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NCI Building Systems Announces Changes to Reportable Business Segments

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PRESENTATION

Operator

Greetings, and welcome to the NCI Building Systems call to discuss changes in its reported business segments. (Operator Instructions) As a reminder, this conference is being recorded. I would now like to turn the conference over to your host, Darcey Matthews, Vice President of Investor Relations. Thank you. You may begin.

Darcey Matthews *NCI Building Systems - VP Investor Relations*

Good morning, everyone, and thank you for your interest in NCI. I am joined today by Mark Johnson, our Chief Financial Officer. During this call, we may make forward-looking statements that are subject to risks and uncertainties, which are described in greater detail in our Form 10-K. Actual results may differ materially from those expected or implied. Forward-looking statements are as of the date they are made, and the company undertakes no obligation to update any forward-looking statements beyond what is required by applicable securities law. Yesterday, after market closed, we released 2 years of historical data in the new segment format in an 8-K. Our copy of the 8-K is available under the SEC Filings tab on the Investors section of our website at www.ncibuildingsystems.com. On today's call, Mark will provide a review of our new segment reporting structure and a rationale for the changes. After that, we will take your questions. And with that, let me now turn the call over to Mark.

Mark E. Johnson *NCI Building Systems, Inc. - Executive VP, CFO & Treasurer*

Great. Thanks, Darcey. Good morning, and welcome everyone. As many of you know, accounting and disclosure rules require that companies report their financial results in the same manner in which the management team analyzes performance and allocates resources.

Beginning in fiscal 2018, we have modified our internal operating structure in connection with the recent retirement of Norm Chambers and the succession of Don Riley to CEO. As a result, management and our accounting teams determined it was appropriate to realign our reporting framework with the way we are strategically managing the business. So effective the first quarter of 2018, we will begin reporting Insulated Metal Panels as a separate business segment. Additionally, when we purchased CENTRIA in

2015, as a move to expand our insulated panel product offerings, it also included a small coatings business. This business will now be in our Metal Coil Coating segment. As Darcey mentioned, we provided 2 years, 8 quarters, of historical data with the new financial reporting segment structure. We will report our results for the first quarter of 2018 consistent with this new segmentation.

Our 4 reportable segments are now Engineered Building Systems, Metal Components, Insulated Metal Panels and Metal Coil Coating. The Corporate and Other category will be a reconciling entity rather than a reportable segment. It will consist of the unallocated portions of the corporate cost. A couple of items to note with the new segment reporting. As we have discussed in the past, in addition to strong customer channels within the Insulated Metal Panels segment, we also worked to accelerate insulated panel growth to solutions sold by both our Buildings and Components segments. With our new segment reporting structure, these transactions are treated as intercompany sales from our IMP segment to its sister segments. Historically, when we have supplementally reported the impact of Insulated Metal Panels on our consolidated results typically as a percentage of our total revenue and total EBITDA, the reported amount were inclusive of the markup achieved by the Engineered Buildings and Metal Components segments from these transactions.

Under the appropriate accounting for these intercompany transactions for segment reporting purposes, this markup by the Buildings and Components segment are retained by those segments and are not included in the Insulated Metal Panels segment results. Also, I would like to address a couple of special financial items that were previously reported in our results for fiscal 2017 as they pertain to the individual operating segments.

During the fourth quarter of the year, we took a goodwill impairment charge of \$6 million related to the CENTRIA coil coating business. As a result, this charge is now properly represented in our Metal Coil Coating segment and excluded from the adjusted results for the segment as a special item. Then in the second quarter of 2017, there was a \$9.2 million gain on the recovery of insurance proceeds related to an IMP facility. This gain has been properly reflected in the Insulated Metal Panels segment and has been excluded from the adjusted results for the segment as a special item. These items, along with other special items, are identified in the accompanying reconciliations of GAAP results to non-GAAP information.

And with that, I'll now turn the call back to the operator to open the line for questions. Before I do that, however, I would be remiss if I didn't remind everyone on the call that we will not be commenting on the financial performance for the first quarter of 2018 or any other forward-looking information until our earnings call next week on March 7. Thank you.

QUESTIONS AND ANSWERS

Operator

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(Operator Instructions) Our first question comes from Matthew Bouley with Barclays.

Matthew Adrien Bouley Barclays Bank PLC, Research Division - Research Analyst

I guess just a couple questions on how to think about the IMP segment going forward? So Mark, I mean you can see, obviously, that kind of the total sales growth is well ahead of the internal sales growth as a result of kind of your -- the acceleration of the intersegment business. Are we kind of at normalized levels on that now, or is that something that we can expect to see going forward on the growth line?

Mark E. Johnson NCI Building Systems, Inc. - Executive VP, CFO & Treasurer

That's a good question. I would say that we've seen some really rapid growth in that area in 2017. And we expect to continue to be able to accelerate that growth rate and the growth of that product through those channels. But I think we have now lapped a period where the growth was significant. So you won't see the same rate of growth.

Matthew Adrien Bouley Barclays Bank PLC, Research Division - Research Analyst

Okay, understood.

Mark E. Johnson NCI Building Systems, Inc. - Executive VP, CFO & Treasurer

On the internal -- just let me be clear. That's on the internal revenue. For the whole segment, we have consistently said that we expect low double-digit growth for the foreseeable future in that segment.

Matthew Adrien Bouley Barclays Bank PLC, Research Division - Research Analyst

Okay, understood. So then I guess on the margin side, you put up what look like about 60% incremental margin in the IMP segment in '17. So could you help us out with kind of the components to that bridge around volume leverage, price cost, any cost reductions that would have been in that segment? So just trying to understand the right way to think about incrementals going forward.

Mark E. Johnson NCI Building Systems, Inc. - Executive VP, CFO & Treasurer

Sure. I would say that that's our largest incremental margin business. That's the first point to think about that segment. And it's also going to be our fastest-growing segment. Just roughly speaking about the 2017 growth over 2016, we experienced expansion in leverage because volumes increased. We experienced expansion in our ability to price our product for its value across all product lines in that business. And also we experienced a good movement in the mix of that product towards the higher end architectural business. So the incremental margin improvement year-over-year was from all of those categories. In addition, we have been integrating that business with the Metl-Span the business -- or we've been integrating both Metl-Span and CENTRIA. And so we have experienced some cost reduction

as a result of that. So I think we're getting incremental margins from all those areas. It is an emerging business. And is -- does have some growing pains in there as well that offset some of those favorable items. So I think that we have a positive view of that segment going forward.

Operator

(Operator Instructions) Our next question comes from Matt McCall with Seaport Global Securities.

Matthew Schon McCall Seaport Global Securities LLC, Research Division - MD and Furnishings & Senior Analyst

So maybe following up on the last question, the -- you talked about high-end growth, operational low-end growth. Can you talk about where the mix stands for high-end versus low-end right now, kind of the growth rate expectations? And then remind me of the margin delta between the two businesses?

Mark E. Johnson NCI Building Systems, Inc. - Executive VP, CFO & Treasurer

When you say the two businesses, you're talking about the businesses within Insulated Metal Panels, I assume. And there's really...

Matthew Schon McCall Seaport Global Securities LLC, Research Division - MD and Furnishings & Senior Analyst

Yes. I mean -- right, sure.

Mark E. Johnson NCI Building Systems, Inc. - Executive VP, CFO & Treasurer

There's really 3 businesses within there. There's the high-end architectural, which is the highest margin. There is industrial and commercial, which is in the middle. And then you get to cold storage, which tends to be a lower margin application of the product. And I don't think we've ever really defined what those margins are for those segments. But relative to each other, I think there's a 5% to 10% step between each one of those increments in margin.

Matthew Schon McCall Seaport Global Securities LLC, Research Division - MD and Furnishings & Senior Analyst

Yes, percentage points, I'm sorry, sorry.

Mark E. Johnson NCI Building Systems, Inc. - Executive VP, CFO & Treasurer

5 to 10 percentage points.

Matthew Schon McCall *Seaport Global Securities LLC, Research Division - MD and Furnishings & Senior Analyst*

Percentage points, okay. And I guess the other question I have is, we talk a lot about steel. As we look at modeling IMP separately, how do we -- how do you want us to think about steel volatility and the impact of steel on that -- on the profitability of that business?

Mark E. Johnson *NCI Building Systems, Inc. - Executive VP, CFO & Treasurer*

On the profitability of the Insulated Metal Panels business, it's much less significant of a play than it is on the other parts of our business. I would say, steel is in the neighborhood of 40% of the product cost in there. So much, much lower than it is in the rest of the business.

Operator

There appears to be no further questions. I will now turn it back to Ms. Matthews for closing remarks.

Darcey Matthews *NCI Building Systems - VP Investor Relations*

Great. Everyone, thank you for your time this morning. Please let us know if you have any questions. And we look forward to seeing and talking to everybody next week on our quarterly conference call. Have a good day.

Operator

Thank you. This concludes today's conference. All participants may disconnect. Have a good day.

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