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Earnings Call

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Presentation

Operator

Thank you for standing by. My name is Bailey and I will be your conference operator today. At this time, I would like to welcome everyone to the Q3 2024 Interface, Inc's earnings conference call. [Operator Instructions]

I would now like to turn the call over to Christine Needles, Corporate Communications. You may begin.

Christine Needles
Global Head of Corporate Communications

Good morning and welcome to Interface's conference call regarding third quarter 2024 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 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 will turn the call over to Laurel Hurd, CEO.

Laurel M. Hurd
President, CEO & Director

Thank you Christine, and good morning everyone. To begin our call, I want to thank the Interface team for an impressive quarter. Our strong results reinforce the fact that our One Interface strategy is working and yielding tangible results.

The strategy is focused on building strong global functions to support our world-class local selling team, accelerating growth through enhanced productivity of our commercial team, expanding margins through global supply chain management and complexity reduction and leading in design, innovation and sustainability. We're in the early stages of our multi-year plan and we're encouraged by the results we're seeing across the business.

We've talked about the new integrated selling approach that we implemented in Q1 of this year, which combines nora and Interface selling teams in the U.S. These coordinated teams are continuing to yield tremendous results in the Americas business, resulting in currency-neutral net sales, up an impressive 18% in the quarter.

We're seeing momentum in nora rubber sales expanding beyond healthcare into other growth segments including education, biopharma and manufacturing. Our combined selling teams are effectively unlocking

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new opportunities across the product portfolio, while enhancing the customer experience. This is what we'd hope to see and we're encouraged by the team's progress.

Additionally, we recently added the nora brand to our refreshed brand attitude Made for More. This platform brings our brands closer together to drive consistency in how we show up for our customers. It creates efficiency in our marketing and brand efforts and ultimately provides additional sales opportunities.

Turning to our financial results. We delivered a very strong third quarter with currency-neutral net sales growth of 10% and significant profitability expansion. We continue to drive strong momentum in the Americas, and as mentioned, currency-neutral net sales were up 18% year-over-year, continued market share gain.

In EAAA, currency-neutral net sales were flat as growth in EMEA was largely offset by lower net sales in Australia. Additionally, billings in all product [categories] were up year-to-date in both price and volume, which is a great testament to our selling organization and their ability to execute and gain share.

Moving to our market segments, global education billings remain strong, up 18% year-over-year, led by strength in the Americas. Our expanded Open Air collection, nora rubber and 3-millimeter LVT collection continue to resonate with our K-12 and higher education customers. This is a great example of our combined selling teams effectively supporting our customers across the full product portfolio.

Global Corporate Office billings, were up 2% year-over-year where we continue to gain market share when you compare us with overall industry trends. As companies return to the office and update their spaces, our sales team leverages their deep relationships with architects and design firms to meet their needs with our differentiated product portfolio.

Overall, activity continues to increase, particularly in Class A space where we are differentiated by our premium products, design and sustainability leadership.

Health care billings were soft in the third quarter, however, we saw strong double-digit year-over-year order growth. As a reminder, we typically have a longer sales and installation cycle related to our nora products in health care. And our strong healthcare orders will convert to billings in the coming quarters.

And as expected, retail billings were up in the quarter compared to a soft prior year period. Retail is a small part of our overall net sales, but can have periodic unplanned deferrals of store remodel projects, which we experienced in the prior year period.

Turning to orders, strong commercial execution drove a 10% increase in consolidated currency-neutral orders in the third quarter. Currency-neutral orders in the Americas were up 17% with growth across all product categories. In EAAA, currency-neutral orders were flat year-over-year. Growth in Asia was largely offset by Australia with EMEA essentially flat.

As we head into the fourth quarter, our backlog is strong, up 29% year-to-date. We remain focused on commercial productivity, improving the customer experience and aligning our sales teams with the fastest growing geographic markets and segments beginning in the U.S.

Turning to supply chain and manufacturing. We continue to focus on reducing complexity through automation in our manufacturing facilities. As previously mentioned, we will continue to implement new automation and robotics solutions over the next 3 quarters. We are encouraged by the results of these investments in our U.S. manufacturing plants and continue to evaluate other automation opportunities, which will be funded through manufacturing efficiency savings.

Before Bruce gets into the financials, I want to share some notable accomplishments related to sustainability. First, we recently announced that we are making it easier for customers to understand the carbon impact of their product selection. We are delivering embodied carbon metrics on all floor plans created by the Interface Design Studio by using a unique combination of technology and data to calculate the carbon footprint of a project's flooring.

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This helps to put carbon footprint data at the forefront where we know we lead with differentiated low carbon products and it contributes to helping our customers achieve their own sustainability and carbon goals.

Second, we've recently announced that we've expanded our carpet recycling capabilities at our facility in the Netherlands, building on 30 years of progress in support of the circular economy. We can now process CQuest Bio and CQuest BioX backed carpet in EMEA to turn used products into new ones, helping us reduce our carbon footprint.

Third, I'm pleased to share that Interface received the highest distinction in Reuters' recent Sustainability Awards in the Net Zero: Leadership category for our decision to go all in on becoming carbon-negative without offsets.

And finally, I'm proud to report that Interface was added to Newsweek's Greenest Companies list, which is a ranking of top companies in the U.S. that are committed to environmental sustainability. Interface continues to be at the forefront of sustainability as we work to become carbon-negative by 2040, and we appreciate the recognition of our progress.

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

Bruce A. Hausmann
VP & CFO

Well thank you Laurel, and good morning everyone. Third quarter net sales totaled $344.3 million, an increase of 11% versus the third quarter of 2023. Third quarter FX-neutral net sales in the Americas were up 18% year-over-year, driven primarily by strength in the education market segment as well as strong retail billings.

FX-neutral net sales in EAAA were flat year-over-year and on an FX-neutral basis EMEA was up 2%, Asia was down 1% and Australia was down 9% year-over-year on the strong prior year comparison.

Third quarter adjusted gross profit margin was 37.5% on increase of 158 basis points on raw material cost deflation and higher fixed cost absorption due to increased volume compared to the same period last year.

Adjusted SG&A expenses were $85.5 million or 24.8% of net sales in the third quarter compared to $79.2 million or 25.5% of net sales in the third quarter last year. Third quarter adjusted operating income was $43.5 million, up 34% versus adjusted operating income of $32.4 million in the third quarter last year. The increase was driven by higher net sales and higher gross profit margins in the quarter.

Our third quarter effective tax rate benefited from the release of a $2.7 million valuation allowance. This is driven by strong business performance in the U.S. and lower interest expense from accelerated debt repayment. The release of this valuation allowance was unique to Q3 2024 and is not expected to recur.

Third quarter adjusted EPS was $0.48 versus $0.28 in the third quarter last year. Third quarter's adjusted EBITDA was $53.7 million versus $43.7 million in the third quarter last year. We generated $76.2 million of cash from operating activities in the third quarter. In line with our capital allocation strategy, we repaid $51.3 million of debt in the third quarter and $80.9 million year-to-date.

Our balance sheet remains strong with $415 million of liquidity at quarter end, and our net leverage ratio was 1.1x calculated as net debt divided by the last 12 months of adjusted EBITDA. Capital expenditures were $6.5 million in the third quarter of 2024 compared to $5.9 million in 2023.

Turning to our outlook. We delivered impressive results in the third quarter of 2024 and enter fourth quarter with strong orders and a healthy backlog. As a reminder, in the fourth quarter last year, gross profit margin benefited 160 basis points from non-recurring items that reduced cost of sales in that quarter.

Separately, we continue to anticipate strong retail billings in the fourth quarter of 2024, which has slightly lower gross profit margins that are more typical premium products.

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With that backdrop in mind, we are raising our full year outlook and are now anticipating the following for the full fiscal year 2024. Net sales of $1.315 billion to $1.325 billion; adjusted gross profit margin of approximately 36.6%; adjusted SG&A expenses of approximately $345 million; adjusted interest and other expenses of approximately $27 million; and adjusted effective tax rate for the full year of approximately 25%; fully diluted weighted average share count of approximately 58.8 million shares and capital expenditures of approximately $37 million.

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

Laurel M. Hurd
President, CEO & Director

Thank you, Bruce. I want to thank everyone for joining the call today, and I would especially like to extend my thanks to the entire Interface team. Our results this quarter demonstrate the strength and effectiveness of our One Interface strategy, and I'm incredibly proud of the progress we've made across all areas of our business.

As we look ahead, our focus remains on investing in the business, operational excellence and delivering value to both our customers and shareholders. We are confident in our ability to navigate the dynamics of our current market while seizing opportunities that align with our long-term vision.
With that, I will open it up to questions. Operator?

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Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Kathryn Thompson of TRG.

Kathryn Ingram Thompson
Thompson Research Group, LLC

First, I want to focus on non-res repair and remodel, and we've heard very -- a few companies this earning season talk about an improvement in activity in non-res repair and remodel. And you seem to be seeing that as well, given the pace of orders in the past few quarters and bigger growth this quarter in education and health care.

How would you characterize the state of non-res repair and remodel leading into 2025 and how does it compare to going into the current year -- last year? So really what's the pace now going into next year and how does it compare to last year at the same time as you think about momentum?

Laurel M. Hurd
President, CEO & Director

Thanks, Kathryn. First, I'd say I'm really proud of the progress that the teams made. 18% net sales growth in the Americas is a really, really strong quarter. And as you said, our order book also looks good. So we're saying, I think we're definitely outpacing the market with respect to the total market. We're feeling really good about the corporate environment is we're continuing to see more and more activity as people are bringing more associates back to work. So those projects are coming, I think, stronger certainly than a year ago. Our optimism is building with respect to that.

As you said, our education business remains very strong as we're selling the full product portfolio, seeing a lot of growth across our nora products as well in education, both in K-12 and higher ed. So I think we're optimistic that the momentum is building. And within that we are proud of the team's ability to take share.

Bruce A. Hausmann
VP & CFO

Kathryn, I agree. The other thing that's really interesting to me on our earnings this quarter is that, year-to-date all 3 product lines were up both in price and volume and we couldn't say that last year. So it's just another testament to the momentum that we're seeing in the business, the momentum that we're seeing now versus a year ago. So great momentum inside the business and great to see the volume up as well as us being able to hold price in the market.

Kathryn Ingram Thompson
Thompson Research Group, LLC

And just a follow on to that on order growth in Americas, can you give any detail on the breakout across verticals or products? Is there anything that's leading the growth?

Laurel M. Hurd
President, CEO & Director

We don't really -- yes, we don't give a ton of detail in that breakout. The one thing that we did mention in the prepared remarks is that our health care orders were up double digits in the quarter, so we're feeling optimistic about that health care business. And those orders will read through over the coming quarter. Some of those take longer to read through, so that's good momentum for us in the future.

Operator

Your next question comes from the line of Alex Paris with Barrington Research.

Alexander Peter Paris

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Barrington Research Associates, Inc., Research Division

Congratulations on another beat and raise.

Laurel M. Hurd
President, CEO & Director

Thanks Alex.

Alexander Peter Paris
Barrington Research Associates, Inc., Research Division

I just had a question kind of following up on Kathryn's regarding billing. So again, education was up very strong, up 18%, Corporate Office was up 2% kind of bucking the industry trend, and you made some favorable comments about return to office. I just thought whatever additional color I can get on those 2 categories, but also wanted to talk a little bit about retail and health care. So retail is finally up from down last year due to project delays, so what's going on in retail? I'll start there.

Laurel M. Hurd
President, CEO & Director

Our retail business did come back as we had expected. And again, this was really project delays last year. So in the back half of last year, we had several store remodels that were delayed and pushed into the back half of this year, and those read through in the quarter. If you look at the Americas business as an example for that 18%, about 8 points of that growth was the retail comeback, which we had expected and then 10 points of growth across the rest of the market. So a strong quarter for retail, which is exactly what we had expected. We expect that also to carry somewhat forward into the fourth quarter.

And then our Corporate Office business, it does continue to perform really well, was actually up mid-single digits in the Americas. So even stronger than our -- globally our 2% growth. And our teams are really winning projects, as Bruce said, across all categories. So they're doing an incredible job with these One Interface selling teams of selling the full suite of products across LVT carpet tile and also nora rubber. So strong growth in corporate as well.

Alexander Peter Paris
Barrington Research Associates, Inc., Research Division

And then health care, you said that orders were up nicely, which is great. But revenue -- net sales were down in health care slightly. What do you attribute that to?

Laurel M. Hurd
President, CEO & Director

Yes, health care for us, those projects get installed over time, so the time horizon is a bit different. The double-digit order growth in health care is really encouraging and a testament to the team. Again, the combined selling teams really focusing on the end market and we expect those orders to read through. Those projects get installed sometimes over 1 to 2 years.

The bigger projects and the orders come in in bigger chunks, but they also get the billings read through in bigger chunks over a longer period. So we're encouraged that we saw that level of net sales growth in the quarter while health care was not as strong. And then health care orders up, which shows that momentum will continue to read through in the future.

Alexander Peter Paris
Barrington Research Associates, Inc., Research Division

Does that strength in orders in health care translate into higher net sales in health care in the fourth quarter?

Laurel M. Hurd
President, CEO & Director

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I would expect it to. I think it also will flow through into next year. So again, some of those projects are like small medical buildings and those will turn in the quarter. Some of those projects are large health care systems that may have multiple buildings and multiple floors that get installed over 12 to 18 months.

Alexander Peter Paris
Barrington Research Associates, Inc., Research Division

And then I might have missed it, but did you comment on billings across product categories? I think you said they were up year-to-date in all 3, carpet tile, LVT and rubber?

Laurel M. Hurd
President, CEO & Director

That's right.

Bruce A. Hausmann
VP & CFO

Alex, our billings were up with price and volume, which is a great sign in all 3 product categories year-to-date,

Alexander Peter Paris
Barrington Research Associates, Inc., Research Division

Were they up in the third quarter or just up year-to-date or both?

Bruce A. Hausmann
VP & CFO

2 out of the 3 were up and they were up with volume. So, yes, that's again an encouraging sign that it's really encouraging to see how much volume has come back while we're able to hold price. So all encouraging stuff on the top line.

Alexander Peter Paris
Barrington Research Associates, Inc., Research Division

Then the final question from me. Great outperformance on the adjusted gross margin versus your guidance. I think you had guided to approximately 36%, it came in at 37.5%. What is your long-term target there? I think you want to get back to pre-COVID levels. What is that? And then how long will it take you to get there? Is it like a 50 bps per year sort of thing, or is it faster, sooner?

Laurel M. Hurd
President, CEO & Director

Alex, you're right, exactly. Our ambition is to get back up to 38% to 38.5% and we're really encouraged by the progress that we're making. We haven't given a specific timeline. We're honestly just trying to get there as fast as we can and again, encouraged by the progress.

Bruce A. Hausmann
VP & CFO

I would just say, Alex, the good news is that, and you mentioned it. We brought up our gross profit margins in Q4 and for the full year. So if you sort of think about our prior guide for Q4, it was around 34.1%. We brought that up 80 basis points in Q4 to 34.9% as our midpoint guide. And for the full year, as you pointed out, our prior guide was 36% and now we brought it up to 36.6%. So really good strong momentum on that gross profit line row.

Operator

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

David Sutherland MacGregor

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Longbow Research LLC

Congratulations on all the progress, tremendous to see. I guess, what percentage of wins at this point have more than just carpet tile? So include the LVT and the nora versus how that KPI might've stood a year ago or 18 months ago?

Laurel M. Hurd
President, CEO & Director

Yes, it's a great question, David, and not something that we disclose regularly. I would say it's increasing for sure. An example I would say is, in our education space where we had primarily -- initially we were just selling carpet tile into education. We broadened that nicely to include carpet tile and LVT as pretty standard in selling to the education space.

And what we're finding now is nora is also included in those both in K-12, but also in higher ed. So for example, we're getting lab spaces and other spaces in higher ed, which we maybe hadn't had as part of that portfolio in the past. So it's definitely increasing and encouraged by what we're seeing there. I think there's more to go.

David Sutherland MacGregor
Longbow Research LLC

And I guess, this is all just One Interface. It's not necessarily evolving preferences with the customer, it's more you're taking share in those categories with an increasing presence?

Laurel M. Hurd
President, CEO & Director

Yes, it's interesting, when we think about what we did with the One Interface selling teams, which hit, as you know, starting in January, part of that model was that we increased our feet on the street for our nora brand by about 20% to really round out the combined selling teams and make sure we had enough coverage in nora to execute that model.

What we're also seeing is that, we actually put the nora brand in the hands of all of our Interface sellers by changing our compensation structure so that now we're selling as one team and compensating as one team. And so the energy around that -- rubber is a great solution for a lot of flooring opportunities and we've really got an amplified effort across our entire Interface selling team in addition to that increase in feet on the street specific to nora. So we're really seeing a multiplier effect there that's stronger than we anticipated.

David Sutherland MacGregor
Longbow Research LLC

And so with the growth in nora, and just in terms of penetrating your existing base, and then in addition to that, you're talking about growth beyond health care, how do you stand in terms of available capacity in nora? Do you have capacity to support and how much growth and when do you have to start deploying capital to expand that?

Laurel M. Hurd
President, CEO & Director

Yes, it's a great question and we're talking a lot about that. I think the good news right now is we invested in some automation equipment in nora that is live now, that's really helping us to increase our throughput. So we have what we need. I think we'll continue to invest in that space and you may see some additional investments in nora as we continue to grow.

But we're continuing to, kind of, bring on more and more people to support the growth and also continue to invest in automation. So I think we're in good shape. We're talking about it every day.

David Sutherland MacGregor
Longbow Research LLC

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On the raw materials, how much of the benefit that you achieved -- well, first of all, maybe can you just talk about what price cost might have contributed to the gross margins?

Bruce A. Hausmann
VP & CFO

Yes, David, it was a blend between -- if you look at the 158 basis points of gross margin expansion in Q3, it was a blend of raw material cost deflation and also higher fixed cost absorption or lower cost per unit on higher volume. And part of the contribution of that was that we actually beat our revenue number in Q3. So compared to where we thought we would be in Q3, we had more throughput through the plants, which helped us a lot on our fixed cost absorption.

And on the raw side, things are leveling out from a inflation, deflation standpoint, but we did get little bit of year-over-year lift in Q3 that will start to moderate as we move into Q4. And all of that's built toward guide.

Laurel M. Hurd
President, CEO & Director

And David, I'd just add to that also. When our Americas business is up 18%, that regional mix impact also helps us so that flows through as a benefit as well.

Bruce A. Hausmann
VP & CFO

That's true.

David Sutherland MacGregor
Longbow Research LLC

I guess, I'm trying to get a sense of how much benefit there is from just movement in the raw material markets themselves in terms of the price you're paying for these factors versus some of the benefit associated with bringing on a new supply chain leader and really getting much more process-oriented around procurement?

Bruce A. Hausmann
VP & CFO

I think it's a combination of all those things. And you put all of those positive pieces in and it blends into the 158 bps, as Laurel mentioned. Laurel had a really good point that the geographic mix helped us a lot as well, offset a little bit by the retail mix. So there is a lot of pieces in there.

Laurel M. Hurd
President, CEO & Director

And I think a lot of the things that we're seeing with respect to our investments in automation are yet to come. As we've said, I'm pleased with the progress. We now have, I think, it's 3 machines up and running. Maybe the fourth is live by now in our Georgia facility that'll really help with the automation there, but that's going to continue to play out over the next year.

David Sutherland MacGregor
Longbow Research LLC

And that's versus I think you had one line up and running last quarter?

Laurel M. Hurd
President, CEO & Director

That's right, David.

David Sutherland MacGregor
Longbow Research LLC

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So good progress there. I guess just thinking through to 2025, and I'm not sure -- obviously, there's a lot of uncertainty still remaining with regard to what '25 may bring. But I'd be interested in your thoughts in terms of your ability to maintain kind of a gross margin progression, not so much based on what the market may bring, because as we've said, that's uncertain. But just based on the idiosyncratic drivers that you've got in place, the automation, the procurement, the One Interface initiatives, what do you think that could contribute to gross margin progression as you move into the next year?

Laurel M. Hurd
President, CEO & Director

As we've said, our ambition, as you know, is to get back to 38% and 38.5%. I think from a timing standpoint this year, I think we'll be ahead of where we thought. So I'm encouraged by that and yet we still have a lot yet to deploy that I don't think is reading through the P&L yet. So I'm encouraged that we'll continue to make progress.

And as you said, the market will ride that and see where that takes us. But through all of this, we've just said we're going to not pay so much attention to what the market is doing, we're going to do everything we can to continue to drive market share gains and growth which -- and then also the supply chain initiatives all that is within our control to drive that. So I think we're feeling good.

David Sutherland MacGregor
Longbow Research LLC

And then just wrapping up for me, I guess the question on SG&A. You're guiding to $345 million this year of SG&A. I guess a couple of questions here. How much revenue growth can you support based on kind of that level of spend? I'm guessing you're going to get some inflation there in 2025. 3% inflation will be an extra $10 million, but maybe offset that with some productivity and maybe offset, increasing growth spending with cutbacks in non-growth, SG&A. I'm not sure how you approach that. But I guess the question is just how much upside is left in terms of your ability to grow revenue off SG&A before you have to really take SG&A to next level?

Laurel M. Hurd
President, CEO & Director

As we've said, we've been really focused on being efficient in our SG&A and we'll make investments, very thoughtful and intentional investments that we believe will read through to growth. The great example of that is adding the feet on the street to the nora business, which is paying back in dividends. And we're analyzing all of that to see how much more do we need in 2025 to deliver the growth expectations that we have for ourselves. And yet we'll be very diligent on anything that doesn't touch the customer, the innovation or the product design and development.

So it's a dance as you know, right? We need to make sure that we fund the growth. We'll be really intentional. We do a lot of test and learn to see whether or not things pay back. So we're putting really good money to work for us and then being really efficient on anything that doesn't touch the customer.

Operator

There are no further questions at this time. I will turn the call back over to Laurel Hurd, CEO for closing remarks.

Laurel M. Hurd
President, CEO & Director

Well, I want to thank the entire Interface team for an excellent quarter. Congratulations to the team and thanks everyone for listening to the call and have a great day.

Operator
Thank you. This does conclude today's conference call. You may now disconnect.

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