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EDITED TRANSCRIPT

TILE.OQ - Q1 2021 Interface Inc Earnings Call

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CORPORATE PARTICIPANTS

Bruce A. Hausmann *Interface, Inc. - VP, CFO & Treasurer*

Christine Needles *Interface, Inc. - Global Head of Corporate Communications*

Daniel T. Hendrix *Interface, Inc. - President, CEO & Non-Executive Chairman*

CONFERENCE CALL PARTICIPANTS

Brian Biros *Thompson Research Group, LLC - Equity Analyst*

Keith Brian Hughes *Truist Securities, Inc., Research Division - MD*

PRESENTATION

Operator

Good day and thank you for standing by. Welcome to the Q1 2021 Interface, Inc. Earnings Conference Call. (Operator Instructions) Please be advised that this conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to your speaker today, Ms. Christine Needles, Director of Global Communications. Please go ahead.

Christine Needles - *Interface, Inc. - Global Head of Corporate Communications*

Good morning, and welcome to Interface's conference call regarding first quarter 2021 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 federal securities laws. 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 and those described in our most recent annual report on Form 10-K filed with the SEC. The company assumes no responsibility to update forward-looking statements.

Management's remarks during this call also refer to certain non-GAAP measures. Reconciliations of the non-GAAP measures to the most comparable GAAP measures and explanations for their use are contained in the company's earnings release and Form 8-K furnished with the SEC today.

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After our prepared remarks, we will open up the call for questions.

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

Daniel T. Hendrix - *Interface, Inc. - President, CEO & Non-Executive Chairman*

Well, thank you, Christine. Good morning and thank you for joining us today.

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We delivered solid results for the first quarter of 2021 as we continued to reduce our cost structure and benefited from a currency tailwind in the quarter. Tangible signs of recovery emerged in the first quarter and have continued into the second quarter, particularly in the United States and parts of Europe and APAC.

Our first quarter results came in as expected with total sales of $253 million, down 12% from the prior year period. The 2021 first quarter was 13 weeks as compared to 14 weeks in the prior period. We generated strong cash flow from operations of $25 million during the quarter, while continuing to de-lever the company. Overall sales pipeline activity is up, including RFPs and sample activity.

First quarter 2021 orders were up 11% sequentially from the fourth quarter of 2020. Typically, our first quarter orders are lower than the fourth quarter due to seasonality. This is a positive sign that our markets are beginning to recover. The green shoots that we talked about last quarter are showing up tangibly in our numbers and we believe this is sustainable demand.

Looking around the world, we are seeing positive activity inside many of the countries where we do business, but the landscape continues to be mixed. There are strong signs of recovery in the Americas and some parts of Europe and APAC. However, recovery from much of Europe has been slowed by rising COVID cases, a slow rollout of the vaccination and continued lockdowns. APAC, on the other hand, continues to be subject to heightened border restrictions.

These lockdowns and border restrictions are slowing the recovery in many of our markets, particularly outside the United States. However, we continue to see increased RFPs due to reactivation in pipeline and new products. And building from last quarter's sample activity in the United States is approaching pre-COVID levels, which is a leading indicator of rebounding activity.

Let's turn now to our geographies and market verticals. While we do not know the full impact of return to the physical office, we are optimistic about the future. U.S. CEOs have become more bullish on return to the office, but is still unclear when and what that return looks like, but they are going to return. In Europe, the conversation is not about if, but when. The return will happen. This is all good news for our business.

Remember that approximately 80% of our business is renovation and remodel work. Interface is well positioned to benefit from the potential remodeling of space as companies bring their employees back and reconfigure their workplaces for a post-COVID world.

We're also seeing good signs of market recovery in other market verticals, including education, healthcare and government. Healthcare continues to be strong. Education is also coming back, particularly in higher education due to increased renovations and new constructions. And government opportunities are picking up as well.

We're starting to see progress in the dealer market too. I was pleased to see that our Net Promoter Score with our dealers in the U.S. was the best we've seen for a long time. It has been trending upwards since the third quarter of 2020 as we continue to focus on the discretionary dealer market.

We continue to invest in innovation and new product development. On our last call, we talked about exciting developments in our product pipeline for 2021. Let me share a few important updates.

In March, we officially launched our Embodied Beauty collection in EMEA and in APAC, including our first cradle-to-gate carbon-negative carpet tile styles. In addition, we also launched in EMEA, the microtuft Flash Line that is also carbon-negative. Our customers are becoming more carbon conscious and want to specify products that reduce the carbon footprint of their spaces.

Also in Americas, we expanded our popular Open Air carpet tile product platform with 17 new patterns. Open Air allows us to design, manufacture and bring to market products that are attractive, high quality and extremely affordable. Open Air styles work particularly well in areas with large footprints.

We're seeing interest from many of our largest global customers and dealers as well as commercial office improvement and the education market segments. This is one of the fastest take-ups of any product that we've introduced at Interface.

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In resilient, in the Americas market, we recently launched our first vinyl sheet offerings, which are designed to meet stringent needs in healthcare applications. These styles work well in patient room applications and complement our existing rubber opportunity in healthcare and gives us a much bigger part of the market to play in.

Looking forward, April orders started off strong and we're seeing double-digit order growth across all regions. There's continuing demand for our carbon-neutral and carbon-negative products.

We are beginning to see more RFPs with requirements for low-carbon products. We believe this is applicable across all regions and industries, and specifically with global companies that have made a series of carbon footprint reduction commitments over the past 6 to 12 months.

While orders are trending in the right direction and we're seeing some positive signs of recovery, we recognize that we're in the early stages of that recovery. We're hopeful that successful vaccination rollouts continue and we are optimistic about improved performance in the back half of 2021 as companies come back to the office.

With that, I'll turn it over to Bruce for the first quarter 2021 financial recap. Bruce?

Bruce A. Hausmann - *Interface, Inc. - VP, CFO & Treasurer*

Well, thank you, Dan, and good morning, everyone. Our first quarter results came in as expected with net sales of $253.3 million, down 12% compared to the prior year period. And as you may recall, first quarter 2021 consisted of 13 weeks versus 14 weeks in the first quarter of 2020.

Organic growth, which excludes impacts of foreign currency translation, was down 16%. Declines in carpet tile were somewhat moderated by lesser declines in LVT and partially offset by increases in rubber. Sales in the Americas were down 20%, with declines across all product categories. And in EAAA, sales were down 3% in U.S. dollars, aided by favorable currency movements. Carpet tile was down for the quarter, offset by increases in rubber and

First quarter adjusted gross profit margin was 38.5%, down 160 basis points from the prior year period, but up 300 basis points from Q4 2020. This was a strong result as we continue to navigate through the pandemic in Q1 of this year and lapped a strong quarter in Q1 of last year.

We continue to build earnings power through the structural changes in our SG&A, which you will see in our income statement as we progress through the year. Adjusted SG&A expenses were $77.5 million in the first quarter or 30.6% of net sales.

First quarter of 2021 adjusted operating income was $19.9 million versus adjusted operating income of $29.3 million in the first quarter last year. First quarter 2021 adjusted net income was $10 million or $0.17 per diluted share and adjusted EBITDA was $31.5 million for the quarter. Please refer to our press release for reconciliations of GAAP to non-GAAP numbers.

Turning to our balance sheet. The company generated $24.9 million of cash from operations in the first quarter of 2021 and had $405 million of liquidity at quarter end. First quarter 2021 cash flow was higher than prior years on a seasonal basis as variable compensation payouts related to 2020 performance were greatly reduced.

Inventory was down $28 million or 10% year-over-year and finished goods carpet inventory was down 16%. We repaid $12 million of debt in the first quarter.

Net debt or total debt minus cash on hand was $455.6 million at the end of the first quarter. In the last 12 months of adjusted EBITDA were $143.2 million at the end of the first quarter, resulting in a net leverage ratio of 3.2x, calculated as net debt divided by adjusted EBITDA. We continue to be committed to paying down debt and de-levering the balance sheet.

First quarter 2021 interest expense was $7 million compared to $6 million in the prior year. Capital expenditures were $5 million in the first quarter compared to $22 million in the first quarter of 2020.

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Looking at the second quarter of 2021, we expect continued recovery as vaccinations continue to roll out in the U.S., slightly offset by COVID-related disruption in the European and Asian markets. Although we are starting to see positive indicators on the global economic recovery on the horizon, there still continues to be disruption and significant uncertainty due to COVID-19.

As the company continues to monitor this situation, it is anticipating second quarter of 2021 net sales of approximately $290 million and adjusted gross profit percentage of approximately 38.5%. Adjusted SG&A expense in the full year of 2021 of approximately $325 million, which means we have roughly $248 million of adjusted SG&A spend that is anticipated for the rest of the year, and we anticipate the remaining spend will be fairly evenly spread over Q2, Q3 and Q4 of 2021.

We also anticipate adjusted interest and other expense for the full year of 2021 of approximately $34 million and adjusted effective tax rate for the full year of approximately 27%. Capital expenditures for the full year are anticipated to be approximately $30 million. Fully diluted share count at the end of Q1 2021 was 58.9 million shares.

And with that, I'd like to turn the call back to Dan for concluding remarks.

Daniel T. Hendrix - *Interface, Inc. - President, CEO & Non-Executive Chairman*

Thank you, Bruce. I'm proud of the team's continued efforts in driving ESG initiatives across the company. In early April, Interface published our first Communication on Progress, or COP, since becoming a U.N. Global Compact signatory in 2020. As part of our sustainability approach, Interface is supportive of and committed to the United Nations' sustainable development goals as a road map to sustainable development that addresses shared global challenges.

Following through on our commitment to prioritize diversity, equity and inclusion, we established a DEI task force responsible for developing our long-term DEI strategy with feedback from our people. Notably, we are also implementing a global human capital management system that will deliver invaluable data regarding the diversity of our global workforce.

From an environmental standpoint, Interface committed to set a science-based target in line with a 1.5-degree ambition, which aligns with the Paris Agreement's goal to pursue efforts to limit global warming. We continue to focus on reducing the carbon footprint of all our products with an average year-on-year reduction of 10% from 2019.

I'm proud of our team, and I'd like to thank all of our employees. We continue to drive innovation in our research and development as we look to capitalize on trends and create market opportunities all while helping customers lower their carbon footprint. We believe our culture, product and leadership will keep our business adaptable and successful for years to come.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Kathryn Thompson from Thomson Research Group.

Brian Biros - *Thompson Research Group, LLC - Equity Analyst*

This is Brian Biros on for Kathryn. I'll start with the Q2 guidance going forward. Can you give some more color on how that breaks out across the 2 regions and maybe specifically the products in those regions? I guess can we see positive growth for all products in both regions in Q2?

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Bruce A. Hausmann - *Interface, Inc. - VP, CFO & Treasurer*

Brian, this is Bruce. Yes, we're anticipating growth in all of our product lines and we're anticipating growth across EAAA and Americas in Q2. So we are definitely anticipating broad-based growth. The U.S. is probably right now a little stronger than EAAA. As you are probably aware, in EAAA there are still some lockdowns that are happening due to COVID. And there's still a lot of travel restrictions going inside of countries, while the U.S. is further ahead from a vaccination standpoint and from a recovery standpoint.

Brian Biros - *Thompson Research Group, LLC - Equity Analyst*

Helpful. And then a follow-up. Can you just talk about some of the state of the supply chain, I guess, and specifically maybe the ports with demand coming back, are you able to source enough products to meet the demand levels?

Bruce A. Hausmann - *Interface, Inc. - VP, CFO & Treasurer*

Brian, this is Bruce. We're in really good shape from a supply chain standpoint. And I just continue to be so impressed with our supply chain and our plant operators. They've just navigated flawlessly through the COVID-19 pandemic and they continue to navigate even through all of the supply chain disruptions, whether it's the Suez Canal boat thing or it was the -- all the stuff that happened down in Texas. Our team has done a great job.

We are anticipating some inflation in -- starting in Q2 and in the back half and that's baked into our guide as we are thinking about the GP guide that we gave for Q2.

Brian Biros - *Thompson Research Group, LLC - Equity Analyst*

So no major issues with any sourcing products and getting it through the ports?

Bruce A. Hausmann - *Interface, Inc. - VP, CFO & Treasurer*

No, we're in good shape on that. But we've been -- and it's -- again, it's due to good management and thinking ahead.

Operator

Your next question comes from Keith Hughes from Truist.

Keith Brian Hughes - *Truist Securities, Inc., Research Division - MD*

Got a lot going on in the numbers. The revenue in this quarter with the extra seem to be [down]; one fewer week and the currency. If you strip all that out, can you give us how carpet tile LVT and rubber did year-over-year in the quarter?

Bruce A. Hausmann - *Interface, Inc. - VP, CFO & Treasurer*

Keith, this is Bruce. As you mentioned, we had an extra week last year. So it was 13 weeks this year, 14 weeks last year. That differential is about 6% due to the extra week. So if you look at our P&L, we were down 12%. If you strip out that extra week, we were only down 6%. And then, of course, the currency lift is also baked in there. It was about $11 million of currency or roughly 4%.

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Keith Brian Hughes - *Truist Securities, Inc., Research Division - MD*

Okay. So you say in the release that LVT, your carpet tile was down, lesser declines in LVT and gains in rubber. Does that take the week out? And does that include currency or take the currency out or what basis is that on?

Daniel T. Hendrix - *Interface, Inc. - President, CEO & Non-Executive Chairman*

Yes, I was kind of giving you the full company numbers around being down 12% in total and 6% due to the extra week. Haven't really broken out extra week and currency by product line.

Keith Brian Hughes - *Truist Securities, Inc., Research Division - MD*

Okay. So currency, does that help rubber more than the other 2 products or what's the other breakdown?

Daniel T. Hendrix - *Interface, Inc. - President, CEO & Non-Executive Chairman*

Yes, not really. Because we sell rubber all around the world. We sell rubber globally, so it's just wherever we sold rubber in a foreign currency, we got a lift from that this quarter as a result of the U.S. dollar being weaker than the euro or the Australian dollar versus prior year.

Keith Brian Hughes - *Truist Securities, Inc., Research Division - MD*

And I guess final question. We now have segment profit breakout. It shows declines in the Americas for obvious reasons. But there's an increase in the operating income in the EAAA segment. Can you talk about still relatively weak revenue, how you got the profits up?

Bruce A. Hausmann - *Interface, Inc. - VP, CFO & Treasurer*

Yes. So Keith, this is Bruce. That's a combination of strong SG&A control. And also we have obviously decreased our cost structure around the company, including in EAAA, which gives us more leverage and more drop-through on the bottom line, aided slightly a little bit by some currency pickups that we saw on the top and a little bit on the bottom as well in our EAAA region.

Operator

There is no further question at this time. I would now like to turn the call over to Dan Hendrix for closing remarks.

Daniel T. Hendrix - *Interface, Inc. - President, CEO & Non-Executive Chairman*

Yes. Thank you for joining our conference call. I think we had a very solid quarter and look forward to talking to you next quarter. Thank you.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.

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