

Edgar Filing: AZZ INC - Form 10-Q

AZZ INC  
Form 10-Q  
October 09, 2018  
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 August 31, 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 August 31, 2018: |
|------------------------------------------|---------------------------------|
| Common Stock, \$1.00 par value per share | 26,050,242                      |

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Table of Contents

AZZ INC.  
INDEX

|                                                                                                       | PAGE<br>NO.   |
|-------------------------------------------------------------------------------------------------------|---------------|
| <b>PART I. <u>FINANCIAL INFORMATION</u></b>                                                           |               |
| Item 1. <u>Financial Statements (Unaudited)</u>                                                       |               |
| <u>Condensed Consolidated Balance Sheets</u>                                                          | <u>3</u>      |
| <u>Condensed Consolidated Statements of Income</u>                                                    | <u>4</u>      |
| <u>Condensed Consolidated Statements of Comprehensive Income</u>                                      | <u>5</u>      |
| <u>Condensed Consolidated Statements of Cash Flows</u>                                                | <u>6</u>      |
| <u>Condensed Consolidated Statement of Shareholders' Equity</u>                                       | <u>7</u>      |
| <u>Notes to Condensed Consolidated Financial Statements</u>                                           | <u>8</u>      |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations.</u> | <u>16</u>     |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk.</u>                            | <u>21</u>     |
| Item 4. <u>Controls and Procedures.</u>                                                               | <u>21</u>     |
| <b>PART II. <u>OTHER INFORMATION</u></b>                                                              |               |
| Item 1. <u>Legal Proceedings.</u>                                                                     | <u>22</u>     |
| Item 1A. <u>Risk Factors.</u>                                                                         | <u>22</u>     |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds.</u>                           | <u>22</u>     |
| Item 3. <u>Defaults Upon Senior Securities.</u>                                                       | <u>22</u>     |
| Item 4. <u>Mine Safety Disclosures.</u>                                                               | <u>22</u>     |
| Item 5. <u>Other Information.</u>                                                                     | <u>22</u>     |
| Item 6. <u>Exhibits.</u>                                                                              | <u>23</u>     |
| <br><u>SIGNATURES</u>                                                                                 | <br><u>24</u> |

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Table of Contents

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## AZZ INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

(Unaudited)

|                                                                                                                                                                         | August 31,<br>2018 | February 28,<br>2018 |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------|----------------------|
| Assets                                                                                                                                                                  |                    |                      |
| Current assets:                                                                                                                                                         |                    |                      |
| Cash and cash equivalents                                                                                                                                               | \$9,204            | \$20,853             |
| Accounts receivable (net of allowance for doubtful accounts of \$2,398 as of August 31, 2018 and \$569 as of February 28, 2018)                                         | 152,468            | 141,488              |
| Inventories:                                                                                                                                                            |                    |                      |
| Raw material                                                                                                                                                            | 103,959            | 98,475               |
| Work-in-process                                                                                                                                                         | 354                | 2,544                |
| Finished goods                                                                                                                                                          | 8,565              | 9,742                |
| Contract assets                                                                                                                                                         | 71,236             | 51,787               |
| Prepaid expenses and other                                                                                                                                              | 6,657              | 4,265                |
| Total current assets                                                                                                                                                    | 352,443            | 329,154              |
| Property, plant and equipment, net                                                                                                                                      | 209,404            | 216,855              |
| Goodwill                                                                                                                                                                | 324,080            | 321,307              |
| Intangibles and other assets, net                                                                                                                                       | 152,097            | 160,893              |
| Total assets                                                                                                                                                            | \$1,038,024        | \$1,028,209          |
| Liabilities and Shareholders' Equity                                                                                                                                    |                    |                      |
| Current liabilities:                                                                                                                                                    |                    |                      |
| Accounts payable                                                                                                                                                        | \$43,247           | \$54,162             |
| Income tax payable                                                                                                                                                      | 2,453              | 144                  |
| Accrued salaries and wages                                                                                                                                              | 18,725             | 19,011               |
| Other accrued liabilities                                                                                                                                               | 22,768             | 19,622               |
| Customer deposits                                                                                                                                                       | 1,311              | 1,816                |
| Contract liabilities                                                                                                                                                    | 23,763             | 22,698               |
| Debt due within one year                                                                                                                                                | —                  | 14,286               |
| Total current liabilities                                                                                                                                               | 112,267            | 131,739              |
| Debt due after one year, net                                                                                                                                            | 295,679            | 286,609              |
| Other long-term liabilities                                                                                                                                             | 10,759             | 11,696               |
| Deferred income taxes                                                                                                                                                   | 33,394             | 32,962               |
| Total liabilities                                                                                                                                                       | 452,099            | 463,006              |
| Commitments and contingencies                                                                                                                                           |                    |                      |
| Shareholders' equity:                                                                                                                                                   |                    |                      |
| Common stock, \$1 par, shares authorized 100,000; 26,050 shares issued and outstanding at August 31, 2018 and 25,959 shares issued and outstanding at February 28, 2018 | 26,050             | 25,959               |
| Capital in excess of par value                                                                                                                                          | 42,787             | 38,446               |
| Retained earnings                                                                                                                                                       | 544,136            | 526,018              |
| Accumulated other comprehensive loss                                                                                                                                    | (27,048            | ) (25,220 )          |
| Total shareholders' equity                                                                                                                                              | 585,925            | 565,203              |
| Total liabilities and shareholders' equity                                                                                                                              | \$1,038,024        | \$1,028,209          |

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



Table of Contents

AZZ INC.

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

(Unaudited)

|                                          | Three Months Ended |           | Six Months Ended |           |
|------------------------------------------|--------------------|-----------|------------------|-----------|
|                                          | August 31,         |           | August 31,       |           |
|                                          | 2018               | 2017      | 2018             | 2017      |
| Net sales                                | \$222,787          | \$196,329 | \$485,023        | \$401,612 |
| Cost of sales                            | 175,883            | 152,529   | 379,414          | 310,430   |
| Gross margin                             | 46,904             | 43,800    | 105,609          | 91,182    |
| Selling, general and administrative      | 29,799             | 26,413    | 64,808           | 53,772    |
| Operating income                         | 17,105             | 17,387    | 40,801           | 37,410    |
| Interest expense                         | 3,980              | 3,400     | 7,818            | 6,760     |
| Other (income) expense, net              | (857)              | ) 260     | (1,148)          | ) 75      |
| Income before income taxes               | 13,982             | 13,727    | 34,131           | 30,575    |
| Income tax expense                       | 2,738              | 3,941     | 7,169            | 8,727     |
| Net income                               | \$11,244           | \$9,786   | \$26,962         | \$21,848  |
| Earnings per common share                |                    |           |                  |           |
| Basic earnings per share                 | \$0.43             | \$0.38    | \$1.04           | \$0.84    |
| Diluted earnings per share               | \$0.43             | \$0.38    | \$1.03           | \$0.84    |
| Cash dividends declared per common share | \$0.17             | \$0.17    | \$0.34           | \$0.34    |

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

Table of Contents

AZZ INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

|                                                                                 | Three Months<br>Ended August 31, |          | Six Months Ended<br>August 31, |          |
|---------------------------------------------------------------------------------|----------------------------------|----------|--------------------------------|----------|
|                                                                                 | 2018                             | 2017     | 2018                           | 2017     |
| Net income                                                                      | \$11,244                         | \$9,786  | \$26,962                       | \$21,848 |
| Other comprehensive income (loss):                                              |                                  |          |                                |          |
| Foreign currency translation adjustments, net of income tax of \$0              | 455                              | 5,326    | (1,801 )                       | 4,328    |
| Interest rate swap, net of income tax of \$7, \$7, \$15 and \$15, respectively. | (13 )                            | (14 )    | (27 )                          | (27 )    |
| Other comprehensive income (loss)                                               | 442                              | 5,312    | (1,828 )                       | 4,301    |
| Comprehensive income                                                            | \$11,686                         | \$15,098 | \$25,134                       | \$26,149 |

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

Table of Contents

AZZ INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

|                                                                                   | Six Months Ended<br>August 31, |           |
|-----------------------------------------------------------------------------------|--------------------------------|-----------|
|                                                                                   | 2018                           | 2017      |
| Cash Flows From Operating Activities                                              |                                |           |
| Net income                                                                        | \$26,962                       | \$21,848  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                |           |
| Provision for doubtful accounts                                                   | 2,050                          | 47        |
| Amortization and depreciation                                                     | 25,698                         | 24,984    |
| Deferred income taxes                                                             | 467                            | 850       |
| Net loss on property, plant and equipment due to impairment                       | 811                            | —         |
| Net loss (gain) on sale of property, plant and equipment                          | (308 )                         | 554       |
| Amortization of deferred borrowing costs                                          | 343                            | 303       |
| Share-based compensation expense                                                  | 3,659                          | 3,400     |
| Effects of changes in assets and liabilities:                                     |                                |           |
| Accounts receivable                                                               | (13,179 )                      | 939       |
| Inventories                                                                       | (2,171 )                       | (13,304 ) |
| Prepaid expenses and other                                                        | (2,390 )                       | (4,021 )  |
| Other assets                                                                      | (1,017 )                       | (1,106 )  |
| Net change in contract assets and liabilities                                     | (19,278 )                      | (14,197 ) |
| Accounts payable                                                                  | (10,025 )                      | (6,770 )  |
| Other accrued liabilities and income taxes payable                                | 5,845                          | (10,742 ) |
| Net cash provided by operating activities                                         | 17,467                         | 2,785     |
| Cash Flows From Investing Activities                                              |                                |           |
| Proceeds from sale of property, plant and equipment                               | 339                            | 177       |
| Purchase of property, plant and equipment                                         | (7,179 )                       | (16,636 ) |
| Acquisition of subsidiaries, net of cash acquired                                 | (8,000 )                       | (10,250 ) |
| Net cash used in investing activities                                             | (14,840 )                      | (26,709 ) |
| Cash Flows From Financing Activities                                              |                                |           |
| Proceeds from revolving loan                                                      | 178,000                        | 209,000   |
| Payments on revolving loan                                                        | (169,000)                      | (115,500) |
| Payments on long term debt                                                        | (14,286 )                      | (63,504 ) |
| Purchases of treasury shares                                                      | —                              | (5,185 )  |
| Payments of dividends                                                             | (8,844 )                       | (8,845 )  |
| Net cash provided by (used in) financing activities                               | (14,130 )                      | 15,966    |
| Effect of exchange rate changes on cash                                           | (146 )                         | 205       |
| Net decrease in cash and cash equivalents                                         | (11,649 )                      | (7,753 )  |
| Cash and cash equivalents at beginning of period                                  | 20,853                         | 11,302    |
| Cash and cash equivalents at end of period                                        | \$9,204                        | \$3,549   |

## Supplemental disclosures

|                            |         |         |
|----------------------------|---------|---------|
| Cash paid for interest     | \$7,838 | \$7,020 |
| Cash paid for income taxes | \$1,514 | \$7,605 |

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





Table of Contents

AZZ INC.

## CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(In thousands)

(Unaudited)

|                              | Common Stock | Capital  | Retained            | Accumulated | Total                    |           |
|------------------------------|--------------|----------|---------------------|-------------|--------------------------|-----------|
|                              | Shares       | Amount   | 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     | 15           | 15       | 3,644               | —           | —                        | 3,659     |
| Restricted stock units       | 30           | 30       | (563 )              | —           | —                        | (533 )    |
| Stock issued for SARs        | 9            | 9        | (30 )               | —           | —                        | (21 )     |
| Employee stock purchase plan | 37           | 37       | 1,290               | —           | —                        | 1,327     |
| Cash dividends paid          | —            | —        | —                   | (8,844 )    | —                        | (8,844 )  |
| Net income                   | —            | —        | —                   | 26,962      | —                        | 26,962    |
| Foreign currency translation | —            | —        | —                   | —           | (1,801 )                 | (1,801 )  |
| Interest rate swap           | —            | —        | —                   | —           | (27 )                    | (27 )     |
| Balance at August 31, 2018   | 26,050       | \$26,050 | \$42,787            | \$544,136   | \$ (27,048 )             | \$585,925 |

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

Table of Contents

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 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 August 31, 2018, the results of its operations for the three and six months ended August 31, 2018 and 2017, and cash flows for the six months ended August 31, 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 six months ended August 31, 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 six months ended August 31, 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. This ASU will be effective for the Company in the first quarter of its fiscal year 2020 and early adoption is permitted. The ASU requires adoption based upon a modified retrospective transition approach. The Company has not yet determined whether it will elect early adoption and is currently evaluating the impact of the adoption of this standard to its consolidated financial statements and related disclosures. In particular, the Company has made progress in assessing its portfolio of leases for accounting and disclosure purposes. To address the new standard's requirements, the Company is also in the process of assessing the design of the future lease accounting procedures and

## Table of Contents

related internal controls, selecting and implementing lease accounting software, and finalizing policies, including the election of any practical expedients permitted by the standard. While the Company has not yet completed its evaluation of the financial statement impact of the new lease accounting standard, the Company expects to recognize right of use assets and lease liabilities for its operating leases in its consolidated balance sheets upon adoption and thereafter.

### 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 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

Table of Contents

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 six months ended August 31, 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 six months ended August 31, 2018 related to performance obligations satisfied in prior periods. The Company expects to recognize revenues of approximately \$18.2 million, \$4.1 million and \$1.5 million in fiscal 2019, 2020 and 2021, respectively, related to the \$23.8 million balance of contract liabilities as of August 31, 2018.

The increases or decreases in accounts receivable, contract assets and contract liabilities during the three and six months ended August 31, 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.

**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<br>Ended August 31, |            | Six Months Ended<br>August 31, |            |
|------------------------------------------------------|----------------------------------|------------|--------------------------------|------------|
|                                                      | 2018                             | 2017       | 2018                           | 2017       |
| Net sales:                                           |                                  |            |                                |            |
| Industrial - oil and gas, construction, and general* | \$ 120,305                       | \$ 115,834 | \$ 271,613                     | \$ 228,919 |
| Transmission and distribution*                       | 60,152                           | 41,229     | 126,106                        | 84,339     |

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|                   |           |           |           |           |
|-------------------|-----------|-----------|-----------|-----------|
| Power generation* | 42,330    | 39,266    | 87,304    | 88,354    |
| Total net sales   | \$222,787 | \$196,329 | \$485,023 | \$401,612 |

10

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Table of Contents

\* The Company revised its internal methodology for allocating revenues by customer industry during the three months ended August 31, 2018. All prior periods have been recast to conform to this revised methodology.

## 3. Earnings Per Share

Earnings 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 per share (in thousands, except per share data):

|                                                                         | Three Months<br>Ended August<br>31, |         | Six Months<br>Ended August 31, |          |
|-------------------------------------------------------------------------|-------------------------------------|---------|--------------------------------|----------|
|                                                                         | 2018                                | 2017    | 2018                           | 2017     |
| Numerator:                                                              |                                     |         |                                |          |
| Net income for basic and diluted earnings per common share              | \$11,244                            | \$9,786 | \$26,962                       | \$21,848 |
| Denominator:                                                            |                                     |         |                                |          |
| Denominator for basic earnings per common share—weighted average shares | 26,019                              | 25,970  | 26,001                         | 25,991   |
| Effect of dilutive securities:                                          |                                     |         |                                |          |
| Employee and director stock awards                                      | 72                                  | 66      | 61                             | 74       |
| Denominator for diluted earnings per common share                       | 26,091                              | 26,036  | 26,062                         | 26,065   |
| Earnings per share basic and diluted:                                   |                                     |         |                                |          |
| Basic earnings per common share                                         | \$0.43                              | \$0.38  | \$1.04                         | \$0.84   |
| Diluted earnings per common share                                       | \$0.43                              | \$0.38  | \$1.03                         | \$0.84   |

## 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 August 31, 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 six month period ended August 31, 2018 is as follows:

|                                            | Restricted<br>Stock<br>Units | Weighted<br>Average Grant<br>Date Fair Value |
|--------------------------------------------|------------------------------|----------------------------------------------|
| Non-vested balance as of February 28, 2018 | 109,777                      | \$ 56.62                                     |
| Granted                                    | 82,371                       | 42.00                                        |
| Vested                                     | (37,670 )                    | 54.63                                        |
| Forfeited                                  | (7,290 )                     | 55.27                                        |
| Non-vested balance as of August 31, 2018   | 147,188                      | \$ 49.01                                     |



Table of Contents

## Performance Share Unit Awards

Performance share unit awards are valued at the market price of our common stock on the grant date. These 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 awards are subject to the Company's degree of achievement of a target annual average adjusted return on assets during these three-year periods. In addition, a multiplier may be applied to the total awards granted which is based on the Company's total shareholder return during such three-year period in comparison to a defined specific industry peer group as set forth in the plan.

A summary of the Company's non-vested performance share unit award activity for the six month period ended August 31, 2018 is as follows:

|                                            | Performance<br>Stock Units | Weighted<br>Average<br>Grant<br>Date Fair<br>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 August 31, 2018   | 83,125                     | \$ 49.74                                           |

## 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 six month period ended August 31, 2018 is as follows:

|                                     | SARs      | Weighted Average<br>Exercise Price |
|-------------------------------------|-----------|------------------------------------|
| Outstanding as of February 28, 2018 | 148,513   | \$ 43.29                           |
| Granted                             | —         | —                                  |
| Exercised                           | (43,928 ) | 40.96                              |
| Forfeited                           | —         | —                                  |
| Outstanding as of August 31, 2018   | 104,585   | \$ 44.27                           |
| Exercisable as of August 31, 2018   | 104,585   | \$ 44.27                           |

The average remaining contractual term for those stock appreciation rights outstanding as of August 31, 2018 is 2.33 years, with an aggregate intrinsic value of \$1.0 million. The average remaining contractual terms for those stock appreciation rights that are exercisable as of August 31, 2018 is 2.33 years, with an aggregate intrinsic value of \$1.0 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 six month period ended August 31, 2018, the Company issued 37,224 shares under the Employee Stock Purchase Plan.

12

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Table of Contents

## 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):

|                      | Six Months<br>Ended August<br>31, |         |
|----------------------|-----------------------------------|---------|
|                      | 2018                              | 2017    |
| Compensation expense | \$3,659                           | \$3,400 |
| Income tax benefits  | \$823                             | \$1,088 |

Unrecognized compensation cost related to restricted stock units, performance share unit awards, stock appreciation rights, and the employee stock purchase plan at August 31, 2018 totals \$8.8 million.

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

## 5. Segments

## Segment Information

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

|                          | Three Months Ended<br>August 31, |           | Six Months Ended<br>August 31, |           |
|--------------------------|----------------------------------|-----------|--------------------------------|-----------|
|                          | 2018                             | 2017      | 2018                           | 2017      |
| Net sales:               |                                  |           |                                |           |
| Energy                   | \$106,515                        | \$97,299  | \$253,501                      | \$210,504 |
| Metal Coatings           | 116,272                          | 99,030    | 231,522                        | 191,108   |
| Total net sales          | \$222,787                        | \$196,329 | \$485,023                      | \$401,612 |
| Operating income (loss): |                                  |           |                                |           |
| Energy                   | \$4,273                          | \$2,363   | \$14,231                       | \$9,074   |
| Metal Coatings           | 22,076                           | 23,409    | 47,260                         | 44,651    |
| Corporate                | (9,244 )                         | (8,385 )  | (20,690 )                      | (16,315 ) |
| Total operating income   | \$17,105                         | \$17,387  | \$40,801                       | \$37,410  |

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

|                | August 31,<br>2018 | February 28,<br>2018 |
|----------------|--------------------|----------------------|
| Total assets:  |                    |                      |
| Energy         | \$574,230          | \$554,866            |
| Metal Coatings | 453,821            | 460,575              |
| Corporate      | 9,973              | 12,768               |
| Total          | \$1,038,024        | \$1,028,209          |

For the three and six months ended August 31, 2018, 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 for the three and six months ended August 31, 2018, which were also classified within cost of sales in the consolidated statement of income.



Table of Contents

## Financial Information About Geographical Areas

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

|               | Three Months             |           | Six Months Ended   |           |
|---------------|--------------------------|-----------|--------------------|-----------|
|               | Ended August 31,<br>2018 | 2017      | August 31,<br>2018 | 2017      |
| Net sales:    |                          |           |                    |           |
| United States | \$188,278                | \$162,490 | \$401,834          | \$329,219 |
| International | 34,509                   | 33,839    | 83,189             | 72,393    |
| Total         | \$222,787                | \$196,329 | \$485,023          | \$401,612 |

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

|                 | August 31, February 28,<br>2018     |           | 2018 |  |
|-----------------|-------------------------------------|-----------|------|--|
|                 | Property, plant and equipment, net: |           |      |  |
| United States   | \$187,983                           | \$194,418 |      |  |
| Canada          | 17,410                              | 18,254    |      |  |
| Other countries | 4,011                               | 4,183     |      |  |
| Total           | \$209,404                           | \$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 six month period ended August 31, 2018 (in thousands):

|                              | Warranty Reserve |
|------------------------------|------------------|
| Balance at February 28, 2018 | \$ 2,013         |
| Warranty costs incurred      | (1,179 )         |
| Additions charged to income  | 1,221            |
| Balance at August 31, 2018   | \$ 2,055         |

## 7. Debt

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

|                                                  | August 31, February 28,<br>2018 |           | 2018      |  |
|--------------------------------------------------|---------------------------------|-----------|-----------|--|
|                                                  | 2011 Senior Notes               | \$125,000 | \$125,000 |  |
| 2008 Senior Notes                                | —                               | 14,286    |           |  |
| 2017 Revolving Credit Facility                   | 171,000                         | 162,000   |           |  |
| Total debt                                       | 296,000                         | 301,286   |           |  |
| Unamortized debt issuance costs for Senior Notes | (321 )                          | (391 )    |           |  |
| Total debt, net                                  | 295,679                         | 300,895   |           |  |
| Less amount due within one year                  | —                               | (14,286 ) |           |  |
| Debt due after one year, net                     | \$295,679                       | \$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.





Table of Contents

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.

Table of Contents

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 six months ended August 31, 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 six months ended August 31, 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.

16

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Table of Contents

## Orders and Backlog

Our entire backlog relates to our Energy Segment and was \$336.0 million as of August 31, 2018, an increase of \$70.6 million, or 26.6%, as compared to \$265.4 million as of February 28, 2018. Our backlog increased \$35.9 million, or 12.0%, 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 August 31, 2018, our book-to-revenue ratio increased to 1.14 to 1 from 0.97 to 1 when compared to same period of fiscal 2018 and our incoming net orders increased by \$63.8 million, or 33.6%.

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       |

\* Previously reported amounts have been revised to reflect the impact of system conversion changes.

## Segment Revenues

For the three and six months ended August 31, 2018, consolidated revenues increased \$26.5 million, or 13.5%, and \$83.4 million or 20.8%, respectively, as compared to the same periods in fiscal 2018.

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

|                 | Three Months     |           | Six Months Ended |           |
|-----------------|------------------|-----------|------------------|-----------|
|                 | Ended August 31, |           | August 31,       |           |
|                 | 2018             | 2017      | 2018             | 2017      |
| Net sales:      |                  |           |                  |           |
| Energy          | \$106,515        | \$97,299  | \$253,501        | \$210,504 |
| Metal Coatings  | 116,272          | 99,030    | 231,522          | 191,108   |
| Total net sales | \$222,787        | \$196,329 | \$485,023        | \$401,612 |

Revenues for the Energy segment increased \$9.2 million or 9.5%, and \$43.0 million or 20.4%, respectively, for the three and six months ended August 31, 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 \$17.2 million or 17.4%, and \$40.4 million or 21.1%, respectively, for the three and six months ended August 31, 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.

Table of Contents

## Segment Operating Income

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

|                          | Three Months             |          | Six Months Ended   |           |
|--------------------------|--------------------------|----------|--------------------|-----------|
|                          | Ended August 31,<br>2018 | 2017     | August 31,<br>2018 | 2017      |
| Operating income (loss): |                          |          |                    |           |
| Energy                   | \$4,273                  | \$2,363  | \$14,231           | \$9,074   |
| Metal Coatings           | 22,076                   | 23,409   | 47,260             | 44,651    |
| Corporate                | (9,244 )                 | (8,385 ) | (20,690 )          | (16,315 ) |
| Total operating income   | \$17,105                 | \$17,387 | \$40,801           | \$37,410  |

Operating income for the Energy segment increased by \$1.9 million or 80.8%, and \$5.2 million or 56.8%, respectively, for the three and six months ended August 31, 2018 as compared to the same periods in fiscal 2017. Operating margins were 4.0% and 2.4%, for the three months ended August 31, 2018 and 2017, respectively, and 5.6% and 4.3% for the six months ended August 31, 2018 and 2017, respectively. These increases were primarily attributable to the positive factors noted above and improvements in project margins.

Operating income for the Metal Coatings segment decreased by \$1.3 million or 5.7% and increased \$2.6 million or 5.8%, respectively, for the three and six months ended August 31, 2018 as compared to the same periods in fiscal 2017. These changes were primarily attributable to the favorable trends in volumes and selling prices, but were negatively impacted by higher zinc costs and a one-time charge of \$1.3 million during the three months ended August 31, 2018 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. Operating margins were 19.0% and 23.6%, for the three months ended August 31, 2018 and 2017, respectively and 20.4% and 23.4% for the six months ended August 31, 2018 and 2017, respectively. The declines were attributable to higher zinc costs, which were not fully offset by increased selling prices, and the one-time charge for the consolidation of facilities.

## Corporate Expenses

Corporate expenses increased by \$0.9 million or 10.2%, and \$4.4 million or 26.8%, respectively, for the three and six months ended August 31, 2018 as compared to the prior year comparable periods. These increases were primarily attributable to increased employee compensation, outside professional services and general corporate marketing activities.

## Interest Expense

Interest expense for the three and six months ended August 31, 2018 was \$4.0 million and \$7.8 million, respectively, as compared to \$3.4 million and \$6.8 million for the prior year comparable periods. These increases were the result of higher average outstanding debt balances and higher interest rates on variable rate debt. Our gross debt to equity ratio was 0.51 to 1 as of August 31, 2018, compared to 0.55 to 1 as of August 31, 2017.

## Other (Income) Expense

Other income, net was \$(0.9) million and \$(1.1) million, respectively, for the three and six months ended August 31, 2018, as compared other expense, net of \$0.3 million and \$0.1 million for the respective prior year comparable periods. Other income, net increased primarily as a result of a downward revision to estimated losses related to the impairment of a non-trade note receivable that was initially recognized in the fourth quarter of fiscal 2017 upon the bankruptcy declaration of the note debtor. The bankruptcy proceedings have progressed better than anticipated and the Company expects to receive amounts in excess of its initial loss estimates for the outstanding note, which originated from a non-compete litigation settlement with a competitor in a prior fiscal year. This increase in other income, net was partially offset by higher foreign exchange losses that were realized during the three and six months ended August 31, 2018 as a result of unfavorable movements in exchange rates.

## Income Taxes

The provision for income taxes reflects an effective tax rate of 19.6% and 21.0%, respectively, for the three and six months ended August 31, 2018, as compared to 28.7% and 28.5% for the respective prior year comparable periods. The decreases in the effective rate is primarily attributable to the Tax Cuts and Jobs Act of 2017.



Table of Contents

## 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 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):

|                                                     | Six Months Ended |          |
|-----------------------------------------------------|------------------|----------|
|                                                     | August 31,       |          |
|                                                     | 2018             | 2017     |
| Net cash provided by operating activities           | \$17,467         | \$2,785  |
| Net cash used in investing activities               | (14,840 )        | (26,709) |
| Net cash provided by (used in) financing activities | (14,130 )        | 15,966   |

For the six month period ended August 31, 2018, net cash provided by operating activities was \$17.5 million, net cash used in investing activities was \$14.8 million, net cash used in financing activities was \$14.1 million, and a decrease of \$0.1 million from the net effect of exchange rate changes on cash resulting in a net decrease in cash and cash equivalents of \$11.6 million. In comparison to the comparable period in fiscal 2018, the results in the statement of cash flows for operating activities for the six month period ended August 31, 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 six month period ended August 31, 2018 due primarily to net payments made on outstanding borrowings.

Our working capital was \$240.2 million as of August 31, 2018, as compared to \$197.4 million at February 28, 2018.

## Financing and Capital

As of August 31, 2018, the Company had \$296.0 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 August 31, 2018, the Company had approximately \$259.8 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 six months ended August 31, 2018.

19

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Table of Contents

## 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 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 August 31, 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<br>Leases | Long-Term<br>Debt | Interest | Total     |
|------------|---------------------|-------------------|----------|-----------|
| Fiscal:    |                     |                   |          |           |
| 2019       | \$4,291             | \$ —              | \$6,898  | \$11,189  |
| 2020       | 7,293               | —                 | 13,796   | 21,089    |
| 2021       | 5,944               | 125,000           | 13,796   | 144,740   |
| 2022       | 5,728               | —                 | 7,021    | 12,749    |
| 2023       | 5,464               | 171,000           | 694      | 177,158   |
| Thereafter | 26,343              | —                 | —        | 26,343    |
| Total      | \$55,063            | \$296,000         | \$42,205 | \$393,268 |

As of August 31, 2018, we had outstanding letters of credit in the amount of \$27.6 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 six month period ended August 31, 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.



Table of Contents

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 six 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.

Table of Contents

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 August 31, 2018.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

Table of Contents

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).
- 10.7\* First Amendment to the Amended and Restated Employment Agreement, dated October 3, 2018, by and between AZZ Inc. and Tom Ferguson. Filed Herewith.
- 10.8\* First Amendment to the Employment Agreement, dated October 3, 2018, by and between AZZ Inc. and Paul Fehlman. Filed Herewith.
- 10.9\* First Amendment to the Change In Control Agreement, dated October 3, 2018, by and between AZZ Inc. and Tom Ferguson. Filed Herewith.
- 10.10\* First Amendment to the Change In Control Agreement, dated October 3, 2018, by and between AZZ Inc. and Paul Fehlman. Filed Herewith.
- 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

23

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Table of Contents

SIGNATURES

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

AZZ Inc.  
(Registrant)

Date: October 9, 2018 By: /s/ Paul W. Fehlman  
Paul W. Fehlman  
Senior Vice President and  
Chief Financial Officer