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ROCK - Q2 2016 Gibraltar Industries Inc Earnings Call

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## PRESENTATION

**Operator**

Good day, ladies and gentlemen, and welcome to the Gibraltar Industries' second-quarter 2016 earnings conference call. Today's call is being recorded and webcast. My name is Chris and I will be your coordinator today. (Operator Instructions)

I would like to now turn the conference call over to your host, Mr. David Calusdian, from the investor relations firm Sharon Merrill. Please proceed, sir.

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**David Calusdian** - *Sharon Merrill Associates - IR*

Good morning, everyone, and thank you for joining us. If you have not received a copy of the earnings press release that was issued this morning, you can find it in the Investor Info section of the Gibraltar website, Gibraltar1.com. During the prepared remarks today, management will be referring to presentation slides that summarize the Company's second-quarter performance. These slides also are posted to the Company's website.

Please turn to slide 2 in the presentation. The Company's earnings release and slide presentation contain forward-looking statements about future financial results. The actual results may differ materially from the anticipated events, performance, or results expressed or implied by these forward-looking statements. Gibraltar advises you to read the risk factors detailed in its SEC filings, which can also be accessed through the Company's website.

Additionally, Gibraltar's earnings release and remarks this morning contain non-GAAP financial measures. Reconciliations of GAAP to adjusted measures have been appended to the earnings release.

On the call this morning are Gibraltar's Chief Executive Officer, Frank Heard, and Chief Financial Officer, Ken Smith.

At this point, please turn to slide 3 in the presentation, and I'll turn the call over to Frank.

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**Frank Heard** - *Gibraltar Industries, Inc. - CEO, President, COO*

Thanks, David. Good morning, everyone, and thank you for joining us on our call today. Gibraltar delivered another quarter of strong results that included earnings above our guidance, plus top- and bottom-line growth over comparable period last year. We reported a more than 300% increase in GAAP net income and a 90% increase in adjusted net income.

This earnings beat was largely a result of the accelerated traction with our 80/20 initiative, as well as our team's ability to effectively manage the impact of market dynamics. Additionally, RBI continues to be accretive, as it has been since acquired in mid-June 2015.

We have continued to make excellent progress in executing on our transformative four-pillar strategy, and we're focused on transitioning resources to our most significant opportunities and achieving results from operational improvement initiatives. And, as a result of our progress, we're raising our annual earnings guidance. I'll speak more about our strategic progress and guidance expectations after Ken reviews our financials. Ken?

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**Ken Smith** - *Gibraltar Industries, Inc. - SVP, CFO*

Thank you, Frank, and good morning. I'll start with slide 4 in the presentation, our consolidated results. Second-quarter revenues increased 4% with RBI being the major contributor to revenues as it continues to grow.

And, as cited on the slide, we have two unfavorable comparisons: the divestiture of the European Industrial business and a sales contract for residential postal products that was completed last year. The combined effect of both on 2Q revenues was $23 million in last year's 2Q that did not repeat this quarter. Without those two items in last year's quarter, consolidated revenues would have increased 14%.

We continued to have a strong bottom-line performance from the combined contributions of our base businesses and RBI. And, their combined results significantly increased earnings-per-share.

And, although not shown on slide 4, the Company's consolidated gross margin improved meaningfully by 780 basis points to 25.2% on a GAAP basis. GAAP operating margin in the second quarter grew 540 basis points to 9.8%, and adjusted operating margin grew 380 basis points to a little over 10%.

The profit and margin improvements continue to be a direct result of our successful execution on the four-pillar strategy. We are allocating internal resources to our largest operational opportunities and realizing benefits from executing on the 80/20 initiatives, which were 170 basis points of this quarter's margin expansion.

Also not shown on slide 4 is our 2Q results compared to guidance. Our results did have softer revenues in our Industrial and Infrastructure segment, as we focused on serving key customers amid weak end-market activity.

However, despite a bit lower revenue, our second-quarter profitability was higher than guidance on better-than-expected traction from 80/20 projects within Residential Products segment, plus synergies within the Renewable Energy segment.

Let's turn to slide 5, the performance of our base businesses. This slide represents the results of the Company excluding RBI. As expected, revenues were unfavorable due to primarily two factors that continue to prevail.

First, we had 2015 revenues not repeating this quarter that involve the divestiture of the European Industrial business and the sales contract for residential postal products completed last December. The second factor: sales to Industrial and Infrastructure markets were weaker due to lower shipment volumes and the effect of reduced steel costs on customer pricing. Energy-related market activity remained weak, in part, affected by the continuing low level of oil prices.

Nonetheless, there was substantial profit outperformance by our base businesses. Supplementally, we've also realized reductions on our balance sheet from 80/20 simplification.

Most noteworthy is the reduction of inventories, which for our base businesses went down $30 million in calendar 2015, and an additional $10 million in the six months just ended. This was accomplished while also maintaining or increasing order fulfillment rates for customers.

Next I'll talk about each of our three reporting segments, and I'll start with the segment discussion on slide 6, the Residential Products segment. Revenues for this segment decreased 11% to $120 million, all of that difference being a completed two-year sales contract for centralized mailboxes that we finished up last December. That contract provided second-quarter 2015 with revenues of $15 million and without any meaningful profit contribution.

Apart from that completed contract, this segment has continued to see steady demand for its roof-related residential products, largely in line with the gradual improvement in the repair and remodeling activity. This segment's operating margin increased substantially from the continuing and incremental benefits of improved operational efficiency and its implementation of the 80/20 simplification program.

Turning to slide 7, the Industrial and Infrastructure Products segment. The revenues of this segment continue to be affected by three key factors. First, we divested its European business in mid-April 2016, so 2Q of 2015 benefited from its then revenues and small operating loss.

Second, lower shipment volume continues from weak end-market conditions, primarily commodity-related and upstream energy markets. And third, lower average selling prices due to the lower raw material costs, which have a correlation to average selling prices.

Yet, regarding profitability, profit dollars and margins increased. This segment's profit improvements stem from a variety of increased efficiencies in its North American business. Of this segment's 230 basis point increase in GAAP operating margin, the 80/20 related simplification projects contributed 180 basis points of it.

Now turning to slide 8, our third reporting segment, the Renewable Energy and Conservation segment. Since Gibraltar did not own RBI for the entire second quarter last year, slide 8 presents RBI's pro forma results for the 90-day and 180-day period ended June 30, 2015. This was made in order to provide an apples-to-apples comparison between the time periods.

As you can see, revenues continued to grow as expected, although Q2 2015 benefited from the completion of key projects. Operating margins increased meaningfully. Although the 80/20 program within RBI began just this year, its margin expansion is evidencing procurement synergies with which Gibraltar is assisting and trending towards our expectation of its operating margins rising into the teens.

At this point I'll turn the call back to Frank. Please turn to slide 9, continued progress on value creation strategy.

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**Frank Heard** - *Gibraltar Industries, Inc. - CEO, President, COO*

Thank you, Ken. Our ongoing strong financial performance is a direct byproduct of our team's ability to rapidly transform our culture and effectively execute on our four-pillar strategy. The first of these pillars is "operational excellence", where our focus remains on reducing complexity, simplifying our product offering, and adjusting our cost structure to better support our partners.

The emphasis here continues to be our 80/20 initiative, and we are extremely pleased with the results that we are delivering. We now have all of our business units participating in the 80/20 process, including the RBI business.

As Ken cited, our second-quarter and year-to-date results have been lifted by the success of this initiative. In 2015, we removed $12 million of costs from our income statement, and we're on track to achieve an incremental $16 million in 2016.

As a result, we're well on our way to achieving, if not exceeding, our initial five-year target of $25 million of pre-tax savings. Presently, we're in the fourth inning of this process.

During innings 1, 2, and 3, we were focused on saving money on the income statement by implementing things like data analysis, segmentation, and zeroing up individual cost structures as it relates to products and customers. Among other benefits, this has resulted in better alignment of our pricing, overhead, and resources to better support our key customers.

Innings 4, 5, and 6 are targeted at yielding greater structural changes affecting the balance sheet. This is where we are today, as we're preparing to implement follow-on management tools of in-lining our manufacturing processes linked with market-rate-of-demand replenishment tools.

These follow-on tools are focused on manufacturing the highest-volume products for our largest customers and on a much higher level of capacity utilization. We expect these methods will yield additional benefits in the area of lower manufacturing costs, lower inventories and fixed assets, and an even higher level of service to our customers.

Innings 7, 8, and 9 will take place during years 3 to 5, focusing on driving top-line growth with new and innovative products. During these later innings, our initiatives will be tailored towards reallocating sales and marketing talent to target specific end-user groups in order to better understand their needs and the various market opportunities that may be available, resulting in new product ideas and opportunities that generate profitable growth.

The second of the four pillars in our strategy is "portfolio management." We're leveraging our work in 80/20 to improve the financial health of each one of our businesses.

We're taking a very strategic look at our customers and end markets, and how we allocate leadership time, capital, and resources to the highest-potential platforms and businesses. Through this measured approach, we're able to more deeply understand and evaluate each businesses' optimal business models and market opportunity and financial returns before determining the best approach and options available for each business. Already we're seeing a significant payback from this strategy, including spending less capital in 2016 compared with historical levels, with a higher expected rate of return on invested capital, which for 2016 may reach low double digits.

As noted on our last quarter's call at the start of Q2 2016, we divested our European Industrial business from our portfolio, which contributed $36 million in revenue to our Industrial and Infrastructure Products segment for full-year 2015, with breakeven operating results. We based our decision to divest this small business on our assessment that capital would be better applied to more significant opportunities at this point in time. Ultimately, our near-term emphasis in portfolio management is on positioning the Company and our resources so that we can add more attractive markets and businesses to Gibraltar's portfolio.

The third of the four pillars is greater Product Innovation. As we noted last quarter, we continue to expect four of our current product platforms to be key areas for greater product innovation and are focused on accelerating their development. They are: centralized mail and parcel delivery, residential air management, transportation infrastructure, and renewable energy, including green technologies.

We define innovative products as those with patent protection. These continue to represent 4% of revenues for the quarter. And, our objective is to approach 10% of revenues by 2020, driven initially by internal product development but, by then, by acquired product lines as well.

To give you an update on our ExpressLocker centralized parcel storage product, we've already sold 112 units and we're only halfway through 2016, compared with 100 units in all of 2015.

Our fourth strategic pillar is acquisitions. Over the past 18 months our focus has evolved from reactionary and opportunistic to a very proactive and strategic approach to driving growth. As a result, we're building a quality pipeline of opportunities. We continue to look for opportunities in five key high-growth markets involving prospects that have clear opportunities to improve market share and drive operational enhancements.

Before leaving slide 9 I wanted to note another very important corporate initiative: leadership and talent development. During the past 18 months, we've added new talent through promotions, external hiring into 24 of our top 75 key roles in the organization. Under our new and seasoned Senior Vice President of HR and Organizational Development, Cherri Syvrud, we're focused on further developing a solid bench of well-matched talent across and deep into the organization, to help ensure our focus on operational excellence remains sustainable. Ultimately our success comes down to our people, and our team has never been stronger.

Now, turning to guidance on slide 10, we are increasing our earnings guidance for full-year 2016. This comes from over-performance in the first half of 2016 and continuing momentum, propelled by the 80/20 program and the increasingly accretive contribution from the RBI acquisition.

On a GAAP basis, we expect earnings for 2016 in the range of $1.38 to $1.48 per diluted share, compared with $0.74 per diluted share in 2015. Without special items, adjusted earnings per share for 2016 are also higher than our previous guidance, now expected to be between $1.37 to $1.47 per diluted share, and compares favorably to the $1.09 in adjusted EPS for 2015.

Our updated and increased earnings guidance reflects continuing and meaningful profit improvements by all segments, including a very favorable comparison in third and fourth quarter to the segments' aggregate operating profit for the second half of 2015, along with higher charges for equity-related compensation.

Regarding revenue guidance, we have modestly lowered our expected 2016 top line, as revenues from industrial-related markets, particularly upstream energy markets, was weaker in the second-quarter 2016 and likely will persist throughout the balance of the year. Comparing expected 2016 revenues to revenues of 2015, the 2016 top line is up against some unfavorable comps aggregating $100 million. This includes $30 million related to the European Industrial business which we have divested, $50 million related to the two-year sales contract for residential postal products completed in December 2015, and $20 million of sales for what we have estimated as a "sales bubble" related to the solar market in 2015 as developers pushed to complete new solar installations ahead of the then-expected reduction in the investment tax credit. And, revenue growth in 2016 would have been a positive 9% compared to 2015 absent these three factors.

Now to conclude our prepared remarks, we're off to an excellent start on the Company's transformation. We're midway through Year 2, and for 2016 we'll deliver a second consecutive year of sequential and meaningful financial improvement in terms of absolute profit dollars, returns, and cash flows. More specifically, operational excellence and the initial 80/20 simplification tool is delivering higher-than-expected operating results, and we're only in the early innings of implementing the full suite of the toolbox.

So the continuing momentum and incremental profitability from 80/20 will be complemented by the next series of tools, of in-lining and market-rate-of-demand replenishment, plus the tools for top-line growth including trade focus. And, we continue to track the five-year chart that we shared with you, depicting the opportunity for higher EPS and return on invested capital.

We remain fully confident in our ability to continue achieving our three key goals: first, increasing adjusted earnings; second, making more efficient use of capital; and third, delivering higher shareholder returns than we did in the prior year. At this point we'll open the call up for any questions you may have. Thank you.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Ken Zener, KeyBanc.

**Ken Zener** - *KeyBanc Capital Markets - Analyst*

Good morning, gentlemen. Lots of different elements going on here: obviously raised guidance, the success in Residential, as well as RBI. But I think what I hear from investors a lot, Frank and Ken, is that, when I think about the opportunity slide as you describe it -- it really hasn't changed since your March 15 Analyst Day, which is good, right? You're executing on what you thought.

But it really goes to the -- doesn't it seem like you're doing better than you perhaps would have thought then, Frank? How can it not move, given all the success that you've had?

I don't know. Does it seem like it's conservative now on some of these lines that you drew out? Because obviously the acquisition portfolio, simplification, the blue line is almost a 250 for 2017.

Is that something that you're comfortable investors thinking about? Obviously as your equity -- your stock price has moved up, that the bar has been raised.

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**Frank Heard** - *Gibraltar Industries, Inc. - CEO, President, COO*

Yes, I think reflecting on when we first looked at the portfolio in early 2014, and what we thought we had in terms of a balance sheet, and how we could leverage that going forward in a thoughtful way in terms of the four-pillar strategy, certainly that five-year projection was, we thought, relatively aspirational at the time. It depended on a lot of people doing the right things at the right time. And certainly the track to the blue line we thought would have been -- represented a fairly dramatic transformation of the Corporation's financial results and hopefully put us more into best-in-class against the evolving peer group.

I think approaching two years into the process -- and I would emphasize just the approaching side -- is that it's still relatively early days. But certainly at the end of 2016, we'll step back and reflect on whether or not that five-year projection needs some revision. And if we think that's the case, we'll probably take steps to communicate that to the investor world in a more -- in a similar fashion that we did originally during our Nasdaq presentation.

But, yes, we've still got the back end of 2016 to complete. Certainly we feel confident about how the various strategies are playing out and expect to see continued improvements in future years. So I think it's a legitimate point.

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**Ken Zener** - *KeyBanc Capital Markets - Analyst*

Okay. I just -- that's the big question I get, given the momentum both in earnings and stock price.

Going to the quarter now, the rise in Residential margins -- you obviously talked about the $15 million I think, Ken, going away, that had no margin. Having said that, you still went up. Even adjusting for that, you went up very nicely.

Can you refer to the components of that growth? We had some -- Owens Corning reported a 34% rise yesterday in the second-quarter asphalt shingles shipments, which I assume are fairly correlated to your vent and gutter products. Can you talk about the growth you saw in the roofing?

I know you did a big 80/20 initiative last year in the Residential and in the West. Was that -- was roofing the biggest driver of that? Or was it the mailboxes? We can quantify the dilution that went away from the Canadian part of the business.

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**Ken Smith** - *Gibraltar Industries, Inc. - SVP, CFO*

The two subcategories that had the most favorable comparisons were the commercial side of commercial mailboxes. So we sell to others than just that one contract we completed, and that balance of other customers had increased orders in the quarter.

And on the residential roof-related products, those also benefited from low double-digit improvements. We had -- and that was on balance for the whole US; there were certain pockets of the country that were stronger than others for our roof-related products. But those two subcategories were favorable this quarter compared to Q2 last year.

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**Ken Zener** - *KeyBanc Capital Markets - Analyst*

Thank you. And then you said solar bubble, Frank. Was I mistaken?

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**Frank Heard** - *Gibraltar Industries, Inc. - CEO, President, COO*

You were not mistaken.

**Ken Zener** - *KeyBanc Capital Markets - Analyst*

Could you clarify? I don't want to put my math -- it looks like it was down a little organically. Can you talk about what that -- I realize there was that huge pull forward because of the expectation that FY 2017 credits were going to go away, which have now been extended, which is a good thing. But can you talk about what that -- organically I think you suggested it was down.

But what does the cadence mean? Does it mean we're entering a tough back half of the year, and then 2017 could be flat?

Or -- I know you guys obviously got it at a good price and the execution has been very good. But can you give us the cadence, so people don't end up with the wrong impression?

**Ken Smith** - *Gibraltar Industries, Inc. - SVP, CFO*

In our view, if we remove those anomalies of incentives that affected different contiguous time periods, the market still continues to grow right around the 10% rate, absent those incentive aberrations that have affected. And RBI has continued to participate fully in that.

While also, as you can see on the margins, they are focused on getting higher returns, so they are adjusting their sales prospecting and filters in order to optimize the resources and get higher returns while also participating in the market lift.

**Ken Zener** - *KeyBanc Capital Markets - Analyst*

Good, and --

**Frank Heard** - *Gibraltar Industries, Inc. - CEO, President, COO*

I think, Ken, the second part of your question is that certainly 2016, because of the bubble in 2015 has some limit -- some downward pressure on it, combined with Ken's comment on being a little bit more strategic about which type of businesses and work we want to allocate our resources towards. The byproduct of that is they're making a significant amount more money, combined with some of our synergistic activities.

For 2017, we expect the market to continue to grow at 9%, 10%, 11%, and we don't expect -- the whole bubble effect will have migrated away and we should be closer to market and hopefully above market, if we develop incremental strategies to drive share gains.

So we think this is kind of a 'one year off'. We knew it going in. What we knew going in was we thought credits were going to come off, and we expected to see an opposite effect. But now that they've held, you get this artificial bubble for a very short period of time. But the guys are doing a nice job working their way through that.

**Ken Zener** - *KeyBanc Capital Markets - Analyst*

Yes, just so we have the right context -- and this is my final question. Installed cost of solar -- you are in that mid-market in terms of you're not doing the utilities, which I believe bidding for utilities in Texas are even getting down to $0.04 to $0.05 a kilowatt. So could you talk about your general installed cost, so investors have an understanding of how the falling cost curve in solar makes it commercially viable? Thank you.

**Frank Heard** - *Gibraltar Industries, Inc. - CEO, President, COO*

Well, I'll let Ken jump in as well. We have ongoing product development processes that -- the whole balance-of-systems cost within the context of us getting solar installation has come down probably 75% over the last five years or so. Getting closer and closer to grid parity.

We're down to the last final piece of that puzzle in terms of taking additional cost out from a systems perspective. Balance-of-systems is part of that. Our component within racking, we certainly are in the process and have taken additional costs out that will, number one, not only enhance our operating profit going forward, but also allow us to participate in the market in terms of remaining price-competitive.

So we're in very good shape from that perspective. And that's something we knew going in, and our people have executed very nicely on that.

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**Operator**

Al Kaschalk, Wedbush Securities.

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**Al Kaschalk** - *Wedbush Securities - Analyst*

Good morning, guys. Just to follow up on the Renewable Energy side on slide 10, I think you clarified and said going forward, meaning 2017 and beyond, you're still comfortable with that 9% to 11% type of top-line growth in Renewable, with some margin benefit on higher-return-oriented projects. I just wanted to clarify that the 5% growth that you have in there on the 2016 assumptions, that's after you annualize for the $80 million from the acquisition.

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**Ken Smith** - *Gibraltar Industries, Inc. - SVP, CFO*

Yes. As well as, Al, we had 2015 -- at least it was the first half of 2015, RBI had some significant contracts that they were able to complete, and the size of which aren't nearly the same magnitude as we had this year and other small details.

The UK was a strong market in the front half of 2015, as they had a very strong governmental push to install renewable energy. We participated in that in calendar 2015, and those features are not generally the same this year. So that's an element of it.

And we have -- the team that leads RBI is doing a nice job in -- as Frank cited -- being more targeted in what projects they pursue and close out this year, in order to drive their margins up. You can see the margin performance has been outstanding for them.

So we're -- it's all in the backdrop, though, of a market that continues to participate and grow and expand. And RBI is doing a really good job participating in that and driving their profitability up while being selective on what they design, fabricate, and install for customers.

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**Al Kaschalk** - *Wedbush Securities - Analyst*

Does the -- is it implied that more profitable or higher-return-oriented projects are necessarily longer in duration, or shorter in duration?

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**Ken Smith** - *Gibraltar Industries, Inc. - SVP, CFO*

Ask that question again, Al.

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**Al Kaschalk** - *Wedbush Securities - Analyst*

I'm just trying to -- if there is any change in -- is it a short-order, short-visibility business? I'm just trying to understand if your focus or the enhancing the profitability is a key component there, therefore may show a little bit slower top line than maybe some had thought, and still keeping it in that 9% to 11%. I'm just trying to --

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**Ken Smith** - *Gibraltar Industries, Inc. - SVP, CFO*

It is, but the duration and size of contracts aren't substantially different than their historical profiles of what they were installing. And the backlog that they continue to have in any given day still approximates three- to three and a half months-worth of revenue. So the highway of headlights beyond that is still dependent on securing new contracts.

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**Al Kaschalk** - *Wedbush Securities - Analyst*

Okay. Second, in the prepared remarks -- and I don't know if it was Ken or maybe it was Frank -- in terms of capital resources and allocation, you commented allocating capital to some of the largest opportunities. Are you at a spot where you are, for lack of a better word, controlling the dollars that are being invested to those with the absolute highest return regardless of the size? Or are you focusing on -- where is the next incremental dollar of capital being allocated?

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**Ken Smith** - *Gibraltar Industries, Inc. - SVP, CFO*

I would say the -- a split answer, Al. Surely on short-term tactical capital expenditures, we do have dollar thresholds above which projects are reviewed and supported out of the Corporate office. And there's been vetting since last fall through now as -- when we built a plan for 2016 and now as projects come up for formal approval, certainly circumstances can change and market conditions can change, where we favored something last fall but now we favor emphasizing some other piece of the plan or a new element of the plan.

There have been examples in 2016 where new projects not heretofore contemplated or presented or considered are now coming before us for approval. And we have largely supported those because they are driving a new product or they are driving an increase in cost-reduction opportunities that have been identified by engineering folks or redesigns in response to customers.

So we're reacting tactically but still within an envelope that we -- of aggregate CapEx spending this year that's in the tens of millions to spend.

On a longer window of how we're spending capital for the portfolio management aspect of the Company, all of our potential prospects in the acquisition arena do involve the Corporate folks. And there are times when we have multiple opportunities at the same time, and we're weighing where the most optimum returns and likelihood of returns that we can get. And so we'll deemphasize certain opportunities while we go strong on the ones that we think we can be successful on and have high returns in the ownership period under Gibraltar.

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**Al Kaschalk** - *Wedbush Securities - Analyst*

Great. Finally, if I may, Frank, just on a broader picture. You used the baseball analogy on innings, and each of those had a nice little split of a third, a third, a third.

Are you suggesting or setting us to expect that each of those groups of processes, including the innings 4 through 6, the follow-on tools -- is that from a duration standpoint? Is the expectation that those would take an equal amount of time?

In other words, if the initial part -- it the entire plan was five years, the initial first three innings were 18 months; is innings 4 through 6 a time frame of 18 months as well? Or what should we expect?

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**Frank Heard** - *Gibraltar Industries, Inc. - CEO, President, COO*

Yes, I think that would be a -- obviously, there's overlap. Some of the businesses are further through the early innings a little bit quicker than other businesses, simply because they're simpler businesses or they got started earlier. So there is some overlap.

The second phase of tools, which we are well into in 2016, we're getting the benefits, some of the early inning work carrying over into that $16 million. And we're getting some of the early benefits later in the year of the middle work, which is the in-lining MRD.

Where we're focused in those middle innings is the in-lining MRD. Manufacturing A items for A customers in more of an in-line basis versus a batch-based process, not only is going to allow us to shed more unproductive inventories in various forms, as we get more focused at just making the top products in a more repetitive in-line basis, we fully expect to see lower manufacturing costs on some of our even biggest runners. So our cost of goods sold should go down to some degree, and we're in the process of quantifying the magnitude of that going forward.

The other side of that, if we get focused at manufacturing A items, there may be other items that need to stay in the product line to support ultimately the end user who has to build a house. We can't just sell them the high runners; we also have to sell them some of the slow runners.

We'll treat those differently. We'll either make them in a batch-based process or outsource them. And to be quite honest, I think our history of trying to do everything for everybody probably provides us some cost-reduction opportunities not only in the manufacturing of the A items but also the outsourcing of the B and C items as well so.

We're going to get some structural benefits in terms of reduced inventories. We're going to get some lower costs that certainly weren't in the first year of $12 million in savings and, by and large, not in the second year of $16 million. So we are going to exceed our $25 million.

To what degree? I think we'll have a better understanding of that over the coming months, and we're certainly getting it sooner.

I think the other aspect -- and it goes to your question on capital allocation as it relates to at least supporting the businesses we own today. What will come out of this is, to a large extent, quite a bit of excess capacity. So as we move equipment around and get it more focused at manufacturing A items, we'll also find that we've got a fixed-asset base that's probably somewhat inflated over what our real needs are. So that also suppresses some of the capital spending in future years as well.

And understand the number Ken has quoted of $15 million or $16 million of capital spend, that now includes RBI in that as well, not just the legacy businesses. So it's quite a bit of improvement from the team.

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**Al Kaschalk** - *Wedbush Securities - Analyst*

Great. Thanks for the color and good luck.

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**Operator**

Daniel Moore, CJS Securities.

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**Daniel Moore** - *CJS Securities - Analyst*

Good morning and thank you. I wanted to focus a little on the Industrial side. Obviously, some challenges here in the very short term. Wondering if you are seeing any evidence yet or potential evidence of pickup in activity or conversations as it relates to the Highway Bill and as we look to 2017.

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**Ken Smith** - *Gibraltar Industries, Inc. - SVP, CFO*

The order activity continues to be elevated because of states doing some budgetary planning and estimating on key projects, as they involve general contractors in the planning effort. So much like we described in our first-quarter call, we're expecting that elevated level of quotation and estimating to translate into bids, and then subcontracts that we bid on, and winning our portion of those so that we enter 2017 with a higher backlog. And it will affect higher revenues in 2017.

But 2016 is largely and continues to be a planning effort for states to prioritize, particularly, their longer and more expensive projects.

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**Daniel Moore** - *CIS Securities - Analyst*

Very helpful. A similar question on postal and parcel, without obviously the highway impact. Are there any conversations at this stage regarding other regions potentially shifting to centralized mail?

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**Frank Heard** - *Gibraltar Industries, Inc. - CEO, President, COO*

I think as a general note, if you follow the press, there's been some various articles where the U.S. Postal Service has begun to change some of their policies on a federal level. Whether or not they actually get embraced at the state level and various regions around the country becomes another issue.

I think -- so the general momentum in terms of the environment is, I think, moving in the direction that we expect: that over time all the regions will be adjusted in some way, shape, or form to utilize more centralized mail than home delivery mail, as first-class mail has quickly gone away.

What we see at an ever-increasing rate -- and certainly that shows up in our commercial core numbers in the mailbox, which is primarily centralized mail -- most new home construction starts get associated with centralized mail versus additional home delivery mail. So that's certainly a rising tide as we continue, as you see new home construction, whether it's multifamily or single-family. That becomes a greater and greater percentage of centralized mail delivery versus single-family mail.

All that being said, to our knowledge there is no specific issue where a particular region is over the next -- over the coming months are going to try to take mail delivery away from an established group of residents in continental United States.

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**Daniel Moore** - *CIS Securities - Analyst*

Okay. Lastly, maybe just shifting over to the Renewable Energy, very nice uptick, obviously, in margin. And as you said, I think you said on the last call that you haven't really attacked that area yet with 80/20. Maybe just a little bit more detail on what drove the upside.

Is 12%-plus sustainable here in the near term? And how much room is left in that segment?

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**Ken Smith** - *Gibraltar Industries, Inc. - SVP, CFO*

I gave it the top banner in the prepared remarks, Dan, about procurement savings. But given Gibraltar's larger size and wider base of raw material and logistics providers that we utilize, we brought that to bear to the procurement of those same items that RBI utilizes for its customers and products. So RBI is realizing some lower points of raw material costs and freight in-and-out costs because of attaching themselves to our greater purchasing power.

And yes, I do and we do think that this is going to be a sustainable level of profitability for them.

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**Frank Heard** - *Gibraltar Industries, Inc. - CEO, President, COO*

I think that's probably what we identified as a third of the opportunity in terms of transforming RBI's rate of return from a 10% to a 15%. Another third would have been some project initiatives that they are taking to refine their ongoing product design in order to maintain a competitive position in the marketplace while also increasing their margins. They've done a nice job executing on that.

And that new product, those new product revisions are becoming a larger and larger piece of their ongoing cost of goods sold. And we expect that will probably peak at some point in 2017. So we think -- we know we'll see some additional and meaningful benefits out of that next third.

Then I think the last third is the work we're doing on the 80/20 process that we're still very early days of looking at how those tools can be applied to a completely different business model that they have from a value proposition perspective. And we're starting to see some opportunities present themselves, but I would argue that we're not getting any financial benefits on the 80/20 tools at this point. We're still early days.

But we're feeling very good about RBI's top-line growth opportunities relative to the market, not only growing share within a rising tide, but also they have some adjacent markets, whether it be residential or commercial rooftop or the larger tracker space. So we're feeling good about the top line, and we certainly are confident that they are going to continue to improve their operating returns going forward.

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**Daniel Moore** - *CIS Securities - Analyst*

Lastly, if I might sneak one more in, in terms of M&A, are there any of the three or four areas of your focus that you're seeing a greater or increased level of dialogue or potential over the next six to 12 months?

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**Ken Smith** - *Gibraltar Industries, Inc. - SVP, CFO*

Let's see. I'm thinking back on the prospect list. They are pretty evenly distributed, although if there was one weight it could be in -- probably is Residential and Renewables where we have a slight advantage.

But all of those targeted categories do have prospects for us that are of high interest.

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**Daniel Moore** - *CIS Securities - Analyst*

Very helpful. Thanks for the color.

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**Operator**

Michael Conti, Sidoti.

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**Michael Conti** - *Sidoti & Company - Analyst*

Hey, good morning. Yes, so most of my questions have been answered, but just a few follow-ups. On the Residential organic growth rate, if you didn't discontinue items within Residential -- and I'm talking for the full-year guide -- do you have an idea on what that organic growth rate would be? I'm just trying to get a sense of an apples-to-apples comparison and get an idea on how much growth you guys are plotting due to 80/20.

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**Ken Smith** - *Gibraltar Industries, Inc. - SVP, CFO*

Oh, man. I'd say it's -- if we didn't have the discontinued products or the completed projects contract that we finished last December, I'd say that segment would probably be up 5% or so this year compared to last year.

**Michael Conti** - *Sidoti & Company - Analyst*

Then with the drivers on the margin expansion, did you break out how much of that was due to 80/20 on the Residential side, 690?

**Ken Smith** - *Gibraltar Industries, Inc. - SVP, CFO*

We did not. But in answer to your question because that was not in my remarks this morning, that's a little over 200 basis points of the improvement, Mike, came from their 80/20 implementation.

**Michael Conti** - *Sidoti & Company - Analyst*

Got it. Then just switching over to the Infrastructure side. Are there any major projects that D.S. Brown is currently bidding on? Just to give us an idea on the demand for their products.

And then can you just remind us of the margin profile of D.S. Brown compared to Residential and Industrial?

**Ken Smith** - *Gibraltar Industries, Inc. - SVP, CFO*

Mike, we generally don't go into that level of detail for competitive reasons and others.

**Michael Conti** - *Sidoti & Company - Analyst*

Got it. Thanks; that's all my questions, guys.

**Operator**

Walter Liptak, private investor.

**Walter Liptak** - *Seaport Global Securities - Analyst*

Hi. Thanks. Great quarter, guys. Wanted to ask, from a high level, with the $25 million over three years of benefits, so the $16 million for 2016: that's been identified? Or has that already been booked through your income statement?

**Frank Heard** - *Gibraltar Industries, Inc. - CEO, President, COO*

We booked approximately half of it through the income statement.

**Ken Smith** - *Gibraltar Industries, Inc. - SVP, CFO*

Of what was actually realized. But several of those projects that have got initial traction in the first half have further benefits coming up in Q3 and Q4, and there's also identified projects yet to start that will be impactful for our second half.

**Walter Liptak** - *Seaport Global Securities - Analyst*

Okay, that's great. All right. So it sounds like there some of those that come through in 2017 as well; or there may be more projects.

So that $25 million looks like it's already been upped, but it could go up further. Is that the case?

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**Frank Heard** - *Gibraltar Industries, Inc. - CEO, President, COO*

Yes, I think certainly that would be an accurate conclusion that we're going to get -- probably be able to close out 2016 after two years of work, primarily out of the early innings, topping out the $25 million. And then we're going into this Phase 2 of structural changes where we've got to -- and starting that process now and setting up 2017 where we'll start to focus on the in-lining and MRD and outsourcing programs which, to this date, we haven't.

We've done some conceptual work from a quantification perspective. We think those are meaningful dollars. But -- so we expect to get more and do it sooner than what we expected over the five-year cycle.

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**Walter Liptak** - *Seaport Global Securities - Analyst*

Okay, great. Switching gears over to the Industrial business, the margins look very good, especially with the volume decline of 8%. I wonder, how much of the margin improvement, profit improvement is because of the divestiture, just elimination of losses, and how much is 80/20?

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**Ken Smith** - *Gibraltar Industries, Inc. - SVP, CFO*

Well, the divestiture had essentially breakeven operating results. So there was no contribution in the prior-year periods.

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**Walter Liptak** - *Seaport Global Securities - Analyst*

Okay.

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**Ken Smith** - *Gibraltar Industries, Inc. - SVP, CFO*

So the removal of that related revenue had no bearing, at least the absolute dollars of last year's profit.

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**Walter Liptak** - *Seaport Global Securities - Analyst*

Okay, great. So it looks like these businesses in Industrial are making great progress with 80/20.

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**Ken Smith** - *Gibraltar Industries, Inc. - SVP, CFO*

Amazingly so.

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**Walter Liptak** - *Seaport Global Securities - Analyst*

Yes. So I wonder, at this point when you look through the whole portfolio, are there still things that are potential divestitures? Are you guys done, and this is the business the way it will look into the future?

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**Frank Heard** - *Gibraltar Industries, Inc. - CEO, President, COO*

At this point, all the businesses are making meaningful progress in terms of making more money at a higher rate of return and more efficient use of capital. And we continue to support all the businesses in the near term.

And as they work their way through the 80/20 process, even the businesses in what we would have assumed are more commoditized markets from a couple years ago are finding opportunities for growth and transforming themselves in terms of reallocating their time and their capital. So I think it's certainly early days to conclude that the portfolio -- if the portfolio changes going forward it would be the byproduct of new acquisitions as opposed to divestitures at this point in time.

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**Walter Liptak** - *Seaport Global Securities - Analyst*

Okay. Sounds good. Okay, thank you, guys.

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**Operator**

Ladies and gentlemen, we've reached the end of our question-and-answer session. I'd like to turn the call back over to Mr. Heard for any closing remarks.

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**Frank Heard** - *Gibraltar Industries, Inc. - CEO, President, COO*

Thank you, everyone, for joining us on our call today, and we look forward to speaking with you about our third-quarter results. This concludes our call.

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**Operator**

Ladies and gentlemen, this does conclude our teleconference for today. We thank you for your time and participation. You may disconnect your lines at this time and have a wonderful rest of the day.

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