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Interface, Inc. (TILE)

Q2 2022 Earnings Call

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Laurel M. Hurd
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Analyst, Thompson Research Group

Keith Hughes
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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, my name is Rob, and I will be your conference operator today. At this time, I would like to welcome everyone to the Interface, Inc. Second Quarter 2022 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

Christine Needles, Corporate Communications, you may begin your conference.

Christine Needles

Corporate Communications Leader and Executive Director of Diversity, Equity, and Inclusion, Interface, Inc.

Good morning, and welcome to Interface's conference call regarding second quarter 2022 results, hosted by Laurel Hurd, CEO; and Bruce Hausmann, 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 and Quarterly Report on Form 10-Q 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 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.

Lastly, this call is being recorded and broadcasted for Interface. It contains copyrighted material and may not be rerecorded or rebroadcasted without Interface's expressed 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 Laurel Hurd, CEO.

Laurel M. Hurd

President & Chief Executive Officer, Interface, Inc.

Thank you, Christine, and good morning, everyone. We delivered another strong quarter with sales up 18%, reflecting growth across all our core segments and regions, while continuing to navigate ongoing inflationary pressure and foreign currency headwinds.

I continue to be impressed with our team and in the way we're managing through a challenging inflationary environment. Our strong execution, along with pricing and productivity gains, helped to mostly offset over 1,500 basis points of input cost inflation in the quarter.

We continue to see strong demand for our carbon neutral and carbon negative products highlighted by a 10% increase in both orders and backlogs during the quarter. Orders in the Americas were strong, growing 17% year-over-year. In EAAA, orders increased 2% on a currency neutral basis with our second quarter growth negatively impacted by the Russia-Ukraine war and COVID lockdowns in China. Globally, our backlog is up 19% year-to-date, which puts us in a position of strength as we enter the back half of 2022.

In the second quarter, we continued to execute on our diversification strategy, resulting in share gains in our key market segments. Corporate office was up 17%, education was up 20%, and health care was up 13%.

Our strong results in the quarter underscore our established position as an industry leader in design and sustainability in the commercial flooring space. The team was thrilled to see an increase in participation at in-person events around the world, including Clerkenwell Design Week in London, Milan Design Week and, of course, NeoCon.

We were excited about the customer response to Interface at NeoCon where our Americas sales and marketing team showcased a host of new products across the full portfolio. From the Beaumont Range carpet tile collection and Fresco Valley LVT, to norament pado rubber flooring, we demonstrated our integrated flooring solutions with inspiring design and innovation.

We continue to receive recognition for our industry-leading products and sustainability leadership. At NeoCon, we took home two HiP awards, including the Health + Wellness category for our Desert Scapes collection and a Rising Star award in the manufacturing category. We also won the MetropolisLikes Award for Beaumont Range.

On the sustainability side, we received the 2022 Judges' Choice Award from Environment + Energy Leader for our carbon negative carpet tiles and backing. We achieved this through decades of research and development and because we're the first to commercially scale this type of innovation in our industry. And we were once again recognized as a sustainability leader in the annual GlobeScan survey, among an impressive list of companies

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including Unilever, Patagonia, IKEA, and more. Interface is the only company to maintain a spot on this esteemed list for 26 years running and the only flooring company to have ever been recognized.

Our many successes this quarter are a testament to the power of our story, our legacy, and our continued commitment to run our business in a way that creates a climate fit for life.

Overall, our second quarter results are strong and I'm extremely proud of our global teams for their tireless effort to advance our position as an industry leader in sustainability and design. I would also like to thank our customers for the trust they place in us every day to deliver high-performing, beautiful, and innovative flooring solutions.

With that, I'll turn it over to Bruce to go through the financials. Bruce?

Bruce A. Hausmann

Chief Financial Officer & Vice President, Interface, Inc.

Thank you, Laurel, and good morning, everyone. Second quarter net sales increased 17.6% to $347 million. Organic sales growth, which excludes the impact of currency translation, was 22.8%. Net sales in the Americas were up 32%, driven by continued strength in the commercial market. In EAAA, net sales were up 1.2%, and currency neutral net sales were up 12.1%.

Second quarter adjusted gross profit margin was 34.3%, a decrease of 315 basis points from the prior year period, as we continued to see higher freight, labor and raw material costs, partially offset by higher pricing to our customers.

While we're not happy with the gross margins at this level over the long haul, we are proud of the team in mostly offsetting over 1,500 basis points of inflationary pressure that we saw in Q2. We also anticipate continued inflationary pressure in the back half of 2022, which we will continue to work to offset with pricing and productivity.

For the past two years, we have focused on building earnings power, by making structural changes to our SG&A, and we are seeing fruits of these efforts in the P&L. Adjusted SG&A expense for the second quarter was $80.4 million or 23.2% of net sales, compared to $79.4 million or 26.9% of net sales in the same period last year.

Second quarter adjusted operating income was $38.5 million, up 24% versus adjusted operating income of $31.1 million in the second quarter last year. This was a great result on strong net sales growth, excellent work by our sales team and our supply chain operators to mostly offset inflation that is at a 40-year high, and continued vigilant focus on SG&A management.

Fully diluted earnings per share was $0.28, up 7.7% versus $0.26 in the second quarter last year. And adjusted fully diluted earnings per share was $0.36, up 20% versus $0.30 in Q2 last year. Second quarter's adjusted EBITDA increased 13.4% to $49 million in the second quarter of 2022.

Turning to our balance sheet and cash flows, the company used $12.7 million of cash from operations in the first half of 2022. As a reminder, our customary seasonality is to use cash in the first half of the year and generate cash in the back half.

Liquidity at the end of the quarter remained strong at $345 million, comprised of $92 million of cash and $253 million of borrowing capacity on our revolver. Inventory was $318 million, up 23% year-over-year, primarily due to raw material inflation.

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Our balance sheet remains strong. Net debt, or total debt minus cash on hand, was $453.7 million at the end of the second quarter. And the last 12 months of adjusted EBITDA was $186.7 million and our net leverage ratio was 2.4 times, calculated as net debt divided by adjusted EBITDA. We continue to have confidence in our strong balance sheet and our capital structure.

Capital expenditures were $4.3 million in the second quarter of 2022, compared to $6.9 million in the second quarter last year. In May, we announced a new $100 million share repurchase authorization. During the second quarter, we repurchased approximately $5.6 million of Interface common stock.

Turning to our outlook, there continues to be significant macroeconomic and geopolitical uncertainty in the global economy. Persistent inflation and rising interest rates present challenges to the business, while FX-related headwinds negatively impact the foreign currency-denominated net sales we generate outside the US, when we translate those sales into US dollars.

At the same time, these challenges are being partially offset by strong execution by our sales and manufacturing teams, continued demand in the commercial market, including office, education and healthcare, where we have a leadership position, and a strong backlog as we move into the back half of the year.

As we sort through these factors and think about what to expect in the back half, we are anticipating the following. For the third quarter of 2022, net sales of $325 million to $345 million. To note, we are anticipating FX to decrease our year-over-year third quarter net sales growth rate by approximately 5%. Adjusted gross profit margin of approximately 33.5% on persistent inflation. Adjusted SG&A expenses of approximately $83 million. An adjusted interest and other expenses of approximately $9 million. An adjusted effective tax rate of approximately 28%. And fully diluted weighted average share count at the end of the third quarter of approximately 59.1 million shares.

And for the full fiscal year 2022, we are anticipating: Net sales of $1.3 billion to $1.325 billion. Adjusted gross profit margin of approximately 34.5% to 35%. Adjusted SG&A expenses of approximately $326 million. Adjusted interest and other expenses of approximately $32 million. An adjusted effective tax rate of approximately 28%. Fully diluted weighted average share count at the end of the year of approximately 59.2 million shares. And capital expenditures of approximately $30 million.

While we're continuing to see solid growth in the business, our second half net sales comp will not look as strong as in the first half of 2022, as we lap the very strong net sales results achieved in the second half of last year. We will also continue to manage inflationary headwinds by engaging in ongoing selling price increases and executing productivity initiative in our manufacturing facilities. By leveraging our strong financial foundation and our brand, we are confident our expertise will allow us to continue to capitalize on growth opportunities and execute our value creation strategy.

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

Laurel M. Hurd

President & Chief Executive Officer, Interface, Inc.

Thank you, Bruce, and thank you to everyone who contributed to our results for the second quarter of 2022.

I'm just over 100 days in role, and even after this relatively short time with the company, I'm very confident we will continue to grow and gain market share with our outstanding design expertise, innovation and our focus on sustainability.

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Let me share a few initial observations based on what I've learned in these first few months with Interface.

To understand our global supply chain and manufacturing capabilities, I did a deep dive into our carpet tile operations in Troup County, Georgia, and in Scherpenzeel in the Netherlands. I also spent time at our nora rubber manufacturing operations in Weinheim, Germany.

Overall, I was struck by the nimbleness of our global supply chain and how the team has been navigating the challenges that have come our way. I'll continue to visit each of our manufacturing sites over the coming months, including a trip to Minto, Australia in a few weeks. It's important that I get out into the business to meet our teams and see our operations in action.

I've also spent time with our designers on the product and innovation front. Their latest designs across carpet tile, LVT and rubber truly work as an integrated system that allows us to deliver beautiful spaces to our customers. It's critical for us to continue to amplify our commitment to design and innovation. It's core to who we are and key to accelerating our growth in the marketplace.

I also worked closely with global leaders and with their teams to gain a deeper understanding of our sustainability leadership. Our people are so proud that Interface has been the pioneer in sustainability for more than two decades, culminating in our introductions of carbon neutral and carbon negative products. Our commitment to push the boundaries of sustainability is in the bones of our business. You can feel it everywhere, along with an incredible sense of pride and purpose.

Finally, I spent time with our sales leaders around the world and witnessed our strong customer relationships and intense focus on designing beautiful, positive spaces for them. More and more companies are encouraging their teams to return to the office and turning to Interface to assist them in redesigning collaborative spaces. Helping our customers meet their carbon objectives has never been more urgent. It's very clear to me that Interface defines best-in-class leadership in design, sustainability and innovation, and there's so much to build on for our future.

Additionally, we actually see some tailwinds that will help us. First, there's a significant amount of government spending that has been approved, but not deployed into the education market, where we have significant strength. We also know that employers have been working to entice their employees back into the office with beautiful spaces, renovated to support increased collaboration and hybrid work, which almost always means fresh carpet and paint. We believe that a potential recession may mean a shift to more of an employer's market, which will give them the ability to get their employees back into the office. This means more renovation, which is great for us.

Overall, I'm confident that our commercial excellence and strong operational and financial discipline will enable us to continue to grow and return value to our shareholders. I've really enjoyed speaking to many of you and look forward to spending more time with you in the back half of 2022.

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

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Kathryn Thompson from Thompson Research Group. Your line is open.

Brian Biros
Analyst, Thompson Research Group

Q

Hey. Good morning. This is actually Brian Biros on for Kathryn. Thank you for taking my questions. Maybe to start on the full year guide adjustment, is that all FX impact or is there anything else embedded in the update?

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

A

Hey, Brian. This is Bruce Hausmann. Good morning. The biggest impact on the change in the full-year guide is really FX, and that's the largest thing that changed as we think about how we move through the quarter. The business continues to perform very, very well. Commercial activity is very robust, and we're entering the second half with a very strong backlog. So, it's really truly FX is the biggest differential this quarter versus last quarter.

Brian Biros
Analyst, Thompson Research Group

Q

Okay. Yeah. I figured that was the case. Can you talk about monthly trends or kind of just the exit rate from the quarter? We've seen other companies have accelerated momentum through the quarter, and then others saw a pretty sharp drop near the end. So, just curious, what you guys were seeing and how you would characterize it?

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

A

Hi, Brian. This is Bruce again. We had a really strong June. So we saw no deceleration in the business. And really, if you think about how the quarter sort of moved, it was strong throughout. And we're continuing to see strength in the business as we enter into Q3.

Brian Biros
Analyst, Thompson Research Group

Q

Encouraging signs. I think last one for me right now, just, I guess, seeing any impact from higher inflation and higher interest rates on projects going on in the market, if anything's being delayed or scaled down or kind of people choosing different products, any impact there that you guys are hearing?

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

A

Yeah. Hi, Brian. It's Bruce again. We have not seen any slowdown from interest rates rising nor have we seen – the commercial activity, again, remains very robust. The one thing that has changed now versus, say, six months ago is I think you might remember, we were listening to the Fed about that inflation would be temporary and we have not seen inflationary, you know, wane.

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We've seen the inflationary pressure going in the back half here. So we're still dealing with that. The good news is that with our premium brand, we're able to get a lot of price and our customers are accepting our price increases. But as we move into the back half, we're continuing to fight inflationary headwinds and that's built into our guide.

Brian Biros
Analyst, Thompson Research Group

Q

Thank you. Pass it along.

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

David S. MacGregor
Analyst, Longbow Research LLC

Q

Yes. Good morning, everyone. I wonder if you could talk about the negative price cost. And, Bruce, just in responding to the last question, you're talking about premium brands and your ability to raise prices. Give us some sense of timing in terms of when does price cost flip positive for you? Yeah, is it in the early 2023? Or just how do we think about that? I noticed the implied fourth quarter gross margin in the guide continues to look like where we are now. So I'm assuming here that maybe it's not in the next couple of quarters, but could you speak to that, please?

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

A

Yeah. Good morning, David.

David S. MacGregor
Analyst, Longbow Research LLC

Q

Good morning.

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

A

No, we're getting closer, if you think about pricing getting at parity with inflation, we're getting a lot closer on that front. We continue to activate pricing in the marketplace, and we plan to continue activating more pricing in the back half as inflation persists. Unfortunately, as you know, the inflation that we were hoping would wane in the back half has not happened. And so, we are continuing to chase it, but we're getting good results. It's a combination of price increases on our core products as well as freight surcharges.

I think that, in the back half, we're going to see a lot of what we saw in the first half regarding inflation and regarding the differential of pricing versus inflation to parity. And then as we move into next year, obviously, the Fed is taking a lot of action to try to reign inflation in. And it's one of our top three things that we're keeping a close eye on as we're looking for that to crest and then start waning, which will obviously make a big difference on the business.

David S. MacGregor
Analyst, Longbow Research LLC

Q

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Okay. And then secondly, just the EAAA orders, up 1.7% on a currency-neutral basis. Can you speak to how incoming daily orders were tracking at the end of the quarter, specifically with respect to the EAAA and how that might be looking in July? Is it showing any signs of improvement?

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

Sure.

David S. MacGregor
Analyst, Longbow Research LLC
Q

And I guess what are you assuming for growth for the segment in your full year guidance?

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

Yeah. Thanks, David. Again, this is Bruce. The softness that we saw in EAAA in the order rate of 2% was really related to China. And it was those extraordinary COVID-related lockdowns that we saw in Q2. For example, you might recall Shanghai was locked down with over 25 million people. Now, we believe that business did not go away. We believe that business was just deferred, but it certainly affected the order rate. We're anticipating a strong back half for EAAA. Construction activity remains robust. The orders exceeded billings in the quarter.

The one thing that we are dealing with, to be fair, is that there are delays on the job sites, which can delay installation of our products. And that's not new news. That's just more of the same that we've been working through. But the commercial activity is strong in Europe and as well as in Asia. And as we enter the back half with a strong backlog, we're very optimistic about our EAAA region.

David S. MacGregor
Analyst, Longbow Research LLC
Q

Good. Good. I'll pass it along. Thanks very much, Bruce.

Operator: Your next question comes from the line of Keith Hughes from Truist Securities. Your line is open.

Keith Hughes
Analyst, Truist Securities, Inc.
Q

Question on gross margin. I hear what you're saying earlier, the implied guidance does have gross margin or at least in the second half pretty low. Are you assuming or are you factoring in more price increases? Are those coming in and what the impact would be, particularly in the fourth quarter?

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

Hi, Keith. This is Bruce. We are factoring in additional price increases. We're also factoring in persistent inflation. We don't see – by the way, you're probably thinking what does this mean for the long haul. We don't see any reason why we can't get back to the pre-COVID levels. We're just sort of working through what inflation at a 40-year high.

And we're working through – obviously, the way that this process works is you buy the raw materials at a very high price. It goes into work in process, becomes finished goods and then, eventually, flushes through the P&L.

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So, you're seeing that cycle. And what we haven't seen is we have not seen inflation go down. And so what we're doing is we're continuing to price to our customers and we're continuing to work through that inflationary environment and through the natural cycle from raw materials to finished goods to revenue.

Keith Hughes
Analyst, Truist Securities, Inc.

Q

And so are you assuming you have more input inflation from what we're seeing today?

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

A

Yes, we're assuming that. Well, we're assuming they're going to be at similar year-over-year rate increases to what we saw in the first half.

Keith Hughes
Analyst, Truist Securities, Inc.

Q

Okay. And just building back on the order rates, you talked about China being a problem in the quarter for obvious reasons. In the second half of the year, what's the outlook for Europe? Or is it weakening there given all the situation in Europe?

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

A

The way that we think about the numbers, specifically for Europe is high-single digits plus some – in local currency, we should see mid-single digits. So on the P&L, it'll be mid-single digits plus probably about a 5% haircut due to inflation. I'm sorry, not inflation, due to FX – pardon me – that we're seeing. As you know, the euro and the US dollar is around parity. And so when we translate those euro-based sales into US dollars, it's about a 5% haircut that we're seeing right now. So we're anticipating a good, strong quarter in Europe, again, because commercial activity is robust. What we're dealing with is obviously the FX-related headwinds.

Keith Hughes
Analyst, Truist Securities, Inc.

Q

Okay. Thank you.

Operator: And there are no further questions at this time. I'll turn the call back over to Laurel Hurd for some final closing comments.

Laurel M. Hurd
President & Chief Executive Officer, Interface, Inc.

Great. Thanks, everyone. I just want to close by thanking all of our Interface associates around the world for your continued efforts, thank our customers for their ongoing support, as well as all of you, and look forward to working with you going forward.

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

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