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ROCK - Q1 2015 Gibraltar Industries Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Gibraltar Industries first-quarter 2015 earnings conference call. Today's call is being recorded and webcasted. My name is Melissa and I will be your coordinator today. (Operator Instructions)

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

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 first-quarter performance. These slides are 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 Company's 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 our 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 will turn the call over to Frank.

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

Thanks, David. Good morning, everyone, and thank you for joining us on our call today.

We started the year out on a strong footing. Net sales increased 5% year-over-year, which reflected continued strong demand for our postal storage products as well as strength for our roofing-related products, while demand from our industrial and transportation infrastructure markets remained weak.

On the bottom line, adjusted earnings per diluted share grew to $0.06, a significant improvement over the loss of $0.05 per share in Q1 last year. In addition to volume leverage, our operational improvement initiatives are gaining traction and have had a positive effect on our Q1 profitability. We are encouraged by these results, but we know this is just the very beginning of what we intend to accomplish in future years.

Many of you participated in our first-ever investor day a little over a month ago, and at that event we detailed our strategy to achieve best-in-class, sustainable value creation over the long term. After Ken reviews our first-quarter financial results in more detail, I will discuss how we plan to leverage the four elements of our strategy to take our results from where we are today to deliver the type of shareholder returns we know we can achieve.

So with that I will turn the call over to Ken.

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

Thanks, Frank, and good morning. I will start by talking about slide 4, entitled consolidated results, and the increases on both the top line and bottom line.

First-quarter revenues benefited from the higher unit volume and pricing, to a lesser degree, while the effects of a stronger US dollar reduced revenues 200 basis points. On the bottom line adjusted operating income and adjusted EPS both improved. The higher contribution of higher volume helped profitability as well as margin improvement actions taken during 2014, including a facility closure and sales channel adjustments, plus improved price management.

Concerning adjusted diluted EPS, this quarter also had an additional benefit from non-operating other income, where we reported $3 million of net gains on derivative contracts from hedges of foreign currencies and select raw material purchases related to transactions within our residential products segment. Of the $0.11 increase in adjusted EPS compared to last year, $0.06 were discrete to the first quarter 2015, representing the non-operating income with the net gains from derivative contracts.

And I describe these net gains worth $0.06 as discrete to the first quarter based on a scenario that the prices of the underlying hedged currencies in metals do not change after March 31, 2015, in which case there would be no further gain or loss in subsequent quarters. Nonetheless, with or without the derivative benefit, we had a good improvement in earnings this quarter compared to last year, driven by controllable internal operational initiatives.

Next I will talk about each of our two reporting segments starting with slide 5, Residential Products. End-market demand from residential housing markets continued to be favorable, complemented by the continuing secular growth in the sales of postal and parcel storage products, which were up substantially following two successive years of plus 20% organic growth. The primary driver for this demand is postal authority initiatives, which are transitioning from mail delivered door-to-door to being delivered through centralized mail receptacles.

Also contributing to the segment's revenue growth was higher sales of roofing-related ventilation accessory products, which in part benefited from efficiencies achieved in the distribution of these products.

Turning to slide 6, Residential Products segment P&L performance. I just described the strong increase in revenues resulting from unit volume growth. The adjusted operating income increased nicely with margin expansion of 220 basis points, led by operating leverage. This significant growth in earnings also included operational improvement and manufacturing efficiencies and tighter management of price and raw material margins.

This is the same segment where margin improvement actions in 2014 took longer than expected. Now in 1Q 2015 we are benefiting from those 2014 actions, such as the facility closure.

The margin improvement of 5.2% does not include any portion of the $3 million gain on derivative contracts reported in the P&L's non-operating other income. Approximately half of that $3 million gain related to settled transactions in the first quarter of 2015 and that settled portion of the gain would equate to an additional 140 basis points for this segment's adjusted operating margin.

Now turning to slide 7, our Industrial & Infrastructure Products segment highlights. As expected, first-quarter revenues decreased affected by important headwinds. The effect of low oil prices has lessened spending on the production of oil and rig counts are down substantially. And, as you know, oil service companies have slashed spending.

This segment historically has derived 15% to 20% of its revenues from the oil and gas end-markets. Additionally, weaker currencies in Canada and Europe, where this segment has operations, have translated into fewer US dollars of revenue. Low oil prices and the strong US dollar are expected to have continuing effects on this segment's order rates and revenues for the balance of this year.

Concerning this segment's revenue exposure to the U.S. transportation market, the current U.S. transportation funding runs out in 24 days and new order rates thus far have been shorter in duration and smaller in terms of dollar size. Despite the uncertainty of future government funding, this segment's backlog increased this quarter, boosted by orders for roadway sealants for maintenance projects, plus a noteworthy project that will use isolation bearings for a non-traditional application in offshore oil production.

We believe our ability to win projects and grow backlog in this market environment is a result of our innovative engineering and responsive manufacturing and fulfillment expertise. And we are bullish about the long-term opportunities in this market.

Turning to slide 8, the Industrial & Infrastructure Products segment's specific P&L performance. Of the 10% drop in revenue, the majority was volume-related, but further affected by a 3 percentage point decrease from weaker currencies in its international subsidiaries.

Regarding adjusted operating income, the segment's management team did a fine job limiting the margin compression to less than 1% effect and revenue dropped 10 percentage points. The mitigating actions were improved manufacturing efficiencies and tighter management of price and raw material margin.

Now on slide 9, our outlook for 2015. In 2015 compared to 2014 we expect market conditions in residential housing to continue its slow and gradual improvement, with industrial and transportation infrastructure markets being unfavorable to 2014 with a net effect of 2015 consolidated revenues being equivalent to 2014. Stated differently, we expect higher residential product revenues this year and being offset by lower Industrial & Infrastructure segment revenues.

Our previous guidance for 2015 consolidated revenues assumed our Industrial & Infrastructure Products segment would produce full-year 2015 revenue equivalent to 2014. Now we expect that segment's 2015 revenues to be unfavorable by mid-single digits on lower order rates from energy-related industrial markets continuing to be affected by the price of oil, as well as affected by the stronger U.S. dollar.

Regarding the Residential Products segment revenue, growth in 2015 will again be led by higher volume for postal products following two successive years of 20%-plus organic growth. Full-year 2015 sales growth for postal products we expect to be around 10% to 14%, with the highest favorable comparisons being in the first and second quarters of 2015.

Apart from our revenue expectations and on the operational side of the Company, we have internal controllable initiatives targeted to improve earnings this year. These include the continued focus on managing prices and material margin, additional consolidation, and any earlier-than-expected results from the simplification 80/20 program launched in Q4 2014.

Now on slide 10, our outlook for 2015. We are reaffirming guidance of adjusted earnings per share. Following the end market color I just described, we continue to expect profitability in 2015 to increase compared to last year, even as consolidated revenues remain equivalent to last year.

We will have the incremental benefit of cost actions we completed last year in overhead staffing, sales channel adjustments, and a facility closure. We also should benefit from 2015 productivity initiatives, such as improving efficiencies in our postal production, and improving results from price management. All of these controllable actions lead to an adjusted earnings per share for 2015 in the range of $0.55 to $0.65.

And for those of you running models, we expect our unallocated corporate expense will approximate 2% of consolidated sales and our income tax rate should approximate 37.5%.

Concerning cash flows in 2015, CapEx spending is targeted to be $16 million, which is approximately $3 million below depreciation expense and $10 million below the combined depreciation and amortization expense. Additionally, we also received in the first quarter of 2015 cash proceeds of $25 million on the sale of one of our facilities.

Now I will turn the call back to Frank for key aspects of our growth plans summarized on slide 11.

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

Thank you, Ken. As I mentioned at the outset of our call, at our recent investor day we outlined our strategy to deliver best-in-class sustainable value creation for our shareholders for the long term. This value-generating strategy has four key elements including operational improvement, portfolio management, product innovation, and acquisitions as a strategic accelerator.

Through this strategy, we are leading a transformational change in our portfolio and our financial results. Our goals are to double our revenue, quadruple our earnings, grow our market capitalization to $1 billion, and achieve best-in-class shareholder return. In achieving this vision, we expect to become more relevant in the capital markets once again.

I would like to spend some time today to review this strategy and provide more details than we have offered on our past calls. Let's start with operational excellence.

At the heart of our operational excellence initiative is simplifying the business, which leads to enhancing our margin profile. As Ken cited in his remarks, we have taken recent measures to align our cost structure to market demand, consolidating facilities and improving operational efficiencies.

Of course, the earnings improvement in our Q1 results was just the beginning. We are well along in implementing our operational priorities and focused on those aspects that can generate the highest benefits in the future. The foundation of our operational improvement efforts will be based on the proven 80/20 simplification process.

In a quadrant analysis of most businesses, one finds that 25% of the customers make up 89% of the revenue and 150% of the profitability. We are refocusing our customer efforts on those who bring in the vast majority of our revenue and profit, at the same time we're treating our other customers differently, but fairly, in order to raise their sales and margin profile. Likewise, 25% of the Company's products are responsible for 89% of the revenue, so we are similarly focusing our resources on those high-volume products that provide us the greatest return.

We started the process in the fourth quarter of 2014 with a comprehensive data analysis and we are now well into the implementation phase. We have the teams in place to further evaluate the opportunities and to act on our 80/20 initiatives with actions such as price improvements and overhead reductions which will benefit the income statement. We believe that over the first three years we will drive 200 to 300 basis points of operating margin improvement from the 80/20 process. Over five years, we expect to achieve an incremental benefit of $25 million in pretax income, or $0.50 a share.

There are also corresponding benefits to the balance sheet as operational assets are reduced relating to inventories, property, and plant and equipment. In year one we expect to reduce our SKUs by more than 3,000 items and our inventory by $12 million with the financial benefit beginning to occur in the back end of 2015.

The second aspect of our strategy is portfolio management, which is a natural byproduct of the 80/20 initiative. We spent considerable amount of time reviewing our portfolio in terms of best use of our financial and human capital and achieving greater shareholder returns. And using the 80/20 process, we will be able to validate our initial thinking on our portfolio by the end of the year and begin to make the necessary refinements in 2016 and beyond.

Product innovation is our third strategic element. Innovation is about allocating new and existing resources on opportunities to drive the type of sustainable returns we want to see. We are focused only on those products and technologies that have relevance to the end user and can be differentiated from our competition. We have a great opportunity to do this in that our customer base is business-to-business and those customers typically have a vested stake in engaging with you to develop a customized solution.

Our focus on innovation will be centered on three areas: postal products, residential air management, and infrastructure. In postal products we're excited about the growing demand for centralized mail and parcel delivery systems. At our investor day we demonstrated our innovative ExpressLocker product, which has been a tremendous success thus far.

We're making further progress in expanding our share in this rapidly changing market. In ventilation, our products today are focused primarily on the roof. Going forward we want to be focused on the whole house from an air management perspective, where we believe we have significant advantages and expertise. We plan to capitalize on the trend towards sealing up the envelope of the house in order to ultimately drive a zero carbon footprint home.

In the infrastructure space, 33% of the bridges in the continental United States are either structurally deficient or functionally obsolete. We have the reputation and the engineered solutions to own the bridge and help bring this infrastructure up to code.

The final element of our strategy is acquisitions. We are focused on making strategic acquisitions in six key areas, three of which are existing platforms and three are new. The existing platforms include the same areas where we will be developing innovative products organically: postal and parcel solutions, infrastructure, and air management.

The new platforms include water management, renewable energy, and outdoor living. The water management space also offers good growth opportunities, such as providing solutions for the current decaying infrastructure or harvesting rainwater or graywater management on the residential side. These are nice adjacencies to our current bar grating capabilities and our water dispersion platform.

Within renewable energy, solar and racking enclosures is still a very fragmented $2.1 billion market space with about 90 racking companies in the U.S. alone, so there are a good number of possibilities.

In outdoor living we see two opportunities to explore. The first capitalizes on the trend towards converting flat roofs on high-rise buildings or commercial buildings into green roofs. In 2013 alone there was about 5 million square feet of roofing space that was converted in the United States, a 25% increase over the previous year.

On the residential side we are capitalizing on the trend of people extending their living space out into their backyards. What these growth platforms all have in common, existing and new, is that they are all large, high-growth markets that are technology-rich and offer higher returns on our investments than what we've experienced in the past. We are seeking to spend $80 to $150 million this year on acquisitions, and the quality of our pipeline is improving all six of those end markets.

Our strategic focus -- operational improvement, portfolio management, product innovation, and acquisitions -- is the lens that we look through to make every single operational and strategic decision at Gibraltar. We are very confident that we have put the right team in place to make those thoughtful decisions to execute on this strategy and achieve our goals of 2015 and for the long term.

At this point we will open the call for any questions you may have.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Ken Zener, KeyBanc Capital Markets.

Ken Zener - *KeyBanc Capital Markets - Analyst*

Good morning, gentlemen. Industrial is the delta to the downside this quarter versus last quarter when you gave guidance, with industrial down 5% or about $20 million in sales. No, that's from energy. What did you do in the quarter? What shifted that enabled you to maintain guidance given that kind of headwind is the first part of my question.

And then second, given the shift or uncertainty into those end-markets, what actions can you take if there is another incremental deceleration?

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

To your first question, Ken, we did -- the downturn in the end-markets relative to the oil and gas wasn't a surprise to us, though in the fourth quarter the management team began to reflect on deal strategies, operational strategies I guess that they could --. Their mandate, like everybody, was to protect their operating income and, despite the downturn in revenue, try to resize and position their businesses operationally to protect the bottom line.

They had done a lot of that thinking late in the fourth quarter. And as they saw the trend continue, they were able to kind of execute on those initiatives to properly resize their facilities and the size of their staffing to accommodate the downturn. To be quite honest, they did a very nice job, so we are quite pleased with it.

We don't expect to see another step down in end-market activity in that. We think we are running across the bottom of the trough and they've done some nice work from a price management perspective. The historical purchases that they had made at higher prices and raw materials that flow through the system and their pricing strategies I think are going to allow them to not only protect that number, but certainly give them a little bit more room to maneuver if they get another unplanned event in terms of end-market activity.

Ken Zener - *KeyBanc Capital Markets - Analyst*

Right. I guess this might be too narrow of a question, but with energy -- obviously oil is starting to recover. It seems like the rig counts are starting to improve. Is that something, considering the deceleration impacted your business, if oil continues to strengthen or the rig counts actually start coming back on because of pricing, would that be an event that could potentially shift you up by the third quarter? What type of visibility do you have into that or how would that translate into your (multiple speakers)?

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

Well, it's hard to predict out that far, Ken, but the trends continued to be meaningful degrees. Yes, they could have a favorable bearing on this segment's performance.

Ken Zener - *KeyBanc Capital Markets - Analyst*

Okay. And then switching over to residential, if it's okay. You highlighted the roofing volume was up 10%, which given what we are hearing from specialty roofing sales, specifically on the shingles side, it seems like that was actually pretty good. Was there preloaded and can you talk about inventory? Was there something special that gave you that good growth in 1Q?

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

That improvement is contrary to some of the other benchmarks. The one like you have mentioned came from sales programs that this segment implemented in 2014 and had increased customer base and penetration of its sales into that. It's now carrying over more fully in the first quarter that really weren't fully in place in the first quarter of 2014. So there is actually a market share gain that is coming through on this first quarter.

Ken Zener - *KeyBanc Capital Markets - Analyst*

Then given the growth that you expect in residential to be offsetting the industrial broadly, and specifically in postal, where you have 50% this quarter and 4Q you were up 40%. You talked about that rate of acceleration beginning to decelerate in the back half.

Did you give us a sense of how that slope might look if you think about first-half growth in res versus the second half within your guidance? Just so we could properly understand that very high growth rate you are seeing and how that will normalize. Thank you very much.

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

I think the first half would be probably plus 20% of this year compared to the comparable period last year and the back half of the year is probably closer to 9%, 10% growth compared to the second half of 2014.

Ken Zener - *KeyBanc Capital Markets - Analyst*

Good. Thank you very much, gentlemen.

Operator

(Operator Instructions) Ladies and gentlemen, we've come to the end of our question-and-answer session. I would like to now turn the floor back over to Mr. Heard for any closing or additional remarks.

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

Thank you, operator, and thank you, everyone, for joining us today. Between now and our next call we will be presenting Gibraltar at KeyBanc's Industrial Conference on May 28 in Boston as well as the CJS Securities New Ideas Summer Conference on July 14 in White Plains, New York. We hope to see you all there. Thank you again.