S&P Global
Market Intelligence

Interface, Inc. NasdaqGS:TILE

Earnings Call

Friday, August 4, 2023 1:00 PM GMT

CALL PARTICIPANTS 2

PRESENTATION 3

QUESTION AND ANSWER 7

Call Participants

EXECUTIVES

Bruce A. Hausmann
VP & CFO

Christine Needles
Global Head of Corporate Communications

Laurel M. Hurd
President, CEO & Director

ANALYSTS

Brian Biros
Thompson Research Group, LLC

David Sutherland MacGregor
Longbow Research LLC

Keith Brian Hughes
Truist Securities, Inc., Research Division

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

Presentation

Operator

Hello, and welcome to the Q2 2023 Interface, Inc. Earnings Conference Call. [Operator Instructions] I will now turn the call over to Christine Needles. Please go ahead. Christine, please go ahead.

[Technical Difficulty]

My apologies for the technical difficulties. I will now turn the conference over to Christine Needles. Please go ahead.

Christine Needles
Global Head of Corporate Communications

Good morning, and welcome to Interface's conference call regarding second quarter 2023 results posted by Laurel Hurd, 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 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.

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 will turn the call over to Laurel Hurd, CEO.

Laurel M. Hurd
President, CEO & Director

Thank you, Christine, and good morning, everyone. Once again, I want to thank the Interface team for delivering a solid quarter. It was in line with our guidance and expectations and strong execution around the globe. Currency neutral net sales were down 5% year-over-year as we anticipated compared to a strong prior year comp that was up 23%. Overall, given ongoing macro challenges, we're pleased with Q2's net sales results and the steady customer demand that we saw throughout the quarter.

We are executing well on our segment diversification strategy to help insulate and strengthen us even further from unpredictable market dynamics in the corporate office segment. Education has grown to 18% of our global billings over the last 12 months, and we anticipate this trend to continue as U.S. schools tap into remaining funds in the $122 billion American Rescue Plan legislation and tackle critical refurbishment and new construction projects across our primary geographies.

Education is seasonally stronger in Q2, so we'll provide a bit more detail on the segment, and it was a bright spot for us this quarter. We saw increased activity in sales in the quarter across several of our larger markets, including the U.S., U.K. and Germany. The school administration invested in refurbishment and maintenance projects during summer break, driving global sales in this segment up 7% year-over-year on top of 20% growth last year.

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

We're differentiated in education because of our reputation for high-quality flooring, overall product performance, and the breadth of our services, support and product warranties. And especially in higher education, many customers have their own sustainability goals and seek out our low carbon footprint flooring to help achieve them. In both K-12 and Higher Ed, our products stand up to the wear and tear of high-traffic areas and provide design aesthetic for positive learning environment for students and teachers.

We effectively leverage our full product portfolio in this segment with broad use of both carpet tile and LVT as well as nora rubber in key geographies such as Germany.

Q2 is also one of our biggest interior design event of the year occurs, NeoCon, where we had our second largest attendance of showroom visitors in our history as attendance continues to rebuild to pre-COVID levels. We've invested in enhanced digital capabilities to improve the customer experience and showcase new Interface Design Studio software that allows us to design the entire floor plate and share the carbon impact of different flooring decisions with our customers. This is a true differentiator as more and more customers need to specify lower carbon products in their projects.

And of course, we are focused on driving growth with new products. At NeoCon, we launched impactful new designs, including Lost Palms and Woven Gradient carpet tile collection and Silk Complex LVT. We also previewed a new global collection launching later this year, that features a modern take on designs of the past as we celebrate our 50th anniversary this year.

We are making meaningful progress in accelerating our new product development, a key component to our strategy, and believe these new products will help us drive market share gains in the back half.

Turning to orders. We continue to see steady order demand and enter Q3 with a strong backlog. Consolidated currency-neutral orders in the second quarter were down 2% year-over-year on a strong prior year comp that was up 10%. Orders were down 3% in the Americas and flat in EAAA. In EMEA, orders were steady, while strong growth in Australia helped offset continued soft post-COVID recovery in Asia. We enter the back half of the year with a solid backlog that is up 13% since the beginning of the year. We feel good about the steady demand we're seeing as customers continue to choose Interface for their flooring solutions while remaining cautious about the dynamic market conditions around the world.

Before I turn the call over to Bruce to discuss our financial results and outlook, I wanted to provide a brief update on our One Interface strategy, which is progressing as planned. As a reminder, this is a multiyear effort focused on resetting our operating model to leverage the power of our entire company to accelerate growth and improve profits.

We are building strong global functions to support our world-class local selling team, expanding margins through global supply chain management and improved productivity and accelerating new products and designs to drive incremental growth. Earlier this year, we announced changes to our executive leadership team roles and responsibilities, and I shared that we have created a new role, Chief Supply Chain Officer to lead efforts on supply chain optimization and help us unlock expanded gross margin.

I'm pleased to share that Bill Blackorby joined us this week, filling this important role in my leadership team. Bill brings more than 25 years of experience leading and managing highly successful teams across complex international supply chain, manufacturing, and distribution operations. Bill will leverage his extensive global experience to accelerate our productivity initiatives and increase agility across our global supply chain organization. With our executive leadership now in place, I'm confident in our team's ability to better leverage the strength of our entire organization to drive improved margins and profitable growth across the business. I'm excited for the future of Interface and the opportunities that lie ahead. With that, I'll turn it over to Bruce to go through the financials. Bruce?

Bruce A. Hausmann
VP & CFO

Thank you, Laurel, and good morning, everyone. Second quarter net sales totaled $329.6 million, a decrease of 4.9% versus last year's strong second quarter, which was up 23%. FX-neutral net sales declined 4.7% year-over-year. Net sales in the Americas were down 3% year-over-year on a very strong

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

prior year comp that was up 32%. In EAAA, net sales were down 8% on a prior year comp that was up 12%.

On an FX-neutral basis, EMEA was down 5%, Asia was down 31% and Australia was up 4% year-over-year. Given the challenging year-over-year comps, we were pleased with Q2's net sales results and the steady customer demand that we saw throughout the quarter. Second quarter adjusted gross profit margin was 33.9%, which is stronger than our guide of 33%, but a decrease of 39 basis points from the prior year period due to lower fixed cost absorption partially offset by higher pricing and favorable product mix. For the first time in many quarters, we saw deflation in our raw material purchases as the overall rates we pay for Q2's raw material purchases decreased 2% year-over-year. That compares to 9% year-over-year inflation that we incurred in Q1's raw material purchases.

As we move into the second half of 2023, we expect further year-over-year raw material deflation. Adjusted SG&A expenses were $83.9 million or 25.5% of net sales in the second quarter, compared to $80.4 million or 23.2% of net sales in the second quarter of last year. The increase was primarily due to inflation.

Second quarter adjusted operating income was $27.9 million, down 28% versus adjusted operating income of $38.5 million in the second quarter last year. The decrease was mostly due to lower net sales volume.

Second quarter adjusted EPS was $0.25 versus $0.36 in the second quarter last year. Adjusted EBITDA was $39.8 million this year versus $49 million in the second quarter last year. We generated $18.3 million of cash from operations in the second quarter, and liquidity was strong at quarter end totaling $384 million, which consisted of $93 million of cash and $291 million of revolver capacity. We repaid $25.9 million of debt in the quarter, resulting in net debt or total debt less cash on hand of $382.6 million at the end of the second quarter. The last 12 months of adjusted EBITDA totaled $150.3 million, and our net leverage ratio was 2.5x, calculated as net debt divided by adjusted EBITDA.

Our required principal and interest payments on all outstanding debt average approximately $10 million per quarter with our strong balance sheet and our strong cash generation, we plan to continue paying down debt is a top capital allocation priority. Capital expenditures were $5.6 million in the second quarter of 2023 compared to $4.3 million in 2022. As we look at our outlook, we remain cautiously optimistic about the back half of the year. We have calibrated our net sales guidance to accommodate our first half actuals and the ongoing slow post-COVID recovery in Asia, while increasing our gross profit outlook based on the improving supply chain environment.

And with that, we're now anticipating the following: for the third quarter of 2023, net sales of $320 million to $330 million. Adjusted gross profit margin of approximately 35.5%, adjusted SG&A expenses of approximately $84 million; adjusted interest and other expenses of approximately $10 million. And adjusted effective tax rate of approximately 31% and fully diluted weighted average share count of approximately 58.2 million shares.

For the full fiscal year of 2023, we are also anticipating net sales of $1.285 billion to $1.310 billion. Adjusted gross profit margin of 34% to 34.5%. Adjusted SG&A expenses of approximately $336 million, adjusted interest and other expenses of approximately $37 million, an adjusted effective tax rate of approximately 29% and capital expenditures of approximately $32 million.

As we move into the second half of the year, we remain focused on our growth strategy and our capital allocation priorities. We are encouraged by the steady demand we're seeing from customers and an improving supply chain environment, which builds momentum to enhance value for our shareholders. With that, I'll turn the call back to Laurel for concluding remarks.

Laurel M. Hurd
President, CEO & Director
Thank you, Bruce. As we look ahead, we expect a strong second half with continued market share gains and strong cash generation. I continue to be impressed with our team's expertise and capabilities to

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

execute our strategy as we position Interface for growth and drive value for our shareholders. We look forward to sharing our ongoing progress on our next call. Thank you.

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

Question and Answer

Operator

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

Brian Biros
Thompson Research Group, LLC

This is actually Brian Biros on for Kathryn. To start on the gross profit outlook for the full year, I believe it was lowered last quarter and then looks like it was raised this quarter. So can you just touch further on kind of the moving pieces there? Kind of remind us what initially brought it down? And then what's changed to raise it back up again?

Bruce A. Hausmann
VP & CFO

Brian, this is Bruce Hausmann. Well, I'm just delighted to tell you that we're finally seeing a more stable supply chain environment and an improving supply chain environment. You know, when we entered the year, there was still a lot of uncertainty around where inflation and where raw material supply was going to go as we entered into 2023 and then as we entered into Q2, it started to stabilize some more, but you might remember that raw materials were up 9% year-over-year, last quarter -- or I'm sorry, in Q1.

And then in Q2, we just continue to see more stabilization and for the first time in many, many quarters, now we're seeing deflation in our raw materials where raw materials were down 2% year-over-year. So basically, this is just sort of updating our guide and our visibility as things continue to improve as we move through the year.

Brian Biros
Thompson Research Group, LLC

So it sounds like it's mostly the raw materials movement is the main driver. Is that right?

Bruce A. Hausmann
VP & CFO

Raw materials is a big piece of it. We're also continuing to initiate and see effects of our productivity initiatives. Now to be fair, that is offset by some -- by less fixed cost absorption. So there are some puts and takes in the number.

Brian Biros
Thompson Research Group, LLC

Got it. And then maybe just can you also touch on, are you seeing any pricing pressure or kind of just increased competition across the business in this kind of lower growth environment here.

On the one hand, it's going to be becoming increasingly competitive out there, but you also have premium products that might be seeing better trends than the lower end products that probably see a lot more price pressure. So just interested to hear what you guys are seeing out there?

Laurel M. Hurd
President, CEO & Director

Yes, Brian, I'll take that. It's Laurel. I would say that we're pretty pleased that our pricing is holding up in the market. When we look at the U.S. market, as an example, we believe we gained share in the quarter. So we feel good about that as well as year-to-date. And as you said, our premium products continue to sell well, and we're launching more and more new products, not only at a premium end, but also at a more approachable price point so we continue to capture jobs across the spectrum. But we're seeing price

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

hold up pretty well. It's competitive out there for sure. We're not losing jobs, but we're pleased with the progress that we're seeing right now.

Operator

Your next question comes from the line of David MacGregor with Longbow Research.

David Sutherland MacGregor
Longbow Research LLC

Yes, and Laurel, this quarter actually, I mean, given where you guys thought you'd be this quarter, the results actually turned out relatively well. So congratulations there. Can you update us on One Interface, just where are you on this? Are there major inflection points in terms of the visible results of this program that we should anticipate in the second half? Or does that maybe occur more in 2024.

Where do you think you're making maybe a little more progress than you thought you would? Where, on the other hand, maybe to be lagging a little bit behind. But as much detail as you can on One Interface would be a big help.

Laurel M. Hurd
President, CEO & Director

Yes, that's great. Thanks for the question, David. Look, I think we're making really good progress. I'd say we're tracking as planned. I'm pleased as we announced that we now have our Chief Supply Chain Officer in place, who's going to help us a lot to continue to enhance our gross margins. So I feel really good about that. Bill is a great addition to the team. He joined us on Monday. He spent his first day down in LaGrange with the team there and really digging in. So I think that will start to see having a meaningful impact as he really works with the team to drive our productivity initiatives. So I'm excited about that.

We also, I would say, we're focused on more new products faster with more meaningful impact in the market across the globe. So the things we're tracking are speed to market and the impact of our new products. So I think you're going to continue to see that. I'd say we're just getting started there, but I feel really good about the early progress in that front.

And then from a marketing perspective, our global marketing leadership team has been finalized, and the team was actually in town this week working through both capabilities where we're really building. We talked about our digital capabilities, which we're strengthening and pushing that around the world, while at the same time, being really efficient, so we have more impact with more efficiency from our marketing initiatives. So I think we'll see really sequential improvement as we continue to balance investing for growth in our strongest, most profitable markets, number one being the U.S., and we're continuing to invest there on the selling side, while we really drive for efficiencies on the back end.

David Sutherland MacGregor
Longbow Research LLC

And with respect to the question of the visibility around results and the cadence of that visibility. How should we be thinking about this? I mean I realize you provide guidance for the balance of the year here, but just thinking about this maybe on a slightly longer-term profile, when do we really see the inflection?

Laurel M. Hurd
President, CEO & Director

I think you'll see, I would call it sequential improvement both in gross margin progress up and SG&A leverage down. So we'll see improvement as we continue to move forward. I don't expect to see a big bang inflection. Again, we're being really thoughtful as we monitor our investments and push some on the selling side up in the U.S., while at the same time, we really moderate the back end of the business. So I think it would be -- you'd think about it as sequential progress and improvement while we're driving growth. So continuing to drive growth on the top line while we improve the margins, both gross profit up and SG&A down.

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

David Sutherland MacGregor
Longbow Research LLC

Okay. Great. Good luck with things there. Just within the order backlog right now, the order book. Can you just talk about what you're seeing near term in terms of just shifting patterns within the U.S. orders? And are you seeing growth in the low carbon, I would expect versus maybe some negative movements elsewhere in the product mix? If you can just talk about what you're seeing there?

Laurel M. Hurd
President, CEO & Director

Yes. Maybe I'll step back and talk a little bit about our billings year-to-date and in the quarter because there's some really good news in there that I can unpack a little bit, and then we can shift to orders.

So if I look at our corporate office, right, which is obviously a big piece of our business, and we look year-to-date at that market, we're actually up in the Americas. We're up in Australia. We're flat in Europe, and we're down in Asia. So we commented on Asia being -- continue to being challenged, which, as you've heard on the economic softness in China continues. So that's one thing. I'd say corporate office is pretty encouraging. We're not naive to the macro environment. We're staying close to it and we're cautious about that in the back half. But year-to-date, we feel pretty good it's holding up well.

And if we look at carpet tiles, our carpet tiles in the quarter, our billings were down mid-single digits globally, low single digits in the Americas, but year-to-date, our billings in carpet tile in the Americas are roughly flat in dollars. So again, we're pleased in our some of our largest end user segments in corporate office as well as in corporate [indiscernible] carpet tile, that those categories are holding up pretty well for us.

And then when we look at orders going forward, orders in the Americas last year were up 17%. So we had a tough comp in orders. So we've got steady demand in the Americas, and it's about where we expected it to be. If I look at Asia, that's one market we've continued to struggle with, but a little color on the orders a year -- first quarter, our orders we shared were down about 50% year-over-year. And this quarter, they're down about 8.5%. So we're seeing the order rate still tough, but better certainly than the trend was previously. It's just taking longer for us to convert those orders to billings as we're continuing to see project delays in the market. So that's an area that we continue to see some delays, and we're being cautious in the back half there.

David Sutherland MacGregor
Longbow Research LLC

Good progress. Last question for me, Bruce, you talked about raw materials up 9% in the first quarter and then down 2% in the second quarter. Is there any way you can help us with the modeling of the second half, how we should be thinking about the cadence into 3Q or 4Q?

Bruce A. Hausmann
VP & CFO

Yes. Around raw material specifically, David, is that what you're asking about?

David Sutherland MacGregor
Longbow Research LLC

Yes.

Bruce A. Hausmann
VP & CFO

Yes. The way that we're thinking about it, obviously, there's a lot of moving pieces. We think that raw materials will be down mid-single digits in Q3 year-over-year, and similar kind of zone in Q4. So we think that, that will help us in the back half. And obviously, that helps us as we move into 2024.

Operator

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

Your next question comes from the line of Keith Hughes of Truist.

Keith Brian Hughes
Truist Securities, Inc., Research Division

How much were units down in the second quarter?

Bruce A. Hausmann
VP & CFO

So Keith, units were down roughly 10% to the second quarter year-over-year, and of course, pricing was up roughly 5%, and that's what got us to the -- what you see in the P&L with a negative 5% growth.

Keith Brian Hughes
Truist Securities, Inc., Research Division

Right. So your guidance for the second half implies revenue growth, low single-digit revenue growth for the half. What kind of unit, what do you expect in units in that number?

Bruce A. Hausmann
VP & CFO

Yes. We're anticipating mid-single digits being down from a volume perspective in the back half, and then pricing will be up. And then that leaves us, if you look at sort of the midpoint of our guide, it will leave us roughly flattish in the back half.

Keith Brian Hughes
Truist Securities, Inc., Research Division

Right. And I guess my question is we look by geography. How -- who have been the leaders in that number who have been the laggards in, I guess, specifically unit?

Bruce A. Hausmann
VP & CFO

Around price volume. Yes, Americas has been actually -- has been stronger around units. For example, if you look at Americas, our volume was down 7% only, versus in the rest of the world, it was down roughly 15%. So where we're seeing the volume line has been more prominent outside the U.S. while Americas has been stronger.

Keith Brian Hughes
Truist Securities, Inc., Research Division

Okay. And I assume you're going to start lapping some price increases from last year. Let me ask it this way. When do you think you'll lap your last move in price in response to the raw material inflation?

Bruce A. Hausmann
VP & CFO

So it kind of -- it feathers in is the answer, because we did pricing throughout the year last year. And so we are getting the wraparound effect of that for sure in the first half of this year, and we'll get some of that in the back half. But Keith, we -- as we look at all of our various markets, where we need to continue taking price, we'll continue taking price. And there will be opportunities to do some of that in certain markets in the back half.

Operator

There are no further questions at this time. I will turn the call to Laurel Hurd.

Laurel M. Hurd
President, CEO & Director

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

Great. Thank you, and thanks for the questions and your engagement this morning. Before we end the call, I wanted to thank the entire Interface team for their continued dedication and efforts. And I also want to congratulate the team for being recognized as one of Time's 100 Most Influential Companies for our carbon neutral and carbon-negative carpet tiles. It's another example of the strength of our sustainability leadership, driving differentiation in the market. So that was exciting news. And with that, I just want to thank you all for listening, and have a great day.

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

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

Copyright © 2023 by S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

These materials have been prepared solely for information purposes based upon information generally available to the public and from sources believed to be reliable. No content (including index data, ratings, credit-related analyses and data, research, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P Global Market Intelligence or its affiliates (collectively, S&P Global). The Content shall not be used for any unlawful or unauthorized purposes. S&P Global and any third-party providers, (collectively S&P Global Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Global Parties are not responsible for any errors or omissions, regardless of the cause, for the results obtained from the use of the Content. THE CONTENT IS PROVIDED ON "AS IS" BASIS. S&P GLOBAL PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Global Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages. S&P Global Market Intelligence's opinions, quotes and credit-related and other analyses are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P Global Market Intelligence may provide index data. Direct investment in an index is not possible. Exposure to an asset class represented by an index is available through investable instruments based on that index. S&P Global Market Intelligence assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P Global Market Intelligence does not act as a fiduciary or an investment advisor except where registered as such. S&P Global keeps certain activities of its divisions separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain divisions of S&P Global may have information that is not available to other S&P Global divisions. S&P Global has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P Global may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P Global reserves the right to disseminate its opinions and analyses. S&P Global's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P Global publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.
© 2023 S&P Global Market Intelligence.

Copyright © 2023 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.