

## QUANEX BUILDING PRODUCTS | NX

*Begins FY'24 With a Solid Q1 Beat; Raising Estimates; Target to \$42*

PRICE \$33.92

PRICE TARGET \$42.00

### KEY TAKEAWAY

Quanex reported a \$2M EBITDA beat for Q1'24 (\$19M vs. consensus of \$17M). The beat versus our model was due to higher sales and margins. Note that EBITDA margin *expanded* 30 bps yr/yr despite a 9% decline in sales in Q1. Quanex guided higher for Q2 and FY'24 and continues to expect stronger demand in H2'24, we believe. With single-family housing permits +21% yr/yr over the past six months, we concur. We are raising our FY'24 EBITDA forecast by 2% (to \$145M) and FY'25 by 2% (to \$155M). Even in a down year (FY'24) we forecast ROIC of 13% versus 15% last year. Given solid returns on capital, we continue to see the potential for multiple expansion. Our 12-month price target goes from \$40 to \$42.

*Building Products*

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### KEY POINTS

**Reports Q1'24 beat.** Quanex reported Q1'24 adjusted EBITDA of \$19M (–6% yr/yr) versus our estimate and consensus of \$17M. The beat was due to higher revenue and margins. Total sales came in at \$239M (–9% yr/yr), which exceeded our estimate of \$229M.

Quanex generated an adjusted EBITDA margin of 8.1%, which increased 30 bps yr/yr and exceeded our 7.4% estimate. *We are impressed that Quanex was able to increase margins yr/yr despite the decline in sales.*

**EU Fenestration drove the beat, margins impressive.** EBITDA was in-line with our forecast at NA Fenestration (at \$14M) and NA Cabinet Components (at –\$1M). The beat was due to higher EBITDA at EU Fenestration (\$10M versus our \$9M) and lower corporate costs. EU Fenestration generated a 20.2% adjusted EBITDA margin in Q1'24, which was 220 bps above our forecast. Margins also improved on a yr/yr basis (+250 bps), despite a 10% decline in sales.

**Cash flow beats, balance sheet remains flexible.** Quanex generated Q1 free cash flow of (\$6M), which outperformed normal seasonal trends and was better than our forecast of (\$19M). The company ended Q1'24 with \$20M in net debt versus trailing 12-month EBITDA of \$158M. We believe M&A remains the strategic priority and expect Quanex to continue to build out its manufacturing footprint.

**Guidance above for Q2 and FY'24.** Management expects Q2 sales to be flat to down 2% yr/yr versus our prior forecast of –5%. In its core North American Fenestration segment, sales are expected to *increase* 2%–4% yr/yr versus our prior –1%. The company continues to expect stronger H2'24 demand, we believe. New residential construction, which accounts for at least one-third of sales, should benefit from stronger starts and permits during H2'23, in our view. Over the past six months, single-family permits are up 21% yr/yr, on average (SAAR).

**Raising estimates; target to \$42.** We are increasing our Q2'24 EBITDA forecast from \$32M to \$34M and FY'24 from \$142M to \$145M. Quanex initiated FY'24 EBITDA guidance of \$145M–\$150M. Our FY'25 estimate goes from \$153M to \$155M. We are increasing our target to \$42 to reflect higher estimates. Our new target is based on 8.9x FY'25 EV/EBITDA and assumes slight multiple expansion. Even in a down year, we forecast ROIC of 13% in FY'24 (versus 15% in FY'23).

### COMPANY STATISTICS

52-Week Range	\$18.71-\$36.57
Market Capitalization (M)	\$1,121
Average Daily Volume (000s)	103
Debt/Total Cap	10.4%
Dividend	\$0.32
Shares Outstanding (M) fd	33.0
Estimated 3-yr EPS Growth	–2%
Enterprise Value (M)	\$1,141
Float (M)	32.6

### FINANCIALS

FYE Oct	2022A	2023A	2024E	2025E
P/E Ratio	12.7x	12.3x	14.6x	13.6x
EV/EBITDA	7.5x	7.1x	7.9x	7.3x
Revenue (M)	\$1,222	\$1,131	\$1,109	\$1,145
Gross Inc (M)	\$269	\$278	\$276	\$290
EBITDA (M)	\$153	\$160	\$145	\$155
EPS				
Q1	\$0.34	\$0.18	\$0.18A	\$0.16
Q2	\$0.80	\$0.66	\$0.51	\$0.54
Q3	\$0.79	\$0.97	\$0.78	\$0.87
Q4	\$0.75	\$0.95	\$0.86	\$0.94
<b>Total</b>	<b>\$2.68</b>	<b>\$2.75</b>	<b>\$2.32</b>	<b>\$2.50</b>
<b>Consensus</b>	---	---	<b>\$2.27</b>	<b>\$2.51</b>

*Consensus estimates from Visible Alpha*

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**Valuation.** On an EV/EBITDA basis, NX shares are trading at 7.9x our FY'24 EV/EBITDA forecast and 7.3x FY'25. Our price target of \$42 is based on 8.9x our FY'25 EV/EBITDA forecast. While our price target assumes multiple expansion, we believe this can be justified by: (1) the company's strong balance sheet, (2) track record of consistent free cash flow generation, and (3) recent improvement in EBITDA margin and ROIC.

Quanex initiated FY'24 free cash flow guidance of \$85M–\$90M. We are raising our forecast from \$74M to \$85M (\$2.58/sh). At some point during H2'24, we expect the company to be net debt free, depending upon M&A activity. We expect Quanex to continue to build out its specialty manufacturing footprint, primarily through acquisitions.

**Risks.** The primary risk to the achievement of our price target is macroeconomic conditions, which could lead to weaker demand for new construction, as well as repair and remodel activity. Historically, repair and remodel activity has steadily grown. However, according to the Leading Indicator of Remodeling Activity, R&R demand is expected to decline at a mid-single-digit rate during 2024 (Harvard University).

**Quanex Building Products**  
Earnings Model

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(\$ millions)	2023A					2024E					2025E				
	Jan	Apr	Jul	Oct	Oct	Jan	Apr	Jul	Oct	Oct	Jan	Apr	Jul	Oct	Oct
	Q1	Q2	Q3	Q4	Year	Q1A	Q2	Q3	Q1	Year	Q1	Q2	Q3	Q1	Year
Net sales	\$261.9	\$273.5	\$299.6	\$295.5	\$1,130.6	\$239.2	\$267.0	\$299.5	\$303.0	\$1,108.7	\$241.5	\$274.0	\$314.5	\$315.0	\$1,145.0
Cost of sales	210.1	206.4	221.1	215.5	853.1	187.7	200.7	222.4	222.4	833.2	189.4	204.6	231.8	229.3	855.2
Gross profit	51.8	67.2	78.6	80.0	277.5	51.4	66.3	77.1	80.6	275.5	52.1	69.4	82.7	85.7	289.9
D&A	10.6	10.5	10.6	11.2	42.9	11.2	11.4	11.4	11.6	45.6	12.3	12.4	12.5	12.5	49.7
SG&A	36.7	27.4	30.5	29.3	124.0	32.4	33.1	33.0	33.3	131.7	32.5	34.3	34.3	34.5	135.5
Restructuring & other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Operating income	4.4	29.3	37.5	39.5	110.7	7.9	21.8	32.7	35.8	98.2	7.3	22.7	35.9	38.7	104.7
Interest expense, net	(2.3)	(2.2)	(2.1)	(1.6)	(8.1)	(1.1)	(1.0)	(1.0)	(1.0)	(4.1)	(1.0)	(1.0)	(1.0)	(1.0)	(4.0)
Other income, net	0.2	(0.0)	0.4	(6.1)	(5.5)	1.0	0.0	0.0	0.0	1.0	0.0	0.0	0.0	0.0	0.0
Pre-tax income	2.4	27.1	35.8	31.8	97.0	7.9	20.8	31.7	34.8	95.2	6.3	21.7	34.9	37.7	100.7
Income Taxes	(0.5)	(5.6)	(4.1)	(4.4)	(14.5)	(1.6)	(4.2)	(6.3)	(7.0)	(19.1)	(1.3)	(4.3)	(7.0)	(7.5)	(20.1)
Net Income (Cont. Ops.)	1.9	21.5	31.7	27.4	82.5	6.2	16.7	25.3	27.8	76.1	5.0	17.4	27.9	30.2	80.5
EPS (Cont. Ops.)	\$0.06	\$0.65	\$0.96	\$0.83	\$2.50	\$0.19	\$0.51	\$0.77	\$0.85	\$2.31	\$0.15	\$0.53	\$0.86	\$0.93	\$2.48
Shares Outstanding (Diluted)	33.1	33.0	32.9	33.0	33.0	33.0	32.9	32.8	32.7	32.9	32.6	32.5	32.4	32.3	32.5
Transaction fees	5.4	0.1	0.4	0.1	6.0	0.2	0.3	0.3	0.3	1.0	0.3	0.3	0.3	0.3	1.0
Other	(0.0)	0.2	(0.1)	5.2	5.2	(0.8)	0.0	0.0	0.0	(0.8)	0.0	0.0	0.0	0.0	0.0
Tax impact of reconciling items	(1.3)	(0.0)	(0.1)	(1.5)	(2.8)	0.1	(0.1)	(0.1)	(0.1)	(0.0)	(0.1)	(0.1)	(0.1)	(0.1)	(0.2)
<b>Adjusted EPS</b>	<b>\$0.18</b>	<b>\$0.66</b>	<b>\$0.97</b>	<b>\$0.95</b>	<b>\$2.75</b>	<b>\$0.18</b>	<b>\$0.51</b>	<b>\$0.78</b>	<b>\$0.86</b>	<b>\$2.32</b>	<b>\$0.16</b>	<b>\$0.54</b>	<b>\$0.87</b>	<b>\$0.94</b>	<b>\$2.50</b>
<b>EBITDA - Cont. Ops.</b>	15.0	39.8	48.1	50.7	153.6	19.1	33.2	44.1	47.4	143.7	19.6	35.1	48.4	51.2	154.4
Adjustments	5.4	0.1	0.4	0.1	6.0	0.2	0.3	0.3	0.3	1.0	0.3	0.3	0.3	0.3	1.0
<b>EBITDA - Adjusted</b>	<b>\$20.5</b>	<b>\$39.9</b>	<b>\$48.5</b>	<b>\$50.8</b>	<b>\$159.6</b>	<b>\$19.3</b>	<b>\$33.5</b>	<b>\$44.3</b>	<b>\$47.6</b>	<b>\$144.7</b>	<b>\$19.8</b>	<b>\$35.4</b>	<b>\$48.7</b>	<b>\$51.5</b>	<b>\$155.4</b>
<b>Percent of Sales:</b>															
Gross Margin	19.8%	24.6%	26.2%	27.1%	24.5%	21.5%	24.8%	25.7%	26.6%	24.8%	21.6%	25.3%	26.3%	27.2%	25.3%
Adjusted EBITDA Margin	7.8%	14.6%	16.2%	17.2%	14.1%	8.1%	12.5%	14.8%	15.7%	13.1%	8.2%	12.9%	15.5%	16.3%	13.6%
Operating Margin	1.7%	10.7%	12.5%	13.4%	9.8%	3.3%	8.2%	10.9%	11.8%	8.9%	3.0%	8.3%	11.4%	12.3%	9.1%
Pre-tax Margin	0.9%	9.9%	11.9%	10.8%	8.6%	3.3%	7.8%	10.6%	11.5%	8.6%	2.6%	7.9%	11.1%	12.0%	8.8%
Net Margin (Cont. Ops.)	0.7%	7.9%	10.6%	9.3%	7.3%	2.6%	6.2%	8.5%	9.2%	6.9%	2.1%	6.3%	8.9%	9.6%	7.0%
SG&A as a % of Sales	14.0%	10.0%	10.2%	9.9%	11.0%	13.5%	12.4%	11.0%	11.0%	11.9%	13.5%	12.5%	10.9%	11.0%	11.8%
D&A as a % of Sales	4.1%	3.8%	3.5%	3.8%	3.8%	4.7%	4.3%	3.8%	3.8%	4.1%	5.1%	4.5%	4.0%	4.0%	4.3%
Tax Rate	19.2%	20.5%	11.5%	14.0%	15.0%	20.8%	20.0%	20.0%	20.0%	20.1%	20.0%	20.0%	20.0%	20.0%	20.0%
<b>Yr/Yr Change:</b>															
Revenues	(1.9%)	(15.3%)	(7.5%)	(3.9%)	(7.4%)	(8.7%)	(2.4%)	(0.0%)	2.5%	(1.9%)	1.0%	2.6%	5.0%	4.0%	3.3%
Gross Profit	(6.2%)	(8.3%)	8.2%	18.6%	3.4%	(0.6%)	(1.3%)	(1.9%)	0.8%	(0.7%)	1.2%	4.6%	7.3%	6.3%	5.2%
SG&A	19.2%	(2.7%)	5.9%	(0.0%)	5.8%	(11.9%)	20.9%	8.1%	13.4%	6.3%	0.4%	3.5%	3.8%	3.8%	2.9%
Adjusted EBITDA	(16.0%)	(11.8%)	9.7%	31.2%	4.6%	(5.8%)	(16.1%)	(8.5%)	(6.2%)	(9.3%)	2.8%	5.7%	9.8%	8.1%	7.4%
Operating Income	(68.8%)	(15.1%)	10.1%	38.3%	(0.5%)	79.8%	(25.6%)	(12.8%)	(9.4%)	(11.3%)	(8.3%)	4.1%	10.0%	8.2%	6.6%
Net Income	(83.0%)	(18.9%)	22.3%	11.0%	(6.6%)	227.3%	(22.6%)	(20.1%)	1.6%	(7.8%)	(19.8%)	4.3%	10.3%	8.5%	5.9%
Adjusted EPS	(46.0%)	(17.5%)	22.9%	25.5%	2.8%	(3.8%)	(22.2%)	(19.8%)	(9.6%)	(15.8%)	(9.3%)	5.6%	11.6%	9.8%	8.0%

Source: Company reports and Thompson Davis & Co. estimates

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