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NCI Building Systems, Inc. (NCS)

Q1 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the NCI Building Systems, Inc. First Quarter Earnings Conference Call. During today's presentation, all parties will be in a listen-only mode. Following the presentation, the conference will be opened for questions. [Operator Instructions] This conference is being recorded today, March 12, 2014.

I would now like to turn the call over to Layne de Alvarez, Vice President of Investor Relations. Please go ahead, Layne.

Layne de Alvarez

Vice President, Investor Relations, NCI Building Systems, Inc.

Thank you. Good morning and welcome to the NCI Building Systems' call to review the company's results for the first quarter of fiscal 2014. To access a taped replay of this call, please dial 1-800-406-7325 and enter the passcode 4668423 and the pound sign when prompted. The replay will be available approximately two hours after this call and will remain accessible through March 19. The replay will also be available at the company's website at ncigroup.com.

The company's first quarter results were issued last night in a press release that was covered by the financial media. In keeping with SEC requirements, I advise that during this call we would be making forward-looking statements that involve risks and uncertainties. Actual outcomes may differ materially from those expected or

implied. For more detailed discussion of the risks and uncertainties that may affect NCI, please review our SEC filings, including the 8-K filed last night.

Forward-looking statements speak only as the date they are made. We undertake no obligation to update any forward-looking statements beyond what's required by applicable securities laws. In addition, our discussion of operating performance will include non-GAAP financial measures. A reconciliation of these measures with the most directly comparable GAAP measures is included in earnings release and the CFO commentary, both of which are available on our website.

At this time, I would like to turn the call over to NCI's Chairman, President and Chief Executive Officer, Norm Chambers.

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

Thank you, Layne, and good morning, everyone, and welcome to our first quarter 2014 conference call. Joining me this morning are Mark Johnson, our Chief Financial Officer; Todd Moore, our General Counsel; and Layne de Alvarez, our Vice President of Investor Relations.

Our first quarter earnings were released last night, so hopefully you all had a time to review the numbers. We'd like to spend most of our time this morning answering your questions, but first I am going to briefly comment on the quarter and Mark will provide some additional color on the financial details.

After the impact of the most severe winter the country has experienced in decades, we are in much stronger position today than we were this time last year. First, we continue to outpace the market. During the first quarter, our sales were up 4.4% while low-rise nonresidential new constructions starts declined 5.5% on a year-over-year basis. The market where our sales had been historically the most robust, two-storey and less, declined 10.6% year-over-year according to McGraw Hill data. These declines in new constructions starts have been largely attributed to the winter weather.

Our performance reflects our customer support as we work to provide the highest quality products combined with exceptional customer service during even the most challenging seasons. We appreciate our customer support of our – in fact of our initiatives to improve the value of products provided to them.

Our first quarter bookings for our Buildings group were up 11% and the buildings backlog was up 4% on a year-over-year basis. You will recall that both bookings and backlog had unfavorable the year-over-year comparisons from November of 2012 through July of 2013. Bookings and backlog have improved year-over-year in both of fiscal fourth quarter 2013 and fiscal first quarter 2014.

Additionally, an indicative of the success of our value pricing initiatives, the growth of dollar value was up 190 basis points higher than the growth in volume for the last seven months, and that improvement is reflected in our current backlog. This is an important reversal of last year's trend in which volume grew faster than value. We expect quarterly improvement in bookings and backlogs to continue throughout 2014 as the economy improves.

Second, key market indicators continue to demonstrate the momentum we began to experience in late 2013 is expected to accelerate through 2014 and beyond. Industrial vacancy rates continue to fall. And 2013 ended with the strongest quarterly absorption for the year since 2005 supporting the notion that tightening supply will necessitate new construction as the recovery advances. The latest Fed Senior Loan Officer Survey showed an

ongoing easing in lending standards, which tends to lead capital spending by four quarters to six quarters. The ABI index has been up 15 over the past 17 months, which also reflects the stabilization of the economy.

Our outlook for fiscal 2014 remains positive. Although the second quarter continues to be negatively affected by the same weather-induced impacts to shipments, February quarter weather was even more disruptive than January. We believe once the weather improves, we will be able to take advantage of the strengthening nonresidential market. We anticipate that we will benefit from significant pent-up demand, although we are likely to be challenged to recover all of the lost work from the first half of our year. Keeping in mind that historically 60% to 90% of our earnings are generated in the second half of our fiscal year, we're not deterred by the slow start.

While we still have work to do to improve our transportation costs, we are already benefiting from the reorganization of our manufacturing operations, which will become even more important as volumes improve and operating leverage kicks in. We've seen meaningful and measurable improvement in certain aspects of our manufacturing cost per ton and expect those efficiencies to be reflected in expanded margins by the second half of the year.

The Buildings group recorded an improved total manufacturing cost per ton with January registering a 7% year-over-year improvement. Improving our delivery times to our customers, completeness and erectability of our buildings is fundamental to their success and ours. And the changes we've made to the Buildings group manufacturing team are committed to do just that.

Historically, our industry has tied pricing almost solely to the rising steel costs. However, we operate in an environment of ever-increasing costs, ranging from transportation to healthcare to increased regulations and to improving wages for our employees and, most importantly, supporting our customer success with systems and additional services. Therefore, we will continue to periodically and thoughtfully raise our prices in a coordinated effort with our customers. When the weather improves and our mix is normalized, we expect to see greater benefits from price improvements.

Finally, despite the challenges we and our customers have faced this winter, I remain confident as do they that we are well-positioned to take advantage of the strengthening nonresidential construction market and look forward to reporting improving performance through fiscal 2014.

Now, I'll turn the call over to Mark, so we can add some color to our financial results.

Mark E. Johnson

Chief Financial Officer, Treasurer & EVP, NCI Building Systems, Inc.

Thanks, Norm, and good morning, all. In our press release and in the CFO commentary, both of which are available on our site, we have provided discussion of the key elements of our financial results. I would like to take a few minutes to provide some additional color.

We were pleased to report a 4.4% increase in revenue during the quarter despite the fact that nonresidential construction was down during that period, particularly for low-rise construction. However, we were unable to drive more profits to our bottom line. Unfortunately, weather and mix were the biggest culprits, combined with continued investments in some key growth initiatives.

Let me walk through some of the impacts of the severe weather conditions had on our operations. First, during the quarter, we had 17 plant closure days versus only seven last year. These disruptions, combined with the midweek holidays, resulted in inefficient production schedule throughout December and January.

Second, our supply chain was disrupted. Material costs and production efficiency were impacted by shortages caused by waterway and road transportation issues associated with the weather. Also just like our operations, our suppliers experienced difficulties in meeting production and delivery commitments.

Third, extended cold temperatures resulted in higher utility expenses and impacted the efficiency with which chemicals are utilizing our insulated panel facilities. The unusual temperature variations increase the amount of scrap and rejected material related to the insulated metal panels.

Fourth, our transportation costs were higher due to the disruption in traffic caused by the major snowstorms as well as the impact of manufacturing delays. In some cases, we were able to ship production within our geographic footprint to meet customer requirements, but incurred higher transportation costs as a result if and possibly most important, our product mix and volume of business was negatively impacted. Poor construction site weather delayed many planned projects because site preparation or foundation work could not be completed as scheduled.

As a result, our product mix shifted towards products that are interior in nature and therefore less disruptive by exterior weather conditions. Partially as a result of weather, we filled record orders for cold storage insulated panel, because they tend to be interior products. All together, we estimate that the combined effect of the disruptions to our supply chain, manufacturing schedules and business mix, negatively impacted our gross margins by approximately 110 basis points.

With weather having had a significant impact on our performance in the first quarter and signs that severe weather is continuing into the start of our second quarter, I want to reflect on the seasonality of our business, but most businesses with exposure to construction, we are highly seasonal and historically between 60% and 90% of our annual EBITDA has been earned in the last half of our fiscal year.

One of the key determinants of the level of seasonality we see in any given year is the severity of the winter weather and its impact on construction site conditions. Therefore, we believe it is reasonable to expect that given the severity of the weather so far this year, our second half earnings in 2014 will be closer to the higher end of the historical 60% to 90% range.

Now, I'd like to provide an overview of our consolidated results for the quarter and touch on some of the key aspects of our segment results. Despite adverse weather and declines in new construction starts, each of our three segments achieved revenue growth. However, gross profit was lower than the prior year, due primarily to the impact of the items I just discussed.

Further, ESG&A expenses while lower as a percent of sales increased by \$1.9 million over the prior year. Our expenses this year included \$700,000 related to the secondary offering completed in January and an incremental \$1.2 million in our Components group to further invest in key growth initiatives.

As a result, we incurred an operating loss of \$3.2 million compared to operating income just over breakeven in the prior year. Adjusted EBITDA for the quarter at \$8 million, was \$5.5 million lower than the prior year. In addition to the decrease in operating income, adjusted EBITDA was negatively impacted by the exclusion of the \$1 million gain on insurance recovery and a \$900,000 negative swing in other income and expenses, which was primarily driven by foreign currency losses due to the recent devaluation in the Canadian currency.

Now, I will provide some highlights for each of our three segments. Our Coating segment operating income increased by nearly \$1 million over the prior year and increased the operating margin from 11% to 12%. While this division was impacted by the various disruptions of adverse weather, these issues were offset by the 10% growth in revenue and a \$1 million non-recurring insurance recovery gain. Third-party external revenue grew nearly 28% as a result of our new Middletown facility, which became operational in January of last year.

Our Component segment operating income declined by \$2 million from the prior year. Revenue grew 2.8% driven by growth in insulated panel offset by small declines in traditional component products. Margins were lower primarily due to weather-induced operating inefficiency and unfavorable mix. The mix issue is primarily the result of lower commercial and industrial insulated metal panel, but higher cold storage insulated panel which typically have a lower margin contribution.

The operating expenses for this segment were higher than the prior year primarily due to \$1.2 million in incremental cost to pursue key growth initiatives, expand our sales and service capabilities and distribution channel.

Our Building segment operating income declined by \$2.4 million from the prior year. Revenue grew 3.2%. Half of the revenue growth came from the incremental erection services while increased volume and prices accounted for the other half. This revenue mix shift reduced the operating margins by approximately 60 basis points while the weather induced inefficiency accounted for an additional 100 basis points.

Now, I'll turn to some highlights on our cash flows and balance sheet. We used approximately \$34 million in cash for operations during the first quarter, compared to \$13 million in last year's first quarter. This is consistent with our typical historical pattern, where we invest in our working capital in the seasonally weaker periods following the fourth quarter peak. The cash investment this year is higher than last year due to the timing of accounts payable payments between our seasonally stronger fourth quarter into our seasonally weaker periods and increases in inventory related to increasing steel cost and lower than anticipated shipments to-date.

Keep in mind that we generate the bulk of our operating cash flow in the second half of our fiscal year. And this year is likely to be even more seasonally weighted to the second half as discussed earlier. We used approximately \$23 million in financing activities this year, compared to \$10 million in the prior year. This increase resulted primarily from the repurchase of approximately \$20 million of common stock in connection with the secondary offering completed in January this year, compared to a \$9 million reduction in long-term debt last year.

Turning now to our outlook. Norm has already commented on our positive outlook for fiscal 2014. I want to focus on our second quarter specifically. In the CFO commentary available on our website and filed in 8-K, we have provided specific expectations for our second quarter for ESG&A expenses, interest expense, effective tax rate, the weighted average diluted share count and capital expenditures.

In addition to these items, the severity of the weather conditions seen in our first quarter have continued so far into our second quarter. One measure we have for this is our own plant closures due to inclement weather. We've had 10 plant closure days so far in our second quarter compared to a total of only three for the entire second quarter last year. Given the continuation of these conditions and the expectation that we will incur approximately \$1.1 million in incremental year-over-year costs related to our growth initiatives, we currently expect our second quarter operating income to improve sequentially, but it will be challenging for us to produce meaningful improvement in operating income over the prior year second quarter.

As I described earlier, we anticipate that the level of seasonality, which is fundamentally a function of weather, will be at the higher end of our historical range and the vast majority of our annual EBITDA will be earned in our second half.

As Norm highlighted earlier, given the investments we've made to streamline and enhance our operations, we look forward to leveraging our operations as we move into the less disruptive second half of the year, as projected low-rise construction starts to pick up and our capacity utilization improves.

Now I would like to turn the call back to the operator for the Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you, sir. [Operator Instructions] Please ask one question, one follow-up and return to the queue for additional questions. Our first question is from the line of Bob Wetenhall with RBC Capital Markets. Please go ahead.

Robert Wetenhall
Analyst, RBC Capital Markets LLC

Q

Hi, good morning.

Norman C. Chambers
Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Good morning, Bob.

Mark E. Johnson
Chief Financial Officer, Treasurer & EVP, NCI Building Systems, Inc.

A

Good morning.

Robert Wetenhall
Analyst, RBC Capital Markets LLC

Q

I was hoping, Mark, maybe you could provide a little bit of color in helping us think about gross margin performance in 2Q and obviously it sounds like you're overall bullish on the backend and the full year outlook. But how do we think about absorption in a low volume environment in second quarter?

Mark E. Johnson
Chief Financial Officer, Treasurer & EVP, NCI Building Systems, Inc.

A

It's a great question. I think the primary challenge to our margins in the first quarter was, is that the level of disruption we had associated with weather. And we have seen that continued through February and into the early parts of March. So we do anticipate that despite the fact that we've had price increases throughout all of our segments, we expect the product mix is still be challenged in our second quarter and some of those disruptions to also continue to occur. So we look to our margins being in the neighborhood of the margins that we had in the prior year, but do not expect that we will see meaningful improvement.

Norman C. Chambers
Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

And Bob, one of the things that I think that is encouraging is that we actually have had more disruption in February than we did in February last year. And from one standpoint, if we can stand in the range of the margins that we had in the second quarter of last year then that would mean we've really made some recovery.

Robert Wetenhall

Analyst, RBC Capital Markets LLC

Q

Got it. That makes sense. And I was also hoping you could give us a little bit of color, it seems like you guys are outpacing the market, which is great taking the some share, but hopefully what's going on in terms of pricing? You spoke a lot about pricing trends in response to offsetting raw material cost. It's kind of the traditional paradigm, but you're also trying to cover some other expenses. What's your full year outlook by segment for pricing improvement? Thanks a lot and good luck.

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Thanks Bob. Yeah, so I think that the 190 basis points that I talked about in terms of the growth and the value in our bookings, over the growth in volume in our bookings, which is really inverse to last year in a positive way, is also as I think I said reflected in our backlog, meaning our margins are up. So at the end of the day, if we can continue to keep that level of spread going forward, and that would indicate meaningful improvement in our Buildings group. Now that's the only place we have this measurable situation, because of bookings and backlog. But I'll tell you that all the – both our coating group and our Components group are equally focused on their margins and profitability and pricing and they're trying to do it in very thoughtful way, but nevertheless we all understand the importance. So we're looking for improvement throughout the year, both in our pricing as well as in our margins that will be reflected in the earnings in Q3 and Q4 in particular. And it'll help to some extent overcome the weather disruption in Q2.

Operator: Thank you. And our next question is from the line of Winnie Clark with UBS. Please go ahead.

Winnie Clark

Analyst, UBS Securities LLC

Q

Good morning.

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Good morning, Winnie.

Winnie Clark

Analyst, UBS Securities LLC

Q

I was hoping that you could give us some color on what you're seeing by end market. Are there are any particular segments that seem to be driving the improvement you're seeing and particularly relative to the outperformance that you realized in the quarter, which was pretty meaningful versus the underlying end market?

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Yeah. So we definitely have seen a meaningful improvement in the warehousing and the storage facilities. And I think that this is in part a growing in a representation of the improvement in overall in the commercial part of the economy, right. And so, the warehousing piece is up about 40%, which is a good indication.

Winnie Clark

Analyst, UBS Securities LLC

Q

Okay. Great. That's helpful. And then just specifically in terms of the lost work that you've realized or you've seen due to weather, what would you say – and I know you might not expect to see it all this year, but is there some way you could quantify what portion of that you think could be recaptured in the second half of the year? And then would you expect to recover all of it or is there a portion of that business that could potentially be gone through more permanently?

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Okay. So, when we broadly think about this we think about that we probably saw an erosion of \$10 million in revenue in the quarter from our expectations. And I know that our teams are working diligently to stay on plan, which means to work to recover that. But from experience, I can tell you that I know that that's a really difficult task, not because the work isn't there, but in part because we have a situation where the people that distribute and build our products kind of can only do a finite amount of work without adding lots of people. So there is a number of aspects that go into whether or not we can capture that. But I will say that I think that we will be able to give more indication at the end of our second quarter call, because we would expect to see some evidence if we are able to start to recover that and we can talk about that in the second quarter call.

Winnie Clark

Analyst, UBS Securities LLC

Q

Okay, great. Thanks so much.

Operator: Thank you. And our next question is from the line of Trey Grooms with Stephens. Please go ahead.

Blake Hirschman

Analyst, Stephens, Inc.

Q

Yeah. Good morning, Norm, Mark, Layne. This is actually Blake stepping in for Trey this morning. My first question is from a top line, which actually exceeded our expectations in the tough winter and – environment this quarter and we understand that February was rough at all, but considering the decent booking should we expect any level of pent up demand and therefore a year-over-year increase in the top line for the second quarter or more like you've kind of alluded to, is that all back half weighted?

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Unfortunately, you were breaking up a fair amount on that question, but I think you were asking whether we are going to see in the second quarter an improvement, is that correct?

Mark E. Johnson

Chief Financial Officer, Treasurer & EVP, NCI Building Systems, Inc.

A

In top line.

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

In the top line.

Blake Hirschman
Analyst, Stephens, Inc.

Q

Yes. That's right.

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Yeah, I mean, we are expecting to see some growth in the top line I mean in fact on a sequential basis.

Blake Hirschman

Analyst, Stephens, Inc.

Q

Okay. Got it. And then lastly, with your expectation for demand to be up mid-to high single digits for the full year, should we start to see any improvement in margin in April, if the weather cooperates, we're just trying to get a feel for how quickly any pent up demand could be flowing through? That's all I got. Thanks.

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Yeah. So I mean as I think I said we're trying to say with some clarity that I think if you take the fact that February is completed and if you take into account the fact that we've had much worse weather than a year ago. And then – but yet are still seeing that we will be around not materially below or above our second quarter 2013, no margins. And that means we're getting some improvement. And that's the point I tried to make to Bob as well. I mean we are seeing some improvement and we're seeing improvement in pricing, we're seeing improvement in our margins as well.

Blake Hirschman

Analyst, Stephens, Inc.

Q

All right. Thank you.

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Yep.

Operator: Thank you. And our next question is from the line of Lee. Lee just dropped off. We have Alex Rygiel with FBR. Please, go ahead.

Alex J. Rygiel

Analyst, FBR Capital Markets & Co.

Q

Good morning gentlemen.

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Good morning.

Alex J. Rygiel

Analyst, FBR Capital Markets & Co.

Q

Norm, can you help us to gauge the pent-up demand out there and also, help us to better understand your confidence that backlog will be improving?

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Well. So my confidence that backlog will be improving is fundamentally the relationship to bookings. So as I think you know, the way that bookings work with backlog is that we start with our backlog at the beginning of the period. We subtract what we have shipped, we subtract what we have canceled, and that's usually older jobs that are in our backlog that we decide to take out. And then we add what we've booked and that gives us the relationship between bookings and backlog.

And our view is that with the increase in the last seven months that we've had with all of the necessary adjustments, being the smoothing that we would see as a result of periods that were slower, I mean we still ended up with a 9.3% improvement in bookings in the seven-month period in value, and about a 7.4% improvement in volume. So my point is that we continue to see improvement in spread, we continue to see improvement in backlog.

Now, I will tell you as I said before I think that we are still at a modest level of recovery anything in the 4%, 5% and 6% is a modest growth. If we see bookings materially increase and backlog increase, something on the order 7%, 8%, or 9%, or 10% would for me be a robust recovery and we're not there yet. So we think that the modest recovery will be the case, but as you can imagine we're probably a tad more conservative than McGraw Hill. If McGraw Hill's view which is about a 12%, that would be a beneficial deal for us in the second half.

Alex J. Rygiel

Analyst, FBR Capital Markets & Co.

Q

Certainly. Based upon your historical experience and whatnot, do you have any concerns that there is going to be oversupply possibly due to a lot of this – the winter weather, and if that could lead to any kind of pricing erosion in the very short term?

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Well, I mean, the markets are competitive, but I'll say that what you generally find is that if the opportunities are in the pipeline and those opportunities are growing, which is the case of a recovering market, you find that pricing pressure often times abate.

What you find is that, when it goes the other way and there is a slowness in the growth in the market, then you can see some aggressiveness. That's what we saw in last year's point. And that was kind of the fundamental – what we tried to make is, gee, this year is so much different than last year, because last year, it's still seeing a decline in both opportunities and booking and backlog and that is not the case today. It's not the case last week. We saw our bookings for last week. We are quite pleased with what we're seeing.

Mark E. Johnson

Chief Financial Officer, Treasurer & EVP, NCI Building Systems, Inc.

A

One of the other things we see with disruptions like this is compression in schedule.

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Very good point.

Mark E. Johnson

Chief Financial Officer, Treasurer & EVP, NCI Building Systems, Inc.

A

Because of the disruptions that we're seeing in the first half, it will compress schedules into the second half of the year and therefore meeting timelines and delivery commitments becomes that much more important and much more of a value-add for our customers.

Alex J. Rygiel

Analyst, FBR Capital Markets & Co.

Q

Very helpful. Thank you.

Operator: Thank you. And our next question is from the line of Lee Jagoda with CJS Securities. Please go ahead.

Lee Jagoda

Director, CJS Securities, Inc.

Q

Thanks. I think all my questions have been answered.

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Great, Lee.

Operator: Thank you. Next question is from the line of Robert Kelly with Sidoti. Please go ahead.

Robert Kelly

Analyst, Sidoti & Co. LLC

Q

Hi, everyone.

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Hi.

Robert Kelly

Analyst, Sidoti & Co. LLC

Q

I might have missed this, the bookings growth year-on-year. How much was pricing responsible for the growth?

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

What we said was that the bookings were up – did I say 11%.

Mark E. Johnson

Chief Financial Officer, Treasurer & EVP, NCI Building Systems, Inc.

A

Yeah, 11%.

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

11% in the Buildings group, which drove a 4% increase in their backlog.

Robert Kelly

Analyst, Sidoti & Co. LLC

Q

How much was price responsible for the 11% growth?

Mark E. Johnson

Chief Financial Officer, Treasurer & EVP, NCI Building Systems, Inc.

A

We saw about a 200 basis point improvement in price. So, it drives a portion of the growth, but the majority of the growth is volume.

Robert Kelly

Analyst, Sidoti & Co. LLC

Q

Okay. By the time you hit the second half given the price increases that you implemented in 4Q, what will be the benefit to top-line from price?

Mark E. Johnson

Chief Financial Officer, Treasurer & EVP, NCI Building Systems, Inc.

A

In the second half or the...

Robert Kelly

Analyst, Sidoti & Co. LLC

Q

Yeah, second half third quarter, once the price increases anniversary, what's the benefit to the top-line?

Mark E. Johnson

Chief Financial Officer, Treasurer & EVP, NCI Building Systems, Inc.

A

Yeah. So, where we saw the price increases impact was in approximately the 150 to 250 basis point depending on which segment you're speaking to. So, we expect to see that level of improvement coming in our second half.

Robert Kelly

Analyst, Sidoti & Co. LLC

Q

So 2% from pricing across the board.

Mark E. Johnson

Chief Financial Officer, Treasurer & EVP, NCI Building Systems, Inc.

A

Yeah. In that neighborhood.

Robert Kelly

Analyst, Sidoti & Co. LLC

Q

Okay. Thanks. And then just as far as, I mean you seen pretty optimistic on the second half based on what you're signing up. What's the margin trend for the second half of the year? You've given us pretty decent color around where you think 2Q will be, but given what you signed up, you have about six to nine months visibility with your backlog. Where do you see margin shaken out for the second half of the year whether it be EBIT or gross?

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Well, we expect to see that we have our margins improve and we'd like to see as much of the margin improvement if it's 200 points is embedded in the backlog, we want to see as much of that come up the tailpipe as we can. And that's primarily why we made the changes in manufacturing, particularly in the Buildings group. We're seeing some good improvement, but that's the game that we have to play the second half and that's capturing the margin that's in the backlog and getting it to the bottom line.

Robert Kelly

Analyst, Sidoti & Co. LLC

Q

What would preclude you from capturing the margins that are in the backlog in the second half?

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Poor performance. Things that are in our care, custody and control, then that leaves aside what weather or hurricanes or anything like that. We have Bob, I think, the point I'm trying to make is that we have in our care, custody and control everything we need to do, get this done. So, short of disruption to a plan or a fire or something like that, then we'll be working to get as much of that improvement as I said that we see is embedded in the backlog.

Robert Kelly

Analyst, Sidoti & Co. LLC

Q

All right. One final one. I believe the buyback related to the offering was around \$18 million, \$19 million, on the cash flow statement you're showing \$23 million of treasury stock purchase. Are you buying over and above what you did with in conjunction with the CD&R offering?

Mark E. Johnson

Chief Financial Officer, Treasurer & EVP, NCI Building Systems, Inc.

A

No, what you see there and we had a similar amount in the prior year, couple of million dollars of stocks that withheld from vesting of shares for employees. So it's where shares are withheld to pay taxes, so it's not an open market purchase.

Robert Kelly

Analyst, Sidoti & Co. LLC

Q

Okay. At what price point would something like that be triggered or is that even in the plans, near-term?

Mark E. Johnson

Chief Financial Officer, Treasurer & EVP, NCI Building Systems, Inc.

A

The buybacks happened typically on the vesting date and 99% of our vesting dates are in December of each year.

Robert Kelly

Analyst, Sidoti & Co. LLC

Q

I see, okay.

Mark E. Johnson

Chief Financial Officer, Treasurer & EVP, NCI Building Systems, Inc.

So it's based on the market price at the time that the vesting occurs.

A

Robert Kelly

Analyst, Sidoti & Co. LLC

Thanks, guys.

Q

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

Thank you.

A

Operator: Thank you. And our next question is from the line of Jack Kasprzak with BB&T. Please go ahead.

Jack F. Kasprzak

Analyst, BB&T Capital Markets

Thanks. Good morning, everyone.

Q

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

Good morning, Jack.

A

Jack F. Kasprzak

Analyst, BB&T Capital Markets

Hey. Just on pricing, so there were price increases last year that will benefit you this year. Are there more price increases, prospective price increases out in the market and does that – if so, do they figure into the 150 basis points to 250 basis points of expected benefit?

Q

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

Well, the benefit that we have now that we have said is embedded in our backlog is consistent with the pricing improvements we've had since the middle of August of last year. There are currently pricing improvements going on in each of our three business groups, and we would like to see that continue that improvement in margin, in the backlog for the remainder of this year, and that's our goal. If we can maintain the 200 basis point spread or improve it a bit, that would be a very good thing for us.

A

Mark E. Johnson

Chief Financial Officer, Treasurer & EVP, NCI Building Systems, Inc.

Yeah. Retrospectively, there were price increases in August of last year and then across our segments, December and January had price increases as well.

A

Jack F. Kasprzak

Analyst, BB&T Capital Markets

Okay. Great. And just big picture, if the 12% McGraw Hill forecast proves out and obviously that's a calendar 2014 forecast, I guess.

Q

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Yes.

Jack F. Kasprzak

Analyst, BB&T Capital Markets

Q

You're more conservative than that right now in your outlook, but if the 12% proves out, I mean just big picture, is that – given your market share gains are growing faster than market right now, you would expect to grow faster than that number?

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Well, that would certainly be a very, very nice market growth. And we have historically performed better the McGraw Hill on both the upside and the downside. So it would be a market that, unless it was all high-rise, that would be a market that would be beneficial for us, no question about it. And when you think about that, as you recall from our filings and then our report, I mean we talk about what we believe incremental 100 million square feet of new construction does and in addition to that, we have the initiatives, so we continue to work in a way that's consistent with the model and the goals we've spoken about.

Jack F. Kasprzak

Analyst, BB&T Capital Markets

Q

Great. Okay. Thanks very much guys. I appreciate it.

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Thank you.

Operator: Thank you. [Operator Instructions] Our next question is from the line of Brent Thielman with D.A. Davidson. Please go ahead.

Brent E. Thielman

Analyst, D. A. Davidson & Co.

Q

Hi. Good morning.

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Good morning.

Mark E. Johnson

Chief Financial Officer, Treasurer & EVP, NCI Building Systems, Inc.

A

Good morning.

Brent E. Thielman

Analyst, D. A. Davidson & Co.

Q

Was the Components group more adversely impacted by weather this quarter than the other segments? Because I am surprised by the margin erosion there, even as you had – I think you had some of the price increases flowing through?

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Actually the legacy products did very well in the quarter. It was the – the sole impact was the fact that we had shifted an inordinate amount of cold storage material and insulated metal panels and that was really what brought their margins down in the Components group.

Brent E. Thielman

Analyst, D. A. Davidson & Co.

Q

Okay.

Mark E. Johnson

Chief Financial Officer, Treasurer & EVP, NCI Building Systems, Inc.

A

The other thing that's worth talking about briefly is a new architectural line that's been built by Components group, which should be operational next quarter or actually the start of our third quarter. And it's very similar to the way the Middletown, Ohio new facility began in January of last year, where it had a drag on margins and earnings as it was ramping up and then was a contributor four quarters later. We expect something very similar to occur for our Components division on the insulated metal panel side. That new plant is a drag on earnings in the first two quarters of this year in the neighborhood of \$1 million, and then it begins to dissipate each quarter thereafter and becomes a contributor, although not fully leveraged, but a contributor to earnings in the first quarter of 2015.

Brent E. Thielman

Analyst, D. A. Davidson & Co.

Q

Got you. Okay. Thank you. And then, I think I heard you mention you had some unfavorable comparisons on backlog and bookings at least on a year-on-year perspective. And I was hoping you can kind of elaborate there, because when I think back a year ago, we had fiscal uncertainty, lack of clarity around tax consequences, and if I recall that was kind of weighing on decisions to proceed with the projects. So, I mean, is the comment around unfavorable comparisons more just around the weather or little bit more color there would be helpful.

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Okay. So just to be clear, what we said is that the last seven months have produced growth in bookings and in backlog and that the growth in the value, I mean, the dollars in both the bookings and our backlog have shown a spread over volume of about 190 basis points to 200 basis points. And that's a positive thing. We want to see our value increase disproportionately to our volume. That's a positive.

Mark E. Johnson

Chief Financial Officer, Treasurer & EVP, NCI Building Systems, Inc.

A

And this is the exact opposite of where we sat at this time last year.

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Yeah, that's the point we're trying to make. Last year, we were in – last year was very – it was negative because everything was trending down. And I think the biggest "Oh, God" for us is hey, this year is different, things are trending up, and it's reflected in our bookings and our backlog.

Brent E. Thielman

Analyst, D. A. Davidson & Co.

Okay. Thank you.

Q

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

Okay.

A

Operator: Thank you. And our next question is from the line of Bob Wetenhall with RBC Capital Markets. Please go ahead.

Robert Wetenhall

Analyst, RBC Capital Markets LLC

Hey, thanks very much. Hey Norm, you mentioned that two-storey and lower construction was up by nearly 11% and the overall market was down by 5.5% while you guys were up 4.5%. Can you explain what's going on there? And if you see a big difference between five-storey and below and two-storey and below and kind of your strategy in that category? Thanks.

Q

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

Yes. So the two-storey and below has been our sweet spot for many, many, many years. And when you think about manufacturing plants and warehousing, they can be very high, but they oftentimes are classed as two-storey, okay? And at the end of the day, smaller buildings are more disruptive – more disrupted by the weather than a high-rise or a mid-rise with just structural steel. And I think it's as simple as that. New construction starts means the ground is being broken and the construction is starting. And I think what we saw was that the weather adversely impacted a very large portion of the low-rise construction reflected in McGraw Hill's two-stories and less. And it was pretty much across the board. But on the same token, we saw some growth. And while I'm bemoaning the margins in the cold storage, the heck of it is, we shipped a lot of cold storage and it was very – I mean, it was profitable, just wasn't as profitable as it is when we have a commercial industrial part of the market. Because those panels can be used internally, so they're not external. The buildings are already up.

A

Robert Wetenhall

Analyst, RBC Capital Markets LLC

So, is part of what you're saying, I'm just trying to understand this, the fact that 10% obviously speaks to your point about there being really disruptive weather. Is there any reason, why when the ground thaws, you won't see a big reversal of this going into 2H. I mean – and maybe Mark, if you could speak to that because I'm just trying to understand in terms of your CFO commentary and soft guidance, we have a lot of downward pressure on the overall McGraw Hill's statistics, should we get a recovery in 2H from a low comparison sequentially?

Q

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

A

Yeah. So we will see some recovery. And the way we're trying to explain this is that we have already seen the negative impact in February, okay? We have had vastly more disruption this February than we did in February of last year. Even with that disruption, we're still saying that margins for the second quarter this year will be on or around what we experienced in the second quarter of last year. Meaning that in March and April we expect to recover and to improve whatever the damage was in February as a result of weather. So we are going to see improvement. And when I look at shipping schedules and whatnot, there's some encouragement. Our teams are doing a good job. There's clearly demand, but I'd rather speak about retrospectively and say, gee, we really did see some recovery from what we lost in the first quarter and it is what it was rather than speak to you now about what I think that number may or may not be. That's the point we're trying to make, Bob.

Robert Wetenhall

Analyst, RBC Capital Markets LLC

Totally understood. Thanks for the clarification.

Q

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

Okay, man. Thank you.

A

Operator: I'm showing no further questions. I'll turn the call back to management for closing comments.

Norman C. Chambers

Chairman, President & Chief Executive Officer, NCI Building Systems, Inc.

Thank you very much for attending the call in our morning opening call and look forward to reporting next quarter. Thank you.

Operator: Ladies and gentlemen, this concludes our conference. Thank you for your participation. You may now disconnect.

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