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Interface, Inc. (TILE)

Q2 2021 Earnings Call

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Sam Darkatsh
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David S. MacGregor
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Kathryn Ingram Thompson
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MANAGEMENT DISCUSSION SECTION

Operator: Good day and thank you for standing by. Welcome to the Second Quarter 2021 Interface, Incorporated Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to your speaker today, Christine Needles, Corporate Communications. You may begin your conference.

Christine Needles

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

Good morning and welcome to Interface's conference call regarding second 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, beliefs, 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.

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Management's remarks during this call also refer to certain 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 Form 8-K furnished with the SEC today.

Lastly, this call is being recorded and broadcasted for Interface. It contains copyrighted material and may not be re-recorded or re-broadcasted without Interface's express permission. Your participation on the call confirms your consent to the company's taping and broadcasting of it.

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

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

Thank you, Christine. Good morning and thank you for joining our call today. Once again, I want to thank the Interface team for helping us to deliver another quarter of strong results. In the second quarter, we saw continued improvements in economic activity in the United States, parts of Europe, and parts of Asia Pacific, particularly China and Australia.

The big story for us, our orders came roaring back in the second quarter. Yes, you heard it right, roaring back in the second quarter, up 38% compared to the prior year period and up 21% sequentially. We're seeing our order momentum pick up globally with Americas up 35% and EAAA up 43%. As a result, order backlog was up 20% compared to the prior year and up $63 million or 39% since the beginning of the year.

We saw strong signs of recovery in the Americas and parts of Europe and parts of Asia-Pacific. But the ongoing pandemic continues to present challenges in our business as we manage against rising COVID cases, rolling lockdowns, labor shortages, inflation, and supply chain challenges. These issues are not unique to Interface but they impacted our ability to get product out the door and, ultimately, our gross profit in the quarter.

As we look to our market verticals, activity in the office market has picked up in recent weeks. More and more companies have announced their plans to return to the office. Many of our customers are talking about flexible and hybrid policies and Interface is in a great position to capitalize on this. Companies are moving ahead with remodel and renovation projects that were previously put on hold. While the recent increase in Delta variant cases may slightly delay return-to-the-office plans, we're continuing to see signs that's a matter of when, not if, people will return to the office.

In the US, K-12 education was another bright spot. The federal stimulus plan is leading to a surge in new projects with many schools upgrading their flooring choices in the process. We're also seeing broad-based strength across other market verticals such as health care and transportation. The dealer discretionary market continues to gain traction with excitement around Open Air products and LVT. And our FLOR business continues to grow.

Momentum for our cradle-to-gate carbon negative backings continues to build in the marketplace. This non-PVC option creates additional opportunity for us, particularly with our global end-user customers. The market is continuing to recognize us for our carbon tech innovations. We were featured in The New York Times Magazine as one of the few commercialized products on the market that use carbon as a resource. Our carbon negative carpet tile backings and products are increasingly showing up in product specifications, and we continue to see robust interest from many of our global customers that have made public carbon reduction commitments.

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Finally, we're gearing up for NeoCon which is back in Chicago in person in October – and will show several new products this year. We have a new carpet tile collection that includes organic, linear, and angular designs. It's a fresh perspective on biophilic design which continues to drive commercial design trends across our vertical markets. As I've said before, we have strong pipeline of new products rolling out this year across carpet tile, LVT, and rubber.

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

Bruce A. Hausmann

Chief Financial Officer & Vice President, Interface, Inc.

Thank you, Dan, and good morning, everyone. Second quarter sales totaled $295 million, up 13.6% from the prior-year period on broad-based increases across all product categories. Organic sales, which exclude the impact of currency translation, were up 8.5%. Sales in the Americas were up 3.6% primarily driven by increases in LVT. And in EAAA, sales were up 27.6% with strength across all product categories. Currency fluctuations had an approximately $12 million positive impact on EAAA's second quarter 2021 sales as compared to the prior-year period.

Second quarter adjusted gross profit margin was 37.5%, slightly behind expectations due to raw material shortages, higher labor costs on a tight labor market, and higher freight costs. Our continued focus on strong cost controls resulted in adjusted SG&A expense of $79.4 million compared to $71.1 million in the prior year. As a percentage of net sales, adjusted SG&A was 26.9%, marking the continued progress we've made to reduce SG&A as a percentage of net sales.

Second quarter adjusted operating income was $31.1 million versus $27.5 million in the second quarter last year. Second quarter 2021 adjusted net income was $17.6 million or $0.30 per diluted share. And adjusted EBITDA was $43.2 million for the quarter. Please refer to our press release for reconciliations of GAAP to non-GAAP measures.

Turning to our balance sheet and cash flows, the company generated $10.3 million of cash from operations in the second quarter of 2021 and $35 million year-to-date. Liquidity at the end of the quarter was $401 million comprised of approximately $102 million of cash and $298 million of borrowing availability. Inventory was down $6 million or 2% year-over-year, and finished goods carpet inventory was down 5%. We paid down $6.5 million of debt in the second quarter.

Net debt or total debt minus cash on hand was $454.2 million at the end of the second quarter. The last 12 months of adjusted EBITDA were $148.8 million at the end of the second quarter resulting in a net leverage ratio of 3.1 times calculated as net debt divided by adjusted EBITDA. We continue to be committed to paying down debt and delivering the balance sheet then we continue to demonstrate progress in this area.

Second quarter 2021 interest expense was $6.2 million compared to $5 million in the prior year period. Capital expenditures were $6.9 million in the second quarter compared to $13.5 million in the second quarter of 2020. Looking at the third quarter of 2021, we expect continued recovery as vaccinations expand globally offset by some continued spread of the virus and its variant particularly for those who are not fully vaccinated which is likely to continue creating a variety of government-mandated restrictions in a number of our markets around the world. We're also anticipating fairly significant raw material cost increases in the back half of 2021 as well as challenges in filling open positions in our US manufacturing facilities and other potential supply chain disruptions.

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As the company continues to monitor the situation, it is anticipating net sales in the third quarter 2021 of $310 million to $320 million, adjusted gross profit percentage in the second half of 36% to 37%, adjusted SG&A expense for the full year of approximately $325 million with the remaining portion spread fairly evenly across the third and fourth quarters, interest and other expense for the full year of approximately $31 million, the adjusted effective tax rate for the full year is anticipated to be approximately 27%, and capital expenditures of approximately $30 million for the full year 2021. Fully diluted share count at the end of the second quarter was 59.1 million shares.

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

Daniel T. Hendrix

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

Thank you, Bruce. We are very encouraged by the positive momentum we're seeing across the business including steadily rising orders and sales. Still in the early stages, the rollout of our carbon negative product line is going exceedingly well. It gives us optimism for continued improved performance in the second half of the year. Our sellers tell me how thrilled they are to be returning to in-person meetings once again. I've joined several of these live meetings and it has reminded me how well we can showcase the superior design and quality that Interface is known for.

At the same time, we're monitoring the Delta variant situation closely. The health and safety of our people is a top priority. I want to thank the Interface team for continuing to deliver for our customers, for closely managing our expenses, and for driving our strategy and mission forward.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from Keith Hughes with Truist. Your line is open.

Keith Hughes

Analyst, Truist Securities, Inc.

Q

Thank you. Well, some encouraging news, Dan, your comments on the orders coming back. I guess, the question is the orders you're seeing, are they more short-cycle renovation jobs or longer-term construction? If you could characterize them any way.

Daniel T. Hendrix

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

A

Yes. Keith, I'd say it's both actually. There are some new construction particularly on the West Coast that we're looking at. But, as you know, renovation is 80% of our business. So, most of it is probably renovation work.

Keith Hughes

Analyst, Truist Securities, Inc.

Q

Okay. And in the quarter, you had a lot more growth in the non-US business in that segment. I guess, as you look at your orders, are they slanting more towards the US or outside the US in terms of this growth?

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

I would say that, well, it's mixed, for sure. I'd say the European – certain markets are really improving. They have opened up like the UK. But in the US, the momentum is really strong and it continues to be strong.

Keith Hughes
Analyst, Truist Securities, Inc.
Q

Okay. And final question just on cash flow. Is debt reduction still the primary goal of cash flow? And maybe as part of that, when do you expect to get back to the dividend and other uses?

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

Keith, it's Bruce Hausmann. Good morning. Yes, debt reduction is still our number one capital allocation priority. And as you can see, we're just continuing to pay down debt and delever the balance sheet, which is fantastic. Once we get below 2.5, maybe we'll take a look at the dividend again. We still have a pretty good down the fairway dividend, and it's something that we'll reevaluate once we get the leverage ratio where we'd like it to be.

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

Yeah, I would say we'll look at dividends in 2022, for sure.

Keith Hughes
Analyst, Truist Securities, Inc.
Q

Okay. All right. Congratulations. Thank, guys.

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

Thank you.

Operator: Your next question comes from David MacGregor with Longbow Research. Your line is open.

David S. MacGregor
Analyst, Longbow Research LLC
Q

Hey. Good morning, everyone. Dan, Bruce, congratulations on the order recovery. That's, as you just said, that's very encouraging. I guess, I wanted to ask about gross margins and see if you can just talk about the puts and takes. And you had called out the raw material inflation and labor and freight. I guess these are things we're hearing a lot about these days. But can you talk about the extent to which you're succeeding or maybe not succeeding with the pass-through on that inflation? And is that a function of maybe the way some of the specified contracts are structured or do you have escalators in there? Just kind of think through how this plays out, these puts and takes play out into the second half of the year and into 2022.

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

Hey, David. This is Bruce Hausmann. It's a great question. We've done a couple of price increases in the first half of the year. And as you know, historically, we're very successful at passing price increases on to our customers

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as our costs increase. In the back half, we are anticipating some double-digit price increases around the yarn. We're probably not going to be able to pass all of that onto our customers. And we're also – obviously, there's – as you know, freight is higher and we're also seeing some higher overtime in our plant, which is sort of a class A problem as the orders are coming in so strong.

So, I think we're in – we were in obviously really good shape in the first half of the year. We think it's going to be – the GP will be a little pinched in the back half, which is why we guided to being 36% to 37%. But then, we also – again, through our differentiators, whether it's design, innovation, or sustainability, we have not taken our eye off the ball around GP. And we think that our GP will be strong and we're going to continue focusing on increasing GP through price increases and productivity.

David S. MacGregor
Analyst, Longbow Research LLC

Q

Can you talk about what GP might look like in that order backlog? Citing the second half pressures you just talked about, I guess. But I'm just thinking maybe some of the orders [indiscernible] (15:19)

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

A

Yeah. Well, I would say that order backlog, obviously, we didn't have the big price increase in the first half of the year that we hadn't seen in the second half of the year. So, the backlog does have basically a profile that would give us the right gross margins, but we have raw material price increases we have to deal with. So, we're going to raise prices on the second half of year to offset them.

David S. MacGregor
Analyst, Longbow Research LLC

Q

Okay. All right. Okay. It sounds good. Maybe just – if there's any way you can talk about any progress you see you've been making in the dealer channel. I know that's an issue you've been pushing pretty hard on. Any share gains there? I mean, just kind of...

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

A

Yeah. I would say we're having a lot of success with the dealer channel. The Open Air product, its priced for the dealers and is one of our hottest products we've ever introduced. So, I expect that we're going to continue to see growth in the dealer market. And it's a big focus with our selling organization as well and in product.

David S. MacGregor
Analyst, Longbow Research LLC

Q

And from an inventory standpoint, I know inventory is pretty tight everywhere these days. Building the dealer channel would presume a substantial investment in inventory. Is there conflict there? And maybe how are you dealing with that?

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

A

I would say that the dealer, our dealer program really is make-to-order. It's not an inventory program at all.

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David S. MacGregor
Analyst, Longbow Research LLC

Q

Okay. Okay. And then just an update on your LVT and your rubber product sort of attachment rates in these orders that you're getting, are you seeing increasing penetration for LVT and rubber in dealer backlog?

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

A

David, this is Bruce. The answer is – the short answer is yes. Our carpet business and our rubber – I'm sorry our carpet business and our LVT business were both up double digits, and our rubber business is up high-single digits. So, we are continuing to see momentum across all product lines, which is great. And you may remember that the rubber business actually was very resilient through the pandemic.

And so, we're just really pleased that all product lines are firing on all cylinders. And we're seeing orders come in with single LVT orders as well as combined orders around LVT plus carpet. And we're seeing a lot of good cross-selling in the healthcare space with carpet and rubber orders that are coming in simultaneously.

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

A

Yeah. David, I'd say that we're actually taking share in LVT. I mean, our LVT business is better than the market for sure.

David S. MacGregor
Analyst, Longbow Research LLC

Q

Great. Thanks very much, guys.

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

A

Thanks.

Operator: Your next question comes from Sam Darkatsh with Raymond James. Your line is open.

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. How are you, bud?

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.

Q

I'm well. Thank you. So, just a follow-up on David's question, maybe a little more specificity. So of the, what was it, 8.5% organic sales growth in the second quarter, ballpark, how much of that was priced year-on-year?

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

Sam, this is Bruce. It is probably maybe one-third price and maybe two-thirds volume.

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.
Q

And then so the second half incremental price that you are looking for, can you help us quantify that or put a range on that or what you're looking for incrementally in the back half versus what you have now?

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

The volume is really strong, which is fantastic. So, it's hard to – I don't necessarily know that we've broken out our guide around price versus volume. But the way that we think about it is that we're going to definitely be increasing prices in the back half again to offset the cost increases that we're seeing in our raw materials and freight. And so, I'm not sure that we necessarily are breaking it our price versus volume around the guide but we'll be definitely doing price increases in the back half, as well as having a lot of volume coming through because as you can seem, our order rate is up quite a bit.

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.
Q

So can we infer basically a similar low, mid-single price action in the back half as you saw in the front half on a year-on-year? Is that a fair way to think about when you...

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

That's probably the best proxy that we have right now.

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

Yeah. I think , Sam, our whole issue right now is we actually can't make all the orders we have. So, we're constrained by what we can make in the United States today.

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.
Q

And that was my next question. And that is, is it – I'm guessing it's not a hard capacity issue based on the industry structure and what have you, it's more of accrued capacity is what I'm guessing based on your overtime comments. What's the prospect in Georgia and elsewhere to take up additional labor, get it trained, and get the folks trained, and [indiscernible] (20:21)

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

So, we're actively trying to hire a lot of people in LaGrange, you got that one right, to ramp up. We don't have constraints anywhere else in the world except in LaGrange, the US.

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Sam Darkatsh
Analyst, Raymond James & Associates, Inc.

Q

Got it. And by constraints, you're talking about labor constraints, not hard capacity constraints?

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

A

Yeah, yeah, labor.

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.

Q

Got it.

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

A

Yes.

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.

Q

And then the SG&A was a pleasant surprise in the second quarter. It looks like it's looking to step up sequentially in the third and fourth quarter. Remind us why that is. I know you mentioned NeoCon but that's not going to be $5 million, I wouldn't think. So, help me understand what the step up is.

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

A

It's two things. One is we're actually entertaining customers again, and that may not happen with the variant, Delta, coming back. So, most all of it is T&E. And then it's commission increases in the United States as we ramp up sales. That's it.

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.

Q

Got it. My last question you just talked about it. What are you seeing in Asia, be it Thailand, Australia, what have you, with [indiscernible] (21:28)

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

A

Yeah. Australia and China are really strong for us today. India is the one market where obviously in the lockdown still today. So, the India's market is one that's still under a lot of pressure.

Sam Darkatsh
Analyst, Raymond James & Associates, Inc.

Q

Very helpful. Thank you, gentlemen. Have a great weekend.

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

A

Thanks, Sam.

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Operator: The next question comes from Kathryn Thompson with Thompson Research. Your line is open.

Kathryn Ingram Thompson
Analyst, Thompson Research Group LLC

Q

Hi. Thank you for taking my questions today. In terms of the orders, could you give color in terms of different types of products? Is there a change in the mix of types of products? And then, also, could you give color in terms of the end markets and distinguish between the US, Europe and other markets for rest of the world? Thank you.

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

A

Yeah. I would say the mix is very similar as it's been. We do have the Open Air product that I alluded to, which is the dealer product, which is the fastest take-up I've seen in any product we've ever introduced. But the one with bright spots for us is really is education. K-12 is really significantly more active today because of the stimulus money. And they're upgrading their facilities. They're actually going to LVT instead of VCT. So, I would say K-12 is one of the markets. Corporate's obviously starting to come back. We're doing really well in health care. And those markets are what's driving it today.

Kathryn Ingram Thompson
Analyst, Thompson Research Group LLC

Q

Would you say that's the same in Europe?

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

A

I would say Europe is more corporate office than anything, in Europe.

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

A

Kathryn, it's Bruce. The other area where Europe is strong is around transportation.

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

A

Yeah. True. And Asia too as well. Our rubber business is really geared for transportation.

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

A

Yeah.

Kathryn Ingram Thompson
Analyst, Thompson Research Group LLC

Q

Okay. And when you look forward in terms of SG&A and managing that, you've made some progress sequentially on a percentage basis, what's the bogey for that when you look, say, four to six quarters out?

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

26%. That's the new bogey that we're shooting for as a company.

Kathryn Ingram Thompson
Analyst, Thompson Research Group LLC
Q

And what are some of the levers to get to that 26%?

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

Well, first of all, it's top line growth going into our SG&A, and it's holding sort of where we are today.

Kathryn Ingram Thompson
Analyst, Thompson Research Group LLC
Q

Okay, okay. And as far as margins go, a lot of different industries have been able to successfully promote pricing changes. You are a little bit different in that it's basically so much more on a project-by-project basis. But sometimes even you can have inflationary pressures that happen even after the order has happened and price increase actions happen. What type of escalators do you have in order to manage some of those sharper unexpected shifts in pricing?

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

Well, our backlog is probably eight weeks, and we don't have any escalators in our backlog. So, as you said, it's just every projects negotiated going forward.

Kathryn Ingram Thompson
Analyst, Thompson Research Group LLC
Q

Okay. All right. Thank you.

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

Thank you.

Operator: There are no further questions at this time. I'll hand the call back to the company.

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

Well, thank you for listening to our call, and hopefully we'll have a great third quarter. Have a great weekend. Thank you.

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

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