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ROCK.OQ - Q3 2022 Gibraltar Industries Inc Earnings Call

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PRESENTATION

Operator

Greetings, ladies and gentlemen, and welcome to Gibraltar Industries Quarter 3 of 2022 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

It is my pleasure to introduce your host, Carolyn Capaccio of LHA. Please go ahead.

Carolyn M. Capaccio - *LHA Investor Relations - SVP*

Thank you, operator. Good morning, everyone, and thank you for joining us today. With me on the call is Bill Bosway, Gibraltar Industries' Chairman, President and Chief Executive Officer; and Tim Murphy, Gibraltar's Chief Financial Officer.

The earnings press release that was issued this morning as well as a slide presentation that management will use during the call are both available in the Investors section of the company's website, gibraltar1.com. As previously noted, Gibraltar classified the processing equipment business in the Agtech segment as held-for-sale with first quarter 2022 results and has removed the related revenues and expenses from the processing business from adjusted results.

Gibraltar's earnings press release and remarks contain non-GAAP financial measures. Tables of reconciliation of GAAP to adjusted financial measures can be found in the earnings press release that was issued today.

Also, as noted on Slide 2 of the presentation, the earnings press release and slide presentation contain forward-looking statements with respect to future financial results. These statements are not guarantees of future performance, and 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 be accessed through the company's website.

Now I'll turn the call over to Bill Bosway. Bill?

William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

Thanks, Carolyn. Hey, good morning, everybody, and thank you for joining today's call. We'll start with an overview of our third quarter results. Tim will take you through our financial performance, and then I'll come back and update you on our outlook for the rest of the year. And then we'll open the call for your questions.

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So let's get started by turning to Slide 3 titled Third Quarter 2022 Results. 2022 continues to unfold in line with our expectations. And we delivered a strong quarter with adjusted revenue up 6%, adjusted operating income up 16%, adjusted EBITDA up 14% and adjusted EPS up 19% to $1.12 per share. All 4 of our segments delivered double-digit operating margin performance, and the Residential and Infrastructure businesses both generated solid revenue growth as well.

In our Residential business, we acquired Quality Aluminum Products, which broadens our geographic channel and product footprint for the business. And Quality Aluminum Products added $0.02 to our adjusted EPS in the quarter. Our backlog decreased 7% during the quarter to $356 million driven by lower backlog in our Renewables and Agtech businesses.

As we experienced during the second quarter, it remains challenging for our renewables customers to finalize contracts and schedule projects as the solar panel supply chain learns how to work through the new UFLPA importation requirements. UFLPA went into effect in June, and the industry expects to see more efficiency, reliability and scale with importation process in the first half of 2023.

In our Agtech business, although project design and quote activity is robust, backlog was down at the end of the quarter when compared to last year's strong order inflow. But we anticipate new bookings to increase as we finish 2022.

Focus on our 5 key performance initiatives have not changed. And given our year-to-date results and current demand profile, we are raising the lower end and narrowing the range of our GAAP and adjusted EPS outlook, and we're also reaffirming our outlook for consolidated revenue.

Let's turn to Slide 4, and we'll talk a little bit about commodity prices, supply chain and general inflation. Hot-rolled coil steel and aluminum spot prices have corrected further as global and regional demand and supply becomes more aligned. And we've also seen slight improvement in structural and plate steel spot prices. In general, steel and aluminum spot prices remain above pre-pandemic levels. And other cost inputs, labor, transportation, et cetera, remain inflated and are expected to continue in the near-term.

Our supply chain is performing better, and we continue to focus on reliability and consistency as we accelerate customer service levels and improve working capital performance. We also continue to work diligently to balance price actions and input costs in a timely manner, accelerate our 80/20 initiatives for productivity and cost reduction, and manage and optimize contract terms with our customers.

Let's move to Slide 5 for an update on the panel supply for the solar industry. So the 2 trade issues impacting solar panel supply. The UFLPA enforcement continues to have the greatest near-term impact on customers' ability to move forward with projects. Just as a reminder, the UFLPA was implemented in late June and is enforced by the U.S. Custom & Border Protection. And while customers continue to work with CBP to understand documentation requirements, panel input -- import flow and availability has remained a challenge for customers. Our industry contacts confirm progress is being made, albeit slower than expected, and expect panel flow to improve in the first half of 2023.

On the second issue, the Department of Commerce delayed its preliminary ruling on the AD/CVD investigation from late August to later this month, November 22, and with its final ruling now expected in April of 2023. We still expect the DOC's preliminary ruling will provide solid direction to the industry and what to expect in the final ruling.

Keep in mind, administration has instructed the DOC to implement a 2-year waiver on tariffs, and we expect the DOC will execute in order to do so in conjunction with or around the time of the DOC's preliminary ruling on the AD/CVD case.

I'd say despite the near-term impact of these trade issues, given the role solar energy production continues to play in U.S. energy policy, the ongoing investment in the industry, the size and growth of the industry and the substantial increase in incentives from the Inflation Reduction Act over the next 10 years, we really remain very excited about our future in this industry and expect the U.S. solar industry to accelerate even faster. And we're also in a very good position to accelerate our business as well.

So with that, I'll turn it over to Tim for a review of our results.

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Timothy F. Murphy - *Gibraltar Industries, Inc. - Senior VP & CFO*

Thanks, Bill, and good morning, everyone. I'll take you through our consolidated segment results, starting on Slide 6. Adjusted third quarter revenue increased 6.4% to $389 million. Approximately half of this growth was organic and was driven by participation gains in price management in the Residential segment, partially offset by continuing end-market supply chain challenges and project delays in the Renewables and Agtech segments. And the other half resulted from the inclusion of our acquisition of Quality Aluminum Products in the Residential segment, which we completed in August.

Backlog at quarter end was $356 million, down approximately 7% from third quarter 2021, driven by customers awaiting greater visibility on near-term solar panel availability and project timing in Agtech, partially offset by continued demand in Infrastructure. Adjusted operating income and adjusted EBITDA dollars increased 16.2% and 14.2%, respectively, in the third quarter with adjusted EPS up 19.1%.

Margin improvements in the business were driven by participation gains, price management, business mix and 80/20 initiatives with Renewables, Agtech and Infrastructure margins continuing to expand and Residential margins down slightly. Weighted average diluted shares outstanding decreased 3.7% to 31.8 million in the third quarter through our share repurchase program, which I'll discuss in a moment.

Now let's review the segments starting with Slide 7, the Renewable segment. Revenue decreased 14.7%, and our backlog was down 9% as customers remain in a holding pattern on existing and new projects as they look for improved visibility on solar panel availability. Our customer project planning activity is very strong and is accompanied by a robust pipeline of contracts in process.

As a reminder, we only include actual orders with signed contracts and deposits in our backlog. Purchase orders without a signed contract and deposit and our verbal agreements with customers are not and have never been included in our new bookings or project backlog.

Profitability continued to improve with adjusted operating margin of 12.9%, up 150 basis points over last year and 590 basis points sequentially, while adjusted EBITDA improved 190 basis points over last year and 570 basis points sequentially. Improvement was driven by project management, price/cost alignment and field operations efficiencies. We expect continued improvement -- we expect continued improved execution to drive margins throughout the remainder of the year.

Our integration is on track and accelerating, and our common ERP system is providing better visibility and enabling us to accelerate implementation of best practices in our supply chain. Our in-sourcing initiatives are underway and expected to provide better flexibility to meet customer demand.

Let's move to Slide 8 to review our Residential segment. Segment revenue increased 25.7% with 19% organic, representing our ninth consecutive quarter of double-digit growth. Quality Aluminum Products, which we acquired in August 2022, contributed an additional 6.7% of growth, and performed as expected in the quarter. Organic revenue was driven by pricing carryover from prior quarters and participation gains, particularly in our roofing and related repair businesses.

We are experiencing normal seasonal demand patterns and have begun to see some initial incremental repair demand from Hurricane Ian. As a reminder, 80% to 90% of our Residential business is driven by existing home repair, either because of aging or weather damage. Historically, home repair has not seen significant impacts from changing interest rates. Repairs, especially the roof, typically occur regardless.

We remain engaged with customers about their plans and expectations over the next few quarters, keeping a keen eye on any changes in demand. Segment adjusted operating income and EBITDA grew 22.6% and 21.6%, respectively. Adjusted operating EBITDA margin contracted 40 and 60 basis points, respectively, due to the inclusion of our recent acquisition, QAP.

On an organic basis, our margins were essentially flat with last year as operational improvements were offset by unfavorable product mix. Going forward, we expect QAP margins to improve as we execute our integration plan and implement 80/20 with the QAP team. Our initial integration work is progressing, and our new team members are very engaged in the process.

Last quarter, we went live on SAP in our mail and package business, which will improve operations with more scalable and effective systems and processes. We will continue our SAP investment as we strengthen each operation with common systems and processes and data and analytics to

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leverage supply chain, 80/20 initiatives, material management, customer service and connectivity, and our brand. We are on track to achieve our objectives for top and bottom line growth for this business this year.

Let's move to Slide 9 to review our Agtech segment. Adjusted revenue decreased 7.3% as project schedules primarily in produce continued to shift. The commercial business continues to be robust with good momentum, and the cannabis business is strengthening as we see progress on regulatory legislation in many states.

After growing 30% last quarter, backlog decreased 7% against a strong comparison last year. Demand remains strong, and we continue to have a number of sizable projects in the final planning stages. We continue to expect accelerating momentum for the remainder of the year and into 2023.

Segment adjusted operating and EBITDA margins improved 200 and 230 basis points, respectively, as the benefits of higher-margin backlog converted into a stronger business mix, improving price/cost management, continued improvements in supply chain, 80/20 and lean initiatives. As a result of these improvements, we expect steady performance as we end the year. With respect to the processing equipment sale, we remain in active discussions, and we'll provide updates when we have them.

Let's move to Slide 10 to review our Infrastructure segment. Segment revenue increased 9.1% on timing of project work and increased non-fabricated product demand. Order backlog increased 11%. We expect increased spending related to the Infrastructure Investment and Jobs Act to continue to impact us positively through the end of this year and into 2023.

Segment adjusted operating income increased 62.5% and operating and EBITDA margin 380 and 370 basis points, respectively, driven by price material cost management, volume leverage, positive mix and improved operating execution. We expect margins to improve on a year-over-year basis for the remainder of 2022 as projects negatively impacted by plate steel inflation are completed.

Let's move to Slide 11 to discuss our balance sheet and cash flow. At September 30, we had $273 million available on our revolver and cash on hand of $22 million. We generated $38 million in cash from continuing operations in the quarter. And excluding QAP, we invested $5.9 million in working capital during the quarter. This represents a decrease of $59.3 million from the $65.2 million we invested in the prior year quarter when we were managing for disruptive supply chain.

Current quarter's investment was driven by reductions in receivables and inventory were offset by decreases in payables and other liabilities. The disruption in supply chains has taken longer to moderate, causing a delay in our plans to further reduce inventory investment.

The reduction in accounts payable was affected by the timing of inventory purchases during the quarter in terms of suppliers. And the reduction in other liabilities was driven by a decline in billings of excess of costs, which results from the timing of billings based on contractual project billing schedules and customer deposits as we continue to work on projects in-house and backlog declined on lower levels of new project bookings.

During the quarter, we made a net cash investment of $51.6 million for the purchase of QAP, largely by drawing on our revolver. QAP added $24 million of net working capital, $15 million in inventory, $20 million of receivables and $11 million of payments. We expect to optimize QAP's working capital investment during integration. Our net leverage at quarter end remained approximately 1/2 turn.

During 2021 and early 2022, we invested in inventory to ensure strong support for our customers' needs during the current supply chain challenges, which enabled us to increase our participation. However, ongoing extended lead times in the supply chain have required us to keep inventory levels higher than we expected. As a result, we've reduced our target for 2022 free cash flow generation to approximately 6% of revenue from 10% to account for the delay in inventory reduction.

We continue to expect strong cash flow generation for the remainder of the year with continued improved earnings and reduction in working capital investment. And as always, we expect to use generated cash flow to fund investments in organic and inorganic growth along with opportunistic stock repurchase, supplemented as needed by use of our revolver depending on timing of any M&A or repurchases during the remainder of the year.

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Let's move to Slide 12 to update you on our share repurchase program. During the third quarter, we repurchased 138,000 shares (sic) [138,500 shares] with a market value of $5.5 million for an average price of $40. We funded this repurchase through the revolver. At Quarter end, we had 31.5 million shares outstanding with a weighted average of 31.8 million during the third quarter.

Now I'll turn the call back to Bill.

William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

Thanks, Tim. Let's move to Slide 13 for an update on our key priorities. Simplify and Focus. The journey continues for us, and we are staying the course and really trying to focus on what we can control. The last 24 months have been a tremendous learning experience for our team. And given the ever-changing end market and macro environment, it's really forced us to assess and challenge many of our operating paradigms.

I believe we've made solid progress with change management in each of our businesses, and we have plenty more opportunity in front of us. Relative to our priorities, as I said, they have not changed.

First and foremost, driving 80-20, at service speed, winning new business, productivity and costs, expanding margins and good cash performance; secondly, managing supply chain to minimize disruption, but also optimize cost and reduce our working capital; third, accelerate our digitization in our operations. It's quote to cash, it's customer service levels, it's supplier connectivity and it's cybersecurity; fourth, improving organizational health, agility and flexibility to operate in this current environment and create the best environment we can; and then finally, just continue to conduct business the right and responsible way every day.

Let's turn to Slide 14, and we'll review our 2022 guidance. So as mentioned at the beginning of today's call, given our performance to date and our current demand profile going into the fourth quarter, we are raising the lower end and narrowing the range of our GAAP and adjusted EPS outlook. Our outlook for consolidated revenue remains $1.38 billion to $1.43 billion compared to $1.32 billion in 2021. We now expect GAAP EPS to range between $2.90 and $3 compared to $2.25 in 2021. And adjusted EPS is expected to range between $3.30 to $3.40 compared to $2.86 in 2021.

Now I want to switch gears and talk briefly about 2023. We're currently engaged in our annual budget planning process, and we will finalize our plan in December. I'd say the macro environment continues to be dynamic. Our end markets are evolving, and our customers are working through their respective plans as well. With general market and customer input, let me share some of my initial observations on our end markets. Let's start with renewables.

The market is expected to grow with a slower first half, accelerating in the second half as panel supply improves. Inherent end-market demand remains strong as customer planning activity is high with a robust project pipeline. Key commodity prices are coming down, and the Inflation Reduction Act should provide positive impact in 2023 once the final guidelines are published.

Switching to Residential. I think the market is returning to its normal seasonality and moving toward traditional normal growth rates. As a result, the level of business in the fourth and first quarter will be lower than what has been experienced in recent years. Interest rates and inflation will continue to impact new housing construction, while housing repair activity should remain relatively solid. Improved supply chain reliability will help optimize channel inventory, and market prices will begin to shift downward as input costs decline and inflation is less impactful.

In Agtech, similar to Renewables, there's a strong customer planning activity and robust project pipeline evolving. Consumer demand for fruits and vegetables remain solid and will drive produce growers to invest in more growing capacity. The momentum in the commercial market will continue, and investment in cannabis growing capacity will increase as we see progress in regulatory legislation in many states.

And then finally, Infrastructure. Infrastructure bill will continue to drive market demand as state DOTs have better visibility of and access to funding over the next 5 years. Airport authorities are also in a stronger position to fund general runway maintenance similar to pre-pandemic levels.

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As mentioned earlier, for us, it's going to continue to be about simplify and focus and focusing on what we can control. Our strategy is solid. Our priorities have not changed. We have a lot of work to do as markets evolve, a lot of opportunity in front of us as well. And I think we also have a lot to be proud of and thankful for.

And lastly, I just -- I really do want to mention our teams in Florida and their families, many of which live and work in the Fort Myers area where Hurricane Ian made landfall. I'd say everyone on our team was impacted in some way by Hurricane Ian. And everybody, fortunately, was able to remain safe during the storm.

There are a ton of stories to tell, but I will say this group is special. A month after the storm hit our folks today continue to deal with damage to their homes and communities, and they have spent countless hours helping others recovers and find support. And in the midst of all of this, our teams continue to manage the business and take care of our customers. It really does make me incredibly proud to have this group of folks in our team. It's the kind of folks that make Gibraltar who we are. So I just want to give them a shout-out.

Now, hey, let's open up the call and we'll take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from Daniel Moore of CJS Securities.

Daniel Joseph Moore - *CJS Securities, Inc. - MD of Research*

Maybe we'll start with the resi side of the business. If you said this, I was a little late to the call, so I apologize. The 19% organic growth, what was pricing versus volume during the quarter?

William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

Yes. Same mix, Dan, as we've been experiencing where it's a combo with price still being the main driver, but volume hanging in there as well. And that volume is coming through, again, participation gains that we've been winning over the last year or so that are kind of continue to read through at this stage.

Daniel Joseph Moore - *CJS Securities, Inc. - MD of Research*

Helpful. And what are you hearing from your resi customers in real time, including big-box retailers? Any inventory reductions given incremental uncertainty and just kind of sequential order trends monthly into Q3 and into Q4?

William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

Yes. On a volume basis, I don't think we've seen at the big-box level a change in volume over the last few months. That's our take based on what we see at POS. I think what I mentioned during the call was the last couple of years, we have really not seen the normal seasonality in Residential business as you would have seen the last 50 years, the patterns, if you will, mainly because the supply chain was such a challenge around the world.

So we never got a break in Q4 and Q1 the last 2 years. I think as the economy has started to slow, that seasonality will come back into play, which is fully expected. We thought that was going to be the case coming into this year. So that's part of this. And then I think things will ramp back up as they normally would as we get into next year.

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But in general, I'd say volumes at the big-box level have stayed relatively consistent with what we've seen in the last couple of months. And then when you start getting into things like Hurricane Ian and so forth, there's a lot of puts and takes as we see it in our business as well.

Daniel Joseph Moore - *CJS Securities, Inc. - MD of Research*

Got it. And the corollary to that, just margins, your ability to maintain the strong margins you've had as, let's say, seasonality in resi demand normalizes to some degree?

William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

Yes. We fully expect to be able to maintain the margin performance that we've been generating. This particular quarter, relatively flat year-over-year. We had some product mix play in. QAP, as we mentioned when we acquired the company, is accretive to Gibraltar, but less margin than our core Residential business to start with. That will change as we integrate and drive that performance upwards. So as we always say, we expect to continue to drive top and bottom line as we move forward. And our thoughts haven't changed on that front as we go into this next phase of the economy moving.

Daniel Joseph Moore - *CJS Securities, Inc. - MD of Research*

All right. One more and I'll jump back in queue. But switching to Renewables. Thank you for the color, obviously, as it relates to the UFLPA and the DOC. It sounds like you still expect full year growth next year, net-net. Once we have let's say, a little bit more clarity, how long do you expect it to take for the supply to ramp back up and work its way through the channel? I mean once your customers are feeling more comfortable, does it take a quarter or 2 kind of for that supply to flow through and then into your business?

William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

Yes. It does vary a little bit, Dan, on that front. But I would expect that you'll see based on the readiness that we know customers have now with where projects are in the planning phase, buttoning up the last 5 yards in the red zone to get the project up and running is going to move relatively quickly.

I think there's a lot of panels that are waiting to come in. And so I would expect that within a quarter, you'll start to see things start -- I think you'll start to see flow come back to more normal levels once that starts happening. I don't think it will take 6 or 9 months for that to occur. I think people are very anxious to get on with it, and it'll happen sooner than later once the panels start to flow in.

Operator

The next question comes from Ken Zener of KeyBanc.

Kenneth Robinson Zener - *KeyBanc Capital Markets Inc., Research Division - Director & Equity Research Analyst*

Could you talk to inventory? It seems to have had an impact on your free cash flow, and you talked about building inventory to make sure you could service your customers. But as you highlighted your Slide 4, input costs are rolling over. So can you talk to how you're managing the risk that you didn't acquire inventory that is above market value, and it will be a drag on your margins?

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William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

Right. So 2 points on inventory. When we went into the quarter, we expected some of the supply chain issues that were coming to an end in Q2 to help us as we went into Q3. I think they took a little bit longer to get worked out than we anticipated. So that forced us to keep a little more inventory on the books than we thought we were going into the third quarter. So that's that impact. And that's just a timing element of the supply chain. That's started to work itself out.

And then we've talked in the past about a price/cost alignment, how do you manage the flushing out of your current input cost while market prices start to move and change. And we anticipated coming into this year that, that would be the case with prices -- market prices starting to shift. We've assumed a little bit sooner than what's probably happened this year. But as that happens, it's just a matter of working with our customers and driving down our inventory cost that we have on the books in conjunction with how prices move accordingly.

And that's how we're managing. And it's really just customer to customer but -- in terms of how we go through this. I wouldn't suggest that we have a gigantic risk in front of us. I think our customers are partnering with us and trying to navigate through. Remember, a lot of that, that we brought in was about driving service for our folks. And so they've been very positive in working with us because they know we brought this in for them specifically to work -- help us work through it. So our hope is that we'll be able to manage that relatively well, and we're starting to see that in Q4 and try to get ourselves really well positioned as we go into 2023.

Kenneth Robinson Zener - *KeyBanc Capital Markets Inc., Research Division - Director & Equity Research Analyst*

Good. And appreciate the comments around the Residential market trends. But focusing on renewables, which at least for me is the more difficult for me to understand business. The fact you're at 12.9% margin, it's a big difference from where you were in the first quarter and the second quarter. You talked about that kind of sustaining earlier in the year. Could you talk to, first -- you talked about Renewable, the market, not guidance, being stronger in the first half versus the second half, I believe, was your commentary regarding 2023.

William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

Yes. So I think as it relates to '23, Renewables as a market will have -- I think will growth year-over-year. The growth in total for the year will be dependent on the ramp between the first and second half. The first half will be slower as people work through the UFLPA importation process.

Kenneth Robinson Zener - *KeyBanc Capital Markets Inc., Research Division - Director & Equity Research Analyst*

Got it. Okay.

William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

Right. And so that's how that's...

Kenneth Robinson Zener - *KeyBanc Capital Markets Inc., Research Division - Director & Equity Research Analyst*

If it's slower, does that mean your margins second half '22 versus the first half of '22 -- I mean, is there a way to think about that? Because that's created so much, I think, volatility around your company. With your margins coming back in, does that mean your run rate in the second half is kind of not a good way to think about the first half of '23? I mean I don't want to actually get guidance. I'm just trying to understand the operating cost of the business.

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William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

Yes. No. So one, always remember there's seasonality in this business, and the first quarter is always the lowest because of construction around -- in the toughest weather months, right? So that's always been the case for the renewables industry. It's always been the case for our business. So that's one thing to think about.

Secondly, if you recall the first quarter of 2022, it was a very difficult quarter for us related to a lot of project movement that occurred the previous year and flowed into Q1. So from a comp perspective, I think we're in a much better position going into next year than we were this past year in regards to the top line situation.

So we're set up, I think, to -- as we said, going into the second half of this year, we expect to generate double-digit margins in this business. We expect that momentum to carry into next year. Those margins, obviously, will be stronger in Q2, 3 and 4 where you have more volume. Q1 seasonally is the lowest, is the slowest, but we're coming also against a tough Q1 and 2022 to compare with as well.

Kenneth Robinson Zener - *KeyBanc Capital Markets Inc., Research Division - Director & Equity Research Analyst*

Right. And then I apologize, just one last one on Renewable. Could you talk to your understanding or conversations with your clients, which are developers, which themselves, right? Try to get cost so they get their own returns? With the yield curve moving so -- well, the yield curve as well as the absolute yield, how is that affecting developers' ability to understand their cost of capital? Is that a headwind separate from all these other issues you've been facing this year?

William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

Yes. I don't know if it's a new headwind, so to speak. I mean this environment has been ongoing for some time. If you think about the industry in 2021, before you started to see impact on yields, fees and overall cost of capital relative to interest rates and so forth, there's unbelievable amount of inflation that hit this industry in such a large way. We talked a lot about that.

Think about hot-rolled coil steel as an example. It was $1,000 more per ton year-over-year at the same period in Q3, right? That's one of your biggest components that go into our customers' set of economics that they're looking at. So yes, you've had interest rates go up. And so cost of these projects on one hand are seeing some headwinds there. But on the flip side, you've seen a significant amount of costs come down on -- operating costs come down as well. So there's a balance, I think, that each of our customers are looking at. Everyone has a little different profile in terms of the return that we're looking for.

But I would say just based on the amount of activity that we're engaged in now, designing, developing and getting projects into the red zone, it's as active as it's ever been. And if you take that step further and look at the land that's out there that's been acquired, what it's earmarked for, I think it's still relatively robust.

And then finally, the last thing I think developers and others are thinking about is the IRA can be very impactful in 2023. So effectively, without getting into the details, there's 2 sets of guidelines that we'll hopefully finalize here relatively soon. One from the Department of Treasury and one from Department of Labor, as it relates to the guidelines such that you can go drive incremental benefits even more so above than where we have been historically.

So I think customers are now using that -- or factoring that into their equation as well when making these decisions. But that's a substantial upside opportunity on top of inflation coming down. So yes, interest rates are still high. But at the end of the day, there are some tailwinds that are starting to kick in that have people excited as well.

Ultimately, at the end of the day, what really matters is we've got to get panels flowing in, number one. And then I think the rest of it will start to balance itself out, at least that's our impression as we talk with many of our top customers. They're not slowing down.

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Operator

The next question comes from Julio Romero of Sidoti.

Unidentified Analyst

Hello? Can you hear me there?

William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

Julio, are you there? Yes. We can hear you.

Unidentified Analyst

This is Stefan Gil on for Julio Romero. I guess the question is on the Renewable segment, what do you foresee as the key variables succeeding in 2023?

William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

Well, number one is panel supply for the industry. Again, that's not what we buy. It's what our customers do, and that's been a problem or challenge for really the last 4 or 5 quarters. And we're hoping that the industry, now that it has a quarter or so behind it with dealing with the new UFLPA in another quarter or so working through that. Those panels will start to flow into the country in a way that our customers are able to move forward with a lot of projects that they've been planning on. That's probably the number one.

Number two, I think, is how does inflation or things that have been highly inflated really impact the returns on their business and [incent] them to move faster and some of the major components, as I just mentioned earlier, coming down significantly versus where we were a year ago. That's helpful. Cost of capital is up a little bit, obviously, with interest rates. But then the Inflation Reduction Act is something that could be incrementally very beneficial for a lot of customers, and they're hoping to be able to take advantage of that in 2023 as well.

So there's a lot of moving parts and a couple of different levers there that could be pulled by customers, but those are things -- I'd say the 3 things that, from our perspective, that matter most for the industry as we move into 2023, and that will be a reflection of our business as well.

Unidentified Analyst

That was helpful. My second question is on the Residential segment. Can you talk a little bit about the QAP deal and the strategic rationale?

William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

I'm sorry, I didn't hear the first part. Talk a little bit about the what?

Unidentified Analyst

Can you talk about the QAP deal?

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Timothy F. Murphy - *Gibraltar Industries, Inc. - Senior VP & CFO*

QAP.

Unidentified Analyst

And strategic rationale behind it?

William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

Oh, QAP, sorry. Yes, so -- sorry, QAP, yes. And the second part of your question?

Unidentified Analyst

The strategic rationale behind it?

William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

So we acquired QAP during the quarter. They're based in Hastings, Michigan. It's a company we've known for quite a while. I spent the last 9 or 10 months having discussions with them. The rationale for us moving forward, one, it opens up the door relative to some channel opportunities. They're very big in residential wholesale, and that really helps balance our portfolio in terms of channels, wholesale versus big box.

They get us into some geographic locations that we haven't been in historically. So we've got a geographic expansion that is very important to us. And then they bring a new set of products -- or an additional set of products that will help us with our customers, which is kind of interesting.

So there's a lot of cross-selling opportunities, whether it's core Gibraltar business selling through the QAP network to its set of customers in the wholesale channel or vice versa coming back through Gibraltar. So those are the 3 core pieces of rationale behind it. We felt we brought the business into the family at a good price, at the right multiple. And yes, we're excited to have them, and we're looking forward to getting through our integration and driving the synergies that we expect to see.

Unidentified Analyst

All right. So can you please speak to the margin profile of QAP? Like it seems to be below that of the legacy Residential segment. So maybe you can talk about the....

William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

Yes. It is. And as...

Unidentified Analyst

Can you talk about the opportunity, if any?

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William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

Yes. We expect to bring the margins up more in line with where our historical performance is in our core business. It's going to take a little time. We've got pretty good synergies that we see starting to flow in that will be impactful in 2023, their supply chain, in particular, getting our 80/20 operating system into the organization, which they've actually already started even before we finished the acquisition.

So this is a good business that has inherently a better margin profile than what we acquired, but there are some things that we can bring to the table, help get them there. But I would expect them to start creeping more towards our core margin profile performance as we move into 2023 or exit 2023. So it will take a little time, but we will get there.

Operator

(Operator Instructions) The next question comes from Walt Liptak of Seaport Global.

Walter Scott Liptak - *Seaport Research Partners - MD & Senior Industrials Analyst*

Well, I wanted to ask -- thanks for the 2023 outlook that you gave at the end of your remarks. And if we kind of look at all those things together, I wonder if you're thinking about 2023 being a revenue growth year and where you think the -- I guess with 80/20 and some of the other things that you're doing, could it be an EPS growth here as well?

William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

Yes. I would say, Walt, you know as well as anybody, our view is this, is we expect to grow on both top and bottom line each year. And I think that's a reasonable expectation as we go into next year. We'll have a better view of that as we finish up the planning process. I mean trying to understand each of the quarters and what the full year is going to look like over the next, really, 1.5 months is where our focus is right now.

But our expectation going into the year based on participation opportunities that we're involved in now and that we're working on in the residential business, I think, would be very helpful. We've got to get the panel situation for the solar industry to open up and when it does, we're in a great position to really execute on that. Our Infrastructure business is humming along. And then Agtech got some really large projects that, as they come across the finish line, will -- should get us off to a good start next year as well.

So if you think about the things that drive -- think about things that drive Renewables, Agtech and Infrastructure, that's half of Gibraltar. That really is probably going to be a little bit more recession-resilient. In other words, the things that are holding back Renewables have nothing to do with the overall economy, so to speak. They have more -- there's trade issues that got to get worked out.

So given the IRA out there pushing even incremental benefits there, I think -- we think that will accelerate as the panel situation gets worked out. That's a good news story, not just next year but going forward. Infrastructure has got a 5-year support plan in place with the infrastructure bill that's out there now, and we're starting to see the impact of that.

And Agtech is just really about people's demand for fruits and vegetables and our commercial business, which are the 2 pieces that really drive that. Those aren't necessarily related to some of the broader macro things in a lot of ways.

And then the Residential, for us, it's about repair. New housing has been a drag for 10 months now. So I think we entered this coming year knowing that, that was going to be the case. And so again, it gets back to how do you drive participation. QAP gives us some incremental growth. And then managing your price/cost and doing that through 80/20 initiatives and other productivity efforts, I think that we're set up for -- to have a solid year in 2023. And we'll give you more -- we'll shed more light on that here early next year when we come out with the plan.

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Walter Scott Liptak - *Seaport Research Partners - MD & Senior Industrials Analyst*

Okay. And in the Residential segment specifically, the comments that you made about Hurricane Ian sounded a little bit mixed. And I wonder why that was or if that was the case. And if you have any damage data or roof replacement data that -- from that hurricane. And then going back up to like the 50,000-foot level on Residential, could 2023 be a growth year in dollars or organics because you've got some of your raw material costs moving around as you talked about earlier?

William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

Yes. Sorry, the second question, be a growth year in dollars or what? What did you -- what was the second part?

Walter Scott Liptak - *Seaport Research Partners - MD & Senior Industrials Analyst*

Yes. I mean if you've got some deflationary metal prices, Residential will be down because of that as opposed to organic growth.

William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

Yes. So first one, Hurricane Ian, sorry, I didn't -- maybe I wasn't -- didn't mean to be unclear. That has -- we're seeing the impact of that. We start to see that almost immediately. The degree of the impact, it takes time to evolve because the first month or 2 or 6 is all about cleanup and then understanding the magnitude, but we -- the damage and then the repair and then how quick can that repair based on just having the labor available, et cetera, et cetera, to kind of work through these things at a major storm like this.

So we've been helping our wholesalers and retailers quickly respond to the needs, and that has started. How long that lasts? That could be months, could be a year. It really depends on storm by storm and magnitude of damage. But we've already started to see impact from it, and we're responding accordingly.

And I will say just again, a shout-out to our teams that are supporting right now. We're sending water and other supplies to wherever our shipments are going for whoever needs it on the back of every truck or what we're (inaudible). So you've got situations where you're delivering trucks to parking lots because the stores don't have either the store is damaged or they don't have enough space inside because they're gearing up for all the work that has to be done.

So we'll get more clarity as time goes on. It's really hard to predict and tell you what the damage or magnitude is and timing. It's just the nature of this. But we're a month or so into this, and there's still a lot of cleanup and work that's going on. But it is having an impact on our orders at this stage.

From a -- question about 2023, yes, you would expect as -- if you remember, as we went through this inflationary upward cycle, we had this constant conversation around our pricing catching up with the inflationary cost, and we drag on margins on the way up. And then finally, we flip the switch once our pricing caught up. And then that's governed oftentimes with our big box in our large retail customers through our contracts.

So as things come down, you have the same type of discussion. So market prices will bring down revenue on the top line as they subside. That's -- we've got that baked into our thought process. Like I said earlier, we thought that was going to happen earlier this year than it did, but we fully expect that in our plan going into next year. We offset that through things like QAP and other participation gains.

So I do think we can continue to grow into next year despite market prices coming down, hitting the top line. We'll offset that through volume pickup, through participation gains and the full year effect of QAP. So yes, we feel like there's an opportunity to grow in 2023. We've got some work to do, but it's absolutely our intent to get there.

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Walter Scott Liptak - *Seaport Research Partners - MD & Senior Industrials Analyst*

Okay. Sounds great. And then switching over to Renewables. The Q&A that we already have about the double-digit 2023 operating margin, it sounded to me like you were saying that that's what you're expecting, the double-digit operating margin for 2023, but not in the first quarter, later on in the year, like second quarter and second half. Is that right?

William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

Yes. So think of it this way, we said coming into the second half, we would run double digit second half. And so that gives us the momentum going into next year. Next year, our intent is to run double digit for the year. We got to finalize those plans. But if you kept that momentum going into next year, that's great. But there is seasonality in this business, right?

Q1 is always the lowest revenue quarter for the industry because of construction in January, February, particularly for us. We do a lot in the Northeast and the East Coast. So it's always been our lowest quarter. So the margin in Q1 will not be necessarily reflective of the full year.

I think the full year, we have a line of sight. We're going to continue the momentum that we've had in 2022 and drive that forward. If we do so, then we'll get back to the performance that you saw in 2020, which if you recall was 12%, 13% operating income. So we think that's very reasonable.

And just to remind everybody, if you think about this quarter, revenue was down 14%, almost 15%, versus last year. And we drove an operating performance that was much better than we had last year. And a lot of it has to do with just getting into the systems and aligning price/cost and our field operations and field efficiency work that the team has been doing over the last really year.

So if you can generate that type of operating performance when you're down 15% in a particular quarter, I think that gives you some confidence that we're in a good position to follow through whatever comes our way. And now and as panel supply starts to open up, that flowing through with some cadence will really -- we're set up to do really well in that environment. So yes, we expect to have a solid year in renewables next year as well.

Walter Scott Liptak - *Seaport Research Partners - MD & Senior Industrials Analyst*

Okay. Yes, that sounds great. Yes, we did notice that the revenues were down in Renewables, and it was a nice operating margin. And I guess that's why I was thinking about double digits for the first quarter because if you can flex cause or be productive even on lower revenue in the first quarter, maybe you can get to the double digits as well.

William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

Yes. Well, we'll -- as we finish up our plans and we'll have a better idea of what that's going to look like. As I talked earlier, recall, this year was a tough Q1. So I think you'll see a marked difference in performance -- operating performance in Q1 versus Q1, but that's mainly because we had a very difficult Q1 this year. But I think as we've always seen in Q2, 3 and 4, with 2 and 3 being your most busy quarters, that's where typically the business generates its highest margins during the year. And that's more volume.

Operator

Ladies and gentlemen, this concludes our question-and-answer session. I will now turn the call over to Mr. Bosway for closing remarks.

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William T. Bosway - *Gibraltar Industries, Inc. - Chairman of the Board, President & CEO*

Well, thank you again for joining us today. We do expect to present at the BofA Virtual Global Energy Conference as well as participate in the CGS New Ideas Conference in the first quarter of 2023. I just want to wish everyone a safe and healthy and happy holiday season, and we look forward to updating you again when we report our fourth quarter results. So thank you and have a great day.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference. Thank you for your participation, and you can now disconnect your lines.

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