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Interface, Inc. (TILE)

Q2 2020 Earnings Call

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CORPORATE PARTICIPANTS

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen. Thank you for standing by. And welcome to the Q2 2020 Interface, Inc. Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions]

I would now like to turn the conference over to your speaker today, Christine Needles, Corporate Communications. Please go ahead.

Christine Needles

Senior Director-Global Communications & Public Relations, Interface, Inc.

Good morning, and welcome to Interface's conference call regarding second quarter 2020 results, hosted by Dan Hendrix, Chairman and CEO; and Bruce Hausmann, Vice President and CFO.

During today's conference call, any management comments regarding Interface's business, which are not historical information, are forward-looking statements within the meaning of the Securities Act of 1933 as amended and the Securities Exchange Act of 1934 as amended by the Private Securities Litigation Reform Act of 1995. Forward-looking statements include statements regarding the intent, belief or current expectations of our management team, as well as the assumptions on which such statements are based.

Any forward-looking statements are not guarantees of future performance and involve a number of risks and uncertainties that could cause actual results to differ materially from any such statements, including risks and uncertainties associated with the ongoing COVID-19 pandemic, including interruptions to our manufacturing operations and reduced demand for our products, economic conditions in the commercial interiors industry, and risks related to lawsuits, investigations and similar legal proceeding that we are subject to from time to time, as well as the risks and uncertainties discussed under the heading Risk Factors in Item 1A of the company's Annual Report on Form 10-K for the fiscal year ended December 29, 2019, and our subsequent quarterly report on Form

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10-Q for the period ended April 5, 2020, which have been filed with the Securities and Exchange Commission. We direct our listeners to those documents.

The company assumes no responsibility to update or revise forward-looking statements made during this call and cautions listeners not to place undue reliance on any such forward-looking statements. Management's remarks during this call also refer to certain non-GAAP measures. The most comparable GAAP measures as well as a reconciliation of the non-GAAP measures to the most comparable GAAP measures is contained in the company's earnings release and Form 8-K furnished with the SEC today, which explains why Interface believes presentation of these non-GAAP measures provide useful information to investors, as well as any additional material purposes for which Interface uses these non-GAAP measures, each of which can be accessed in the Investor Relations section of the company's website, www.interface.com.

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Now, I'd like to turn the call over to Dan Hendrix, Chairman and CEO.

Daniel T. Hendrix

Chairman, President & Chief Executive Officer, Interface, Inc.

Good morning and thank you for joining us on the call. I hope that everyone is staying safe and well. As anticipated, our sales in the second quarter were significantly impacted by the ongoing global pandemic, down 27% in Q2 versus last year.

That being said, I'm proud of the team's agility across the globe, and our swift action to reduce spending and protect cash flow are still positioning us to be the leader in our space over the medium and long-term.

We've been able to hold gross margins at a healthy level and reduced SG&A expenses to deliver adjusted operating income of $27 million in the second quarter. We generated strong cash flow from operations of $48 million in the quarter, ending the quarter with $331 million of liquidity.

We also recently amended our credit facility to provide enhanced financial covenant flexibility through the end of Q1 2022. We have maintained our sales organization and continue to invest in product innovation to drive share gains and long-term growth. We remain steadfastly committed to our purpose and Climate mission, and are on track to deliver our first ever carbon negative carpet tile this year.

Before I share more about our innovation and sales initiatives, let me first turn the call over to Bruce to discuss our second quarter results in more detail. Bruce?

Bruce A. Hausmann

Chief Financial Officer & Vice President, Interface, Inc.

Thank you, Dan, and good morning, everyone. Before I get into details of Q2, I want to provide some insight into what we're seeing so far in Q3, as we continue to navigate through the impacts of COVID-19 and what it's having on our business.

As mentioned in last quarter's call, the more severe the lockdown, the more severe we see a decline in revenue. And while there are a few bright spots geographically where certain countries appear to have gained greater

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control of the virus and the associated economic activities more stabilized, the overall pressure on sales and orders is continuing as we enter the third quarter.

The lockdowns, of course, are occurring around the globe and we're seeing this in our order trends. For the month of April orders were down 32% year-over-year. For the month of May, orders were down 35%; and for the month of June, orders were down 29%. So the good news is that the decline has stabilized, but we're also not seeing a turn yet that puts us back into positive year-over-year growth territory.

As we enter Q3, for the month of July, orders were down 24% and the trend continues to be fairly broad based as orders were down 28% in Americas, 23% in EMEA and 14% in Asia-Pac. We anticipate this order trend will put pressure on sales and operating income in Q3, similar to the way it did in Q2.

With that context in mind, here's more details of the Q2 results. Net sales in Q2 2020 were down 27% versus the prior year period. Sales in our Americas business declined to 28% in the second quarter, the steepest declines were concentrated in carpet tile with resilient flooring largely flat in the quarter.

EMEA sales were down 23% in local currency and down 25% in US dollars. Similar to our Americas business, the carpet tile business was down significantly and resilient flooring was largely flat. Sales in Asia-Pacific were down 31% in local currency, but were down 33% of US dollars. Sales in the region were down significantly in April and May, but improved sequentially in June. Asia's heavier declines are somewhat moderated by less significant declines in Australia.

In our global market segments, we're seeing growth in living, which includes student housing, senior living and multi-residential, transportation, hospitality and education. We continue to be encouraged by the outstanding work of our supply chain and manufacturing teams and the relative stability of our gross margins despite continued production declines.

Second quarter gross profit margin was 37.5%, down 190 basis points versus second quarter gross profit margin last year. And adjusted gross profit margin was 38%, a decrease of 170 basis points compared to adjusted gross profit margin last year.

SG&A expenses were $80 million in the second quarter or 30.9% of sales, while adjusted SG&A expenses were $71 million or 27.4% of sales. In the second quarter, we recorded $6.2 million of one-time charges related to severance payments for our voluntary and involuntary separation programs, plus lease exit costs related to closure of the three remaining floor brick-and-mortar design centers as we continue to shift that business toward online distribution where it continues to gain traction and grow.

We also recorded $2.6 million of asset impairment charges and wrote-off $4.2 million of damaged yarn as a result of a fire at a leased storage facility. At the time of the fire, safety protocols were followed and no one was injured.

It's also important to note that, in SG&A, the company benefited approximately $4 million from various wage supports and employee retention programs around the world as well as temporary furloughs in the Americas and Asia Pacific. As we think about our SG&A run rate, we anticipate SG&A of approximately $80 million per quarter for the remainder of 2020, with total year adjusted SG&A expenses of approximately $320 million this fiscal year. In Q3 and Q4, we're not anticipating as much government-sponsored wage relief and other temporary pick-ups that were realized in Q2, which is why we're anticipating a sequential increase in SG&A run rate from Q2 to Q3.

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Second quarter operating income was $17 million compared with $43 million in Q2 last year. Our adjusted operating income was $27 million versus adjusted operating income of $44 million in the second quarter of last year.

We recorded net income of $5 million in the second quarter or $0.08 per diluted share. Adjusted net income was $16 million or $0.27 per diluted share in Q2, and adjusted EBITDA was $38 million in the second quarter. Please refer to our press release for reconciliations of our GAAP to non-GAAP measures.

Turning to our balance sheet, we continue to vigilantly manage cash and maintain healthy liquidity. As previously announced, we recently amended our syndicated credit facility providing for enhanced financial covenant flexibility through the end of Q1 2022.

Net debt or gross debt minus cash on hand was $528 million and the latest 12 months adjusted EBITDA was $181 million at the end of Q2, resulting in leverage ratio of 2.9 times, calculated as net debt divided by adjusted EBITDA.

Interest expense was $5 million in the second quarter compared to $7 million in Q2 of last year, and depreciation and amortization was $10 million in the quarter versus $11 million in Q2 of last year. Capital expenditures were $13 million in the second quarter compared to $15 million in the second quarter of last year. And we anticipate $45 million to $50 million of capital expenditures for the full year 2020, including planned investments in backing and tufting technologies in the Americas.

With that, I'll turn the call back over to Dan. Dan?

Daniel T. Hendrix

Chairman, President & Chief Executive Officer, Interface, Inc.

Thanks, Bruce. As I mentioned earlier, we have exciting product innovations in the works and remain focused on driving growth in our business. Our carbon negative carpet tile is a huge win for the environment that will also expand our market opportunity in carpet tile with a new non-PVC and bio-based backing offering.

We also recently announced that Interface LVT products now include 39% pre-consumer recycled content, demonstrating our commitment to applying our sustainability expertise to the resilient flooring category. We most recently previewed our new open air carpet tile collection, which pairs classic patterns and neutral colors to offer more options for larger footprint spaces and is developed to fit any budget.

At the NeoCon virtual events this year, we won the 2020 HiP Award in the hospitality flooring category for our Guest Room's product. And our product designer Kari Pei won the Manufacturing Leader category.

Beyond product, we are actively developing key markets and channels, expanding our overall market opportunity. We continue to see significant opportunity in non-office segments. Nora increased our presence in healthcare, education and transportation. And we believe there is a great opportunity to expand in these markets and develop a more meaningful presence in other key segments.

We are helping our customers adapt to their spaces for the current working environment by illustrating how our flooring can help create boundaries or zones for physical distancing and prompt movement through a variety of spaces. And we are partnering with architects and designers to develop flooring solutions that meet future built space design needs.

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Our FLOR brand has a proven omni-channel approach with a successful online presence, and a highly effective synergy program with our commercial business, capitalizing on the resi commercial design trend. We are expanding our presence in the dealer direct market, increasing access to the underdeveloped area of our customer base, particularly in the United States, UK and Australia.

Our immediate focus is on the safety of our employees and their families and protecting the financial position and cash flows of our company. We remain confident in the opportunities ahead and remain grounded in our core purpose and sustainability mission. We have the best selling system in the industry and are focused on growth in a sustainable way.

Thank you to the Interface team for your hard work during these challenging times. Thank you to the frontline manufacturing employees, who continue their hard work in our plants to make and deliver our products. Thank you to our sales teams for staying closely connected with our customers and working constantly to identify and execute on new opportunities every day.

And thank you all of our team members across the globe for their commitment whether you're working on the factory floor, from home or in the field. Your health and safety and that of your families remains our key priority.

Thank you also to our customers and shareholders who continue to support Interface. I remain confident that we have what it takes to emerge from this global pandemic as a stronger and more resilient company.

With that, I'll open it up to questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And your first question comes from the line of Kathryn Thompson with Thompson Research Group. Please go ahead.

Kathryn Ingram Thompson
Analyst, Thompson Research Group LLC

Q

Hi. Thank you for taking my questions today. And I appreciate the color you gave in the prepared commentary. Would appreciate just getting – digging a little bit deeper and clarifying differences by end market and region, and in particular, what types of projects are advancing, slowing or perhaps halted in the near-term. Thank you.

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.

A

Yeah, it's a mixed bag around the world to be honest with you. We're seeing in the European markets some of them starting to recover. I mean, the theme to the whole thing is we're definitely seeing some stabilization around the world. The office market is hit the hardest. The other segments are actually performing pretty well. Half of our business is office and half of is non-office, so we're pretty segmented. So we're going to focus on education and healthcare and the office as well. And we're also going to go down a little bit in price points to go after the dealer market, particularly in three regions. So it's stabilizing and we're going to take advantage of and go after it. I think we have the best selling system in the world and we're just going to go after business and sell.

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Kathryn Ingram Thompson
Analyst, Thompson Research Group LLC

Q

Okay. Thank you. Are you seeing any meaningful changes to shipping rates? Given the production and oil prices, are there any changes in shipping rates just due also to changes in global demand trends?

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.

A

From a freight standpoint, we haven't seen any big freight reductions. And I guess oil's standpoint, we don't make money on freight. So we really don't have an impact on freight. I don't know, Bruce, if you any color on that.

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.

A

Kathryn, this is Bruce. Good morning. We are seeing a deflationary environment...

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.

A

Yeah, for sure.

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.

A

... in the back half with our input costs. As you know, freight is not a big component of our input cost. But the rest of the stuff, we'll get some pickup in the back half.

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.

A

Yeah.

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.

A

We should get some pick up next year as well.

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.

A

Right. So 90% of our raw material inputs are [ph] oil based. (00:16:46) So, yes, we will see some benefit from them.

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.

A

Yeah.

Kathryn Ingram Thompson
Analyst, Thompson Research Group LLC

Q

Okay. And then final question for today, so many companies are happy to make major adjustments that have had, in general, a positive impact on margins, at least in the near-term. What structural changes do you anticipate not

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going away even with an improvement in volumes? And which ones do you think will transition back to kind of "normal"?

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.
A

Kathryn, we're right sizing this business to demand and we're going to focus on products, we're going to focus on innovation in our selling system and we're going to right size our business to what we see out there, stabilizing today around 25%. Hopefully, we'll hit the bottom and we're going to get back the other way. So we're going to right size SG&A to meet demand.

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.
A

And Kathryn, this is Bruce. One of [indiscernible] (00:17:40) business, of course, is that if you think about our manufacturing environment, it's about 30% fixed, 70% variable, which gives us a lot of flexibility around the globe to flex our cost structure. And I just want to give a shout-out to our manufacturing teams and the fantastic job they did throughout the quarter, navigating through the environment. Our production was down. And we got finished goods inventory down $30 million throughout the quarter. So you may notice our inventory was down $8 million and so some of that was some raw materials that we brought in. But the team just did a great job at navigating through the environment and really flexing through with the variable cost structure of the business.

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.
A

Yeah, I like our margin profile and the gross profit line. We've done a great job managing that.

Kathryn Ingram Thompson
Analyst, Thompson Research Group LLC
Q

Great. Thank you very much.

Operator: And your next question comes from the line of David MacGregor with Longbow Research. Please go ahead.

David S. MacGregor
Analyst, Longbow Research LLC
Q

Yeah. Good morning, everyone. Maybe just to pick up on that last point, you talk about being pleased with the gross margin profile. Is there any way you can bridge that 170 basis points for us? I'm sure a lot of it is just productivity associated with the lower volume, but just wondering price and anything else that might be in there.

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.
A

Well. I would tell you, having production down 37% and only having 170 basis points degradation in the margin, that shows you that our margin profile is pretty variable and we're able to meet demand with that.

David S. MacGregor
Analyst, Longbow Research LLC
Q

Sure.

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Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.
A

So, I think that's kind of stead well for us in the future, that margin profile. And our manufacturing folks, and Bruce said it, have done a great job in adjusting to the production levels.

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.
A

Yeah. And David, I would just add, this is Bruce, that our selling organization has done a great job at holding price in this challenging environment.

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.
A

Yeah, for sure.

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.
A

And so, between the holding price with that of what our product demands through innovation and through design, and our leadership position has done really well, accompanied with our manufacturing environment, that has a large variable component to it.

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.
A

Right.

David S. MacGregor
Analyst, Longbow Research LLC
Q

And so I guess you mentioned deflation in the second half. How would deflation in raw materials and production inputs have impacted the second quarter gross margins?

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.
A

We did have a pick-up in the second quarter. It wasn't a large one on input costs, because as you can imagine, we buy in – we buy the raw materials and then we manufacture that goes into inventory and then it eventually flow through. We'll see more of the pick-up in the back half of this year.

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.
A

Yeah. Our pricing is [ph] a quarter of places on our (00:20:21) yarn inputs.

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.
A

Yeah.

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.
A

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Adjusted per quarter.

David S. MacGregor
Analyst, Longbow Research LLC

Q

I'm sorry. Could you repeat that? You cut it on me.

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.

A

So one of our biggest raw material inputs is yarn and our supply contracts adjust quarterly to pricing.

David S. MacGregor
Analyst, Longbow Research LLC

Q

Okay.

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.

A

So we'll see a bigger impact in the second half.

David S. MacGregor
Analyst, Longbow Research LLC

Q

Got it. And then, I guess secondly, you mentioned going after the dealer market and pursuing lower price point. Are you taking equal products in the market, like equal weight product in the market with lower price point or are you going to lower price point with lower weight product? And then, just talk about the different cost of service or the different cost of going to market with the dealer versus the spec market?

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.

A

Well, we have our products [ph] based on (00:21:07) category one, two, three, four and five. The dealer market's a category two product, which we price it – we manufacture it to fit that market to keep our margin. So it's not a different system we go into from a product standpoint. [ph] We're just going to (00:21:20) have more category two products. We're going to use our existing selling organization to sell in that market and focus on the dealer. It's basically treated a dealer like a customer is going after that business.

David S. MacGregor
Analyst, Longbow Research LLC

Q

Okay. So you're not taking like-for-like product down market. You're just going to emphasize a lower weight product within your line structure.

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.

A

Correct, right.

David S. MacGregor
Analyst, Longbow Research LLC

Q

All right. That's good. That's all I had. Thanks very much. Good luck.

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Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.
A

Great. Thank you.

Operator: And your next question comes from the line of Keith Hughes with Truist. Please go ahead.

Keith Hughes
Analyst, Truist
Q

Thank you. I think you said in the prepared comments, resilient flooring was flat in the quarter. Is that correct?

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.
A

Yeah, the resilient has been – was relatively flat. And so there is heavier pressure on the carpet tile, while resilient hung in there pretty strongly.

Keith Hughes
Analyst, Truist
Q

And so within that resilient, how did nora compare with LVT goods?

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.
A

Nora has been our strongest category. Nora has held in amazingly strongly throughout the entire pandemic and has done extremely well. And in certain pockets within nora business, you would never know that COVID-19 pandemic is even happening.

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.
A

Yeah. I would say – nora is big bright spot for us. And I think the second half is going to be pretty good for nora.

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.
A

Yeah.

Keith Hughes
Analyst, Truist
Q

Why is it doing so much better than particularly carpet [ph] at this moment? (00:22:47)

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.
A

It's focused on healthcare, which – obviously, in education, which both of those are doing are very well in transportation. So they're segmented differently from the office.

Keith Hughes
Analyst, Truist
Q

So I think by your comment, it was up in the quarter. It was positive in the quarter.

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Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.
A

Yeah.

Keith Hughes
Analyst, Truist
Q

Okay. And then on the SG&A spending, you talked about like $4 million of government support in SG&A on the $71 million you reported. What other costs are going to be coming back as you go into the third [indiscernible] (00:23:20)

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.
A

Yeah, So, Keith, this is Bruce. So, as you pointed out, it was a combination of furloughs and then the government supported programs that gave us a pickup in Q2. And we don't anticipate of that – as much of that in Q3. And of course, our sales volume changes. We have additional variable SG&A cost that come back. And then, I would just sort of say there's just general seasonality around marketing and promotional programs.

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.
A

Yeah. I'll also say we're going to introduce our carbon negative products, and by the beauty in the third quarter and we're going to make a big splash with that. So we're going to invest in this backing system that I think is going to give us some big advantage.

Keith Hughes
Analyst, Truist
Q

Are you looking at capacity reductions, particularly in carpet tiles, given how weak that business is?

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.
A

Well, I think it's stabilized. We were down 37% of productions. So I think we're going to look at – hopefully, our capacity will go back up [ph] and we'll (00:24:22) get some leverage there second half of the year.

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.
A

Keith, one of the beauties of the whole business that we're – and we're seeing it right on the income statement, is the flexibility of the manufacturing environment to flex up and down as well as the geographic presence that we have, having manufacturing on four continents, really helps us from a competitive standpoint.

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.
A

Right. And we're open for business around the world.

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.
A

Yeah.

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Keith Hughes
Analyst, Truist

Q

Yeah. Okay. Thank you.

Operator: [Operator Instructions] And your next question comes from the line of Sam Darkatsh with Raymond James. Please go ahead.

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.

Q

Good morning, Dan. Good morning, Bruce. How are you?

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.

A

Hey, Sam. Good. How are you?

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.

Q

I'm well. Thank you. I hope you and your families are doing well and staying safe as well. Few questions if I might. The sales down 27% in the quarter, do you have a sense of what volumes were versus pricing like-for-like and/or mix?

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.

A

So, Sam, this is Bruce. It was mostly volume that was down, not price.

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.

A

Yeah. [ph] Our price is stable. (00:25:31)

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.

A

Yeah.

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.

Q

So, price was essentially flat year-on-year?

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.

A

Yeah.

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.

A

Yeah. It was.

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Sam Darkatsh
Analyst, Raymond James & Associates, Inc.

Q

Okay. And then, I don't want to hold you to guidance per se, but would there be a reason to think why gross margins wouldn't hang in there at the 38% range over the next couple of quarters or so? And what are the puts and takes there as we look at our models prospectively?

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.

A

Yeah. Sam, this is Bruce. So, we think – that's why we provided a little bit of insight into what we're seeing so far into Q3. We think that Q3 will look a lot like Q2 based on the data that we have. And so, that's why we wanted to provide the order rates and where they're at, at the end of July. And we'll continue to navigate through this, flex our variable cost structure similar to the way we did in Q2. We'll have a little bit more SG&A. We think our SG&A run rate is around $80 million a quarter. And so, if you think about the top line, it'll probably be fairly in line with where we're seeing orders quarter-to-date, we believe. GP will be, we think, similar to Q2 and SG&A will be in the $80-ish million range.

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.

Q

Two more quick questions if I could. The commentary around finished goods inventory and production was very helpful. Thank you. I'm just making sure I understand how to reconcile the finished goods data with the production. So, if finished goods are down $30 million, I think if my math holds, that's roughly 15% down both sequentially and year-on-year with what you're saying production was down 37%. What's the difference between the finished goods being down 15%, the production being down 37%? What am I missing in the reconciliation there?

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.

A

So, Sam, this is Bruce. I'll kind of help you with the math. And it's hard to see it because you just get the top level numbers. So total inventory, as you know, was down $8 million. If you double click down on that, finished goods were down $30 million and that was 24%. So we did a really nice job at managing finished goods inventory. And the reason why total inventory is only down $8 million is because we actually bought some raw materials because we wanted to make sure that we had supply chain continuity through the COVID-19 environment. So we did pre-purchase some raw materials to ensure that we could meet customer demands and that we would have the materials that we need to do the manufacturing that we need so that we didn't – so we didn't get the product to the customer when they want it.

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.

Q

So then prospectively, when we're looking at second half cash flows, I think free cash flow was essentially a push in the first half. What do you anticipate for cash flows in the back half?

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.

A

Yeah, Sam, we're going to continue – so we had a really, really strong cash flow performance in Q2. We're generating $48 million of cash from operations and $35 million of free cash flow, and we anticipate a good strong cash flow in the back half as well. We're very focused on working capital. And of course, the business will –

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normally does generate cash in the back half. So we believe that we'll be – we'll certainly be very positive from an operating standpoint around cash flow. And we define free cash flow as operating cash minus CapEx. We will also be positive for the year around free cash flow. The company is generating a lot of cash and we're really pleased with all of our liquidity metrics.

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.

Q

Very helpful. Thank you both gentlemen.

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.

A

Thank you, Sam.

Operator: And your next question comes from the line of David MacGregor with Longbow Research. Please go ahead.

David S. MacGregor
Analyst, Longbow Research LLC

Q

Yeah. Thanks for taking the follow-up. I guess I just wanted to go back and maybe come at the question that Keith was asking from a slightly different angle. I mean you've got this very large negative comps here in carpet tile, but your resilient is flat to up. And so I guess I just wanted to understand what's happening in the marketplace and how you're responding to it? Or is there a big change here in terms of the percentage of your business that's specified versus maybe getting an early start on that dealer business that you discussed earlier? Or are the specified contract is just really shifting to kind of 100% resilient or a much higher percentage of resilient? People are really just backing away from specking in carpet tile into these projects. And I'm just trying to get an understanding of why there was such a disparity between those two categories.

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.

A

David, I think that the office market has really been hit the hardest. And that's where our carpet tile business plays in a big way is in the office market.

David S. MacGregor
Analyst, Longbow Research LLC

Q

Right.

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.

A

Commercial office market is down and we're down with a commercial office market. I don't think there's been a big shift [ph] different with (00:30:34) the resilient to carpet tile. I think it's the office market that's created the problems for us.

David S. MacGregor
Analyst, Longbow Research LLC

Q

So then talk about the non-office market, the other 50%, if you would, in terms of what you're seeing there in terms of the question I just asked I guess?

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Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.
A

Well, we're seeing the education actually [ph] come in (00:30:51) pretty good. Hospitality, believe it or not, they're continuing to build the hotels out. Healthcare has been really good for us from [indiscernible] (00:31:00) standpoint.

David S. MacGregor
Analyst, Longbow Research LLC
Q

Yeah. I understand that. What I'm trying to get at is the difference between carpet tile and the resilient. I appreciate the commentary on the health and the category, but I'm just trying to get a sense of what's happening in that mix.

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.
A

Well, I think the resilient is still growing. [ph] And we're pleased (00:31:17) growing faster than carpet tile for sure. But I still think carpet tile has a place in the office market.

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.
A

Yeah. David, this is Bruce. This might help. We don't see the mix shifting in those segments. We just see those segments being a little more heavily weighted toward the resilient product and which is helping us in this environment. And that's why it comes out in an environment like this when office is down so much and those segments are growing, of course, our mix shifts more toward the resilient side of the picture.

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.
A

Right.

David S. MacGregor
Analyst, Longbow Research LLC
Q

Coming into this year, what would office have represented as a percentage of your resilient business?

Daniel T. Hendrix
Chairman, President & Chief Executive Officer, Interface, Inc.
A

I don't think we have that data, David.

Bruce A. Hausmann
Chief Financial Officer & Vice President, Interface, Inc.
A

Yeah.

David S. MacGregor
Analyst, Longbow Research LLC
Q

Okay. All right. Thanks, guys.

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Bruce A. Hausmann

Chief Financial Officer & Vice President, Interface, Inc.

A

All right. Thank you, David.

Operator: And there are no further questions at this time. I will turn the call back over to the presenters for closing remarks.

Daniel T. Hendrix

Chairman, President & Chief Executive Officer, Interface, Inc.

Well, thank you for listening to the call. I hope to talk to you next quarter as well. And please be safe in this environment. Thank you.

Operator: This concludes today's conference call. You may now disconnect.

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