purchase agreement. We evaluate this liability each reporting period, and there has been no change in the value of the liability since it was recorded in December 2012.

As of July 31, 2013 and October 31, 2012, we had approximately $4.7 million and $4.2 million respectively, of property, plant and equipment that is recorded at fair value on a non-recurring basis and classified as Level 3. The fair value is based on broker opinions.

11. Stock-Based Compensation

We have established and maintain an Omnibus Incentive Plan (2008 Plan) that provides for the granting of restricted stock awards, stock options, restricted stock units and other stock-based and cash-based awards.

Restricted Stock Awards

Restricted stock awards are granted to key employees and officers annually, and typically cliff vest over a three-year period with service and continued employment as the only vesting criteria. The recipient of the restricted stock awards is entitled to all of the rights of a shareholder, except that the awards are nontransferable during the vesting period. The fair value of the restricted stock award is established on the grant date and then expensed over the vesting period resulting in an increase in additional paid-in-capital. Shares are generally issued from treasury stock at the time of grant. A summary of non-vested restricted stock awards activity during the nine months ended July 31, 2013 is presented below:

	Restricted Stock Awards	Weighted Average Grant Date Fair Value
Non-vested at October 31, 2012	212,700	$ 16.08
Granted	148,400	18.83
Forfeited	(110,400)	17.40
Vested	(67,300)	16.21
Non-vested at July 31, 2013	183,400	$ 17.46

The weighted average grant date fair value of restricted stock awards granted during the nine-month periods ended July 31, 2013 and 2012 was $18.83 and $15.08, respectively. The total fair value of restricted stock awards vested during the nine months ended July 31, 2013 and 2012 was $1.1 million and $0.9 million, respectively. As of July 31, 2013, total unrecognized compensation cost related to unamortized restricted stock awards totaled $2.1 million. We expect to recognize this expense over the remaining weighted average period of 2.5 years.

Stock Options

Stock options are awarded to key employees, officers and non-employee directors. Director stock options vest immediately while employee and officer stock options typically vest ratably over a three-year period with service and continued employment as the vesting conditions. The fair value of the stock options is determined on the grant date and expensed over the vesting period resulting in an increase in additional paid-in-capital.

We use the Black-Scholes pricing model to estimate the fair value of our stock options. The following table provides a summary of assumptions used to estimate the fair value of our stock options issued during the nine-month periods ended July 31, 2013 and 2012.

	Nine Months Ended July 31,	
	2013	2012
Weighted-average expected volatility	54.9%	54.0%
Weighted-average expected term (in years)	5.2	5.0
Risk-free interest rate	1.0%	0.9%
Expected dividend yield over expected term	1.0%	1.0%
Weighted average grant date fair value	$8.71	$6.70

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The following table summarizes our stock option activity for the nine months ended July 31, 2013:

	Stock Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (000s)
Outstanding at October 31, 2012	2,473,250	$14.57		
Granted	611,600	19.75		
Exercised	(63,814)	14.25		
Forfeited/Expired	(51,486)	18.02		
Outstanding at July 31, 2013	2,969,550	15.58	6.9	$6,342
Vested or expected to vest at July 31, 2013	2,886,361	15.49	6.9	6,308
Exercisable at July 31, 2013	1,908,849	$14.18	5.8	$5,741

The total intrinsic value of stock options (the amount by which the market price of the stock on the date of exercise exceeded the exercise price of the stock option) exercised during the nine months ended July 31, 2013, and 2012 was $0.4 million and $0.8 million, respectively. The total fair value of stock options vested during the nine months ended July 31, 2013 and 2012, was $3.0 million and $2.3 million, respectively. As of July 31, 2013, total unrecognized compensation cost related to stock options was $4.1 million. We expect to recognize this expense over the remaining weighted average period of 2.3 years.

Restricted Stock Units

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

A summary of non-vested restricted stock units activity during the nine months ended July 31, 2013 is presented below:

	Restricted Stock Units	Weighted Average Grant Date Fair Value
Non-vested at October 31, 2012	161,000	$ 15.47
Forfeited	(54,000)	15.08
Vested	(6,000)	18.35
Non-vested at July 31, 2013	101,000	$ 15.47

No restricted stock units were granted during the nine months ended July 31, 2013. During the nine months ended July 31, 2012, the weighted average grant date fair value of restricted stock units granted was $15.33 per unit. Cash used to settle restricted stock units during the nine months ended July 31, 2013, and 2012 was $0.1 million and $0.2 million, respectively.

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12. Other Income (Expense)

Other income (expense) included under the caption "Other, net" on the accompanying condensed consolidated statements of income, consisted of the following for the three and nine months ended July 31, 2013 and 2012:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2013	2012	2013	2012
	(In thousands)			
Foreign currency transaction gains (losses)	$167	$(712)	$498	$(1,329)
Foreign currency exchange derivative gains (losses)	(231)	700	(613)	1,326
Interest income	14	42	48	190
Other	4	(9)	(61)	12
Other income (expense)	$(46)	$21	$(128)	$199

13. Segment Information

We have two reportable segments: (1) Engineered Products and (2) 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 and construction markets. The primary market drivers of our segments are residential remodeling and replacement activity (R&R) and new home construction.

We measure our inventory at the segment level on a FIFO or weighted-average basis; however, at the consolidated level, a portion of the inventory is measured on a LIFO basis. The LIFO reserve is computed on a consolidated basis as a single pool. (See "Inventories", Note 3.) We record LIFO inventory adjustments, corporate office charges and inter-segment eliminations as Corporate & Other. We account for inter-segment sales and transfers as though the sales or transfers were to third parties, at current market prices. Inter-segment sales, related cost of sales, and intercompany profit are eliminated in consolidation. The most significant components of corporate assets include cash and equivalents, property, plant and equipment, and deferred tax assets, among others. We measure segment profit and our chief operating decision makers evaluate segment results based on the U.S. GAAP measure of operating income (loss). We do not allocate interest expense, interest income or income taxes to our operating segments.

Our segment information for the three and nine months ended July 31, 2013 and 2012 was as follows (in thousands):

	Engineered Products	Aluminum Sheet Products	Corporate & Other	Total
Three Months Ended July 31, 2013				
Net sales	$156,765	$102,409	$—	$259,174
Inter-segment sales	58	2,789	(2,847)	—
Depreciation and amortization	8,067	1,820	2,306	12,193
Operating income (loss)	18,561	(490)	(10,955)	7,116
Capital expenditures	$3,343	$4,926	$1,265	$9,534
Three Months Ended July 31, 2012				
Net sales	$134,060	$103,845	$—	$237,905
Inter-segment sales	—	3,179	(3,179)	—
Depreciation and amortization	6,911	1,697	523	9,131

Operating income (loss)	13,063	(3,162)	(8,449)	1,452
Capital expenditures	$3,143	$2,428	$4,828	$10,399
As of July 31, 2013				
Goodwill	$71,302	$—	$—	$71,302
Total assets	$401,449	$142,930	$27,182	$571,561

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	Engineered Products	Aluminum Sheet Products	Corporate & Other	Total
Nine Months Ended July 31, 2013				
Net sales	$388,024	$289,321	$—	$677,345
Inter-segment sales	75	10,172	(10,247)	—
Depreciation and amortization	23,637	5,173	4,579	33,389
Operating income (loss)	27,303	(5,187)	(38,058)	(15,942)
Capital expenditures	$11,718	$13,324	$9,475	$34,517
Nine Months Ended July 31, 2012				
Net sales	$342,223	$251,705	$—	$593,928
Inter-segment sales	—	9,312	(9,312)	—
Depreciation and amortization	20,961	6,154	1,266	28,381
Operating income (loss)	14,949	(16,213)	(24,667)	(25,931)
Capital expenditures	$14,507	$6,107	$11,096	$