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NCS - Q1 2015 NCI Building Systems Inc Earnings Call

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CORPORATE PARTICIPANTS

Layne De Alvarez *NCI Building Systems Inc - VP of IR*

Norm Chambers *NCI Building Systems Inc - Chairman, President, & CEO*

Mark Johnson *NCI Building Systems Inc - CFO*

CONFERENCE CALL PARTICIPANTS

Winnie Clark *UBS - Analyst*

Lee Jagoda *CJS Securities - Analyst*

Drew Lipke *Stephens Inc. - Analyst*

Collin Verron *RBC Capital Markets - Analyst*

Scott Schrier *Citigroup - Analyst*

Brent Thielman *DA Davidson - Analyst*

Sam McGovern *Credit Suisse - Analyst*

Gregory Macosko *Montrose Advisors - Analyst*

PRESENTATION

Operator

Greetings, and welcome to the NCI Building Systems first quarter 2015 earnings conference call.

(Operator Instructions)

As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Ms. Layne de Alvarez, Vice President of Investor Relations. Thank you Ma'am, you may begin.

Layne De Alvarez - ***NCI Building Systems Inc - VP of IR***

Thank you. Good morning and welcome to NCI Building Systems call to review the Company's results for the first quarter of FY15.

The Company's first quarter results were issued last night in a press release that was covered by the financial media, and keeping with SEC requirements, I advise that during this call we will be making forward-looking statements that of involve risks and uncertainties. Actual outcomes may differ materially from those expected or implied.

For a more detailed discussion of the risks and uncertainties that may affect NCI, please review our SEC filings, including the 8-K filed last night. Forward-looking statements speak only as of the date they are made. We undertake no obligation to update any forward-looking statements beyond what is required by applicable Securities Laws.

In addition, our discussion of operating performance will include non-GAAP financial measures. A reconciliation of these measures with the most directly comparable GAAP measures is included in the Earnings Release and the CFO Commentary, both of which are available on our website.

At this time, I would like to turn the call over to NCI's Chairman, President, and Chief Executive Officer, Norm Chambers.

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

Good morning, everyone, and welcome to our first quarter 2015 conference call.

Joining me this morning are Mark Johnson, our Chief Financial Officer; Todd Moore, our General Counsel; and Layne De Alvarez, our Vice President Investor Relations.

Our first quarter earnings were released last night, so I hope you had time to review the results. I'll open the call with a brief review of our quarter before I hand it over to Mark, who will offer additional color to our first quarter financial performance.

Over the last several quarters, many of you recall me saying that I expect our results to “speak for themselves”, reflecting the operational leverage we have been working to improve. In the second half of last year, revenue grew by 5%, delivered a 90% improvement to adjusted operating income. In the first quarter of FY15, adjusted operating income improved from a prior year $3.5 million loss to an $8.7 million profit on 4% top line growth.

Our first quarter financial performance marks the third consecutive quarter of year-over-year improvement in adjusted EBITDA growth and the best first quarter performance since 2008. 17 of our 18 brands within three business segments performed very well, with year-over-year quarterly growth in adjusted operating income. Our streamlined manufacturing organization, commercial discipline, and supply chain management continue to drive improved financial performance for one simple reason: we can better serve our customers. We believe we are clearly on a trajectory consistent with our mid-cycle recovery goal.

We've been focused on simplifying our organizational structure to support greater efficiency and improved execution as market growth continues. As you know, in November 2013 we reorganized manufacturing under John Kuzdal. He and his team have upgraded our manufacturing processes, which have allowed us to begin optimizing our manufacturing effectiveness.

In the first quarter, we consolidated our operations in Southeast Tennessee, which led to the closure of one of our manufacturing plants. We recently hosted two successful job fairs for our colleagues. We are pleased that many employees have already found new employment.

The leaner manufacturing footprint will maximize efficiencies and improve supply chain effectiveness, while increasing concentration of product and service capabilities at existing facilities. John and his team have accomplished a great deal and many opportunities for operational improvement and cost reduction remain.

It is clear that a single focus across all of our manufacturing has enabled us to make improvements more quickly and consistently by removing layers of management. In December of 2014, we began a similar endeavor with our commercial operation, which includes all of our brands within Coating, Components, insulated metal panels and buildings.

As a result, we have eliminated the segment structure to streamline and flatten our organization, replacing it with Don Riley and a small team who will elevate greater teamwork and collaboration across all of our brands, supported by our shared services platform. The refined structure will put an even greater emphasis on creating more value for our customers.

Now I'd like to say a few words about our markets. The volume of new non-res building starts, as reported by McGraw-Hill, has an 83% correlation with changes in the US economy. In other words, it almost perfectly reflects the US economy. NCI has an 87% correlation with the volume of new construction starts. So the economy, new construction starts, and NCI are inextricably connected.

We are now in the fifth year of recovery. Volumes are just recovering to 50 year trough levels. However, end markets that were strong in our first quarter and indicate continued strength in our backlog are: commercial warehousing, retail, manufacturing warehousing and production, garages, local, state and federal government, houses of worship, and recreational end markets. Clearly, we are seeing a broadening economic recovery.

While we will benefit from recovery, our focus is maximizing profitability through initiatives which are under our internal care, custody, and control. Our objective is to significantly improve our core manufacturing efficiencies, while tactically executing our multi-brand front end with keen commercial discipline.

Before I hand over to Mark, I'd like to make a few comments about CENTRIA and the second quarter. I'm pleased to report that the initial phases of integration following the acquisition of CENTRIA have gone well, and we expect our operations will be substantially integrated by the end of our fiscal third quarter. We are aligning our commercial teams within the insulated Metal Panel brands to leverage the value of our extensive product offering across cold storage, industrial, commercial, institutional, and architectural end markets.

We are pleased with CENTRIA's level of new prospects, quoting activity and backlog. The collaborative nature of their sales process lengthens the time to shipment, but we are confident that CENTRIA team will deliver results that reflect their legacy of solid performance, which are in line with our year-end expectations. Speaking more broadly about insulated Metal Panels, we are pleased that our existing Metl-Span business delivered very strong first quarter results on a year-over-year basis.

Our consolidated backlog continues to benefit from strong margins and bookings. The sentiment of our customers corroborates strengthening market conditions. We remain encouraged by the slowly improving economy.

Because the markets we serve are so diverse as the US economy, we have always faced headwinds in some end markets and tailwinds in others. A good example is our exposure to oil and gas. In our Building Group backlog, our exposure to oil and gas has actually decreased to 2.4%, while the overall Building Group backlog has increased by 10% because of tailwinds in end markets I previously mentioned.

At this time, the balance between headwinds and tailwinds modestly favors tailwinds. We believe this will mean that we will deliver year on year improvement in Q2, but probably not to the level achieved in Q1, largely because of disruption from weather in February and early March.

In fact, our early flash report for February indicates that even with the adverse weather that was actually more disruptive to us than the same period last year, we should post year-over-year improvement in February because of our focus on bottom line, supported by commercial discipline, manufacturing improvement, and supply chain management. Furthermore, while our bookings during Q1 were positive but choppy, we nevertheless delivered a 27% year-over-year improvement in February bookings.

Now just a brief word on steel. As longer term investors appreciate, we have a natural steel price hedge within our businesses that counter balance the effect of steel price volatility to our bottom line. Mark will speak more about this shortly.

In conclusion, we believe by staying focused on commercial and manufacturing execution, we can continue to deliver year-over-year growth, and our organizational changes support that objective.

Now Mark will take you through the details of our first quarter.

Mark Johnson - ***NCI Building Systems Inc - CFO***

Thank you, Norm.

In the first quarter, our consolidated revenues increased by 3.9% from the same period last year. The year-over-year revenue improvement reflected higher volumes in our Metal Components segment in addition to the approximately two week contribution of CENTRIA, which added approximately $8.5 million to total sales.

Gross margin in the first quarter increased 320 basis points from the same period last year, reflecting the positive results of operational and strategic initiatives that are beginning to mature. Our focus on production flow, logistics, and supply chain management improved our manufacturing and cost efficiencies.

We also benefited from a higher margin product mix and continued commercial discipline, combined with value oriented pricing. It is also important to remember that the prior year first quarter had been hampered by severe weather conditions, which was not a significant challenge in this year's first quarter.

Our ESG&A expenses were 19.5% of revenue, compared to 19.8% in the first quarter of last year. The inclusion of recently acquired CENTRIA for a small portion of the period added approximately $1.6 million to our ESG&A. The ESG&A costs we have been investing to support growth and productivity initiatives have now stabilized, and these initiatives are beginning to contribute top line and margin growth.

As a result of our revenue growth and margin expansion, we generated an on operating profit in the first quarter of $4.6 million, compared to an operating loss of $3.2 million in last year's first quarter. Our adjusted EBITDA more than doubled to $19.6 million, a 145.3% increase over the same period last year.

Our reported net loss in the first quarter was just below breakeven, a significant improvement compared to a loss of $0.06 per share reported in the 2014 first quarter. Both years have special items, primarily related to acquisition activities, which are reconciled in our earnings release tables.

In pursuing strategic improvements to our business, including acquisitions and restructuring our operations to improve customer focus and operating efficiency, we have been incurring costs which are up unrelated to our underlying operations. To improve transparency and comparability of operating performance between periods, we separately identify special items and disclose adjusted operating income, adjusted net income, and adjusted EBITDA. The tables in our financial release reconcile these adjusted amounts to GAAP reported amounts.

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The recent quarter included $4.2 million in special charges that reduced our operating income. This included $1.5 million related to restructuring our operations and the planned closing of a Buildings plant facility in Tennessee, as Norm mentioned. It also included $1.7 million in strategic development and acquisition related costs, and finally, it included nearly $1 million for short-lived acquisition fair value method adjustments.

With respect to the planned plant closure, we anticipate annual cost savings of approximately $3.0 million per year once complete. Conversely, last year's first quarter included gains from insurance recovery and secondary offering costs that nearly offset each other.

On an adjusted non-GAAP basis, our earnings in the first quarter were $2.3 million or $0.03 per share. Please note that because we generated a profit after adding back the special items in the 2015 first quarter, our fully diluted share count of 74.5 million shares is used in the adjusted earnings per share calculation.

Now I'll discuss some highlights from our operating segments. Our Buildings segment total revenue fell 1.5% to $149.8 million from the first quarter of 2014, and third party sales also fell 1.6%. A portion of the shortfall was related to the falling value of the Canadian dollar, and the remainder was reflective of our focus on higher value project and product opportunities.

Despite the small decline in revenue, our Buildings segment operating income grew meaningfully to $8.7 million, a 432% increase over the prior year. Our operating margin for the segment grew 470 basis points, to 5.8% of revenues.

Improving product and project mix, combined with commercial discipline and production and logistics enhancements, has led to expanding margins. Our Buildings backlog at $299 million finished 10.5% higher than the first quarter of 2014.

Our Coatings segment achieved a 2.5% increase in total sales for the quarter, despite a slight 0.8% decrease in external third party sales. However, segment operating income fell to $4 million compared to the same period of last year, due to a less favorable product mix. We expect to see a more normalized product mix by the second half of this year.

Looking at the performance of our Components division, total sales increased 9.2%, driven by a 10.5 rise in third party sales. Operating income for the components segment more than doubled to $8.3 million, a 102.8% increase over the first quarter last year. Operating margins, which increased by 220 basis points during the quarter to 4.8%, are benefiting from an increasing proportion of value-added insulated panels and improved production efficiency. Since CENTRIA was only included for 16 days during the period, its impact on the results for the quarter was negligible.

Focusing on our balance sheet for a moment, as previously disclosed, we completed the acquisition of CENTRIA on January 16th for $245 million. This acquisition was funded by the issuance of 250 million 8.25% senior unsecured notes. Initially, this transaction increased our net debt leverage to just over 4 times and as we have previously stated, we expect our net debt leverage to decrease to levels at or below the pre-acquisition level of 2.3 times over the next couple of years. Consistent with this leverage reduction commitment, in March following the close of our first quarter, we paid down our existing term loan by $10 million.

Now before I turn the call over to questions, I wanted to make a few comments regarding the cost of steel, one of our primary inputs. Steel prices have declined over the past several months due to weak global demand, the strengthening dollar, and increased output in the US. Recent past cycles have shown that steel price declines have been quickly followed by rapid recovery as producers react with capacity reductions, which we are seeing already.

While we do not expect a sustained period of lower steel costs, such an event would likely stimulate some facets of our demand equation as our opportunities to displace other forms of construction would increase. Historically, the impact of steel price volatility on our earnings has been muted by the complementary nature of our integrated business model. We refer to this internally as our “natural hedge.”

Each of our segments' gross margins generally is impacted by steel price fluctuations, but the impact tends to be in opposing directions and offset each other at the consolidated level. Our consolidated cost of materials in our first quarter was not materially different from the first quarter of 2014, but we expect that based on previously announced price decreases by steel producers, our costs in the second and third quarter will decline sequentially before potentially increasing again in our fourth quarter.

While this should not impact our consolidated gross margin contribution in a material way, declining steel cost has typically caused downward pressure on revenue in the near term as the market reacts to lower input costs. As a result, while the revenue growth we expect in the near term may be a few percentage points lower than it otherwise would have been, we nevertheless expect continued underlying year-over-year revenue growth for FY15. This growth expectation is consistent with the underlying increase evidenced in our bookings and backlog, and as Norm said earlier, the net tailwinds are modestly outpacing the headwinds that we face.

Given our first quarter results, and the second quarter expectation for continued but lower year-over-year improvement, we believe we should have solid year-over-year improvement for the first half which sets us up well as we enter our seasonally stronger second of half. Finally, I want to remind you that I have provided some supplemental commentary on our performance and guidance on certain financial items in the CFO Commentary available on our website and filed as an 8-K.

Now, operator, I'll turn the call back over to you for questions.

QUESTION AND ANSWER

Operator

Thank you.

(Operator Instructions)

Our first question comes from Winnie Clark with UBS. Please proceed with your question.

Winnie Clark - ***UBS - Analyst***

Good morning.

Mark Johnson - ***NCI Building Systems Inc - CFO***

Good morning.

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

Good morning.

Winnie Clark - ***UBS - Analyst***

So execution on your initiatives, outstanding once again. However, sales were a bit weaker than I expected, given the booking and backlog trend you've been seeing. Can you address how business progressed through the quarter? Because I think you got off to a pretty good start in November, but I assume conditions softened a bit in December and January? And then, any color you can provide on Q2 to date would be great.

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

It was choppy as I said. We started off strong in November, a little weaker in the middle, then it started to pick up in January. And February, bookings were very good, up 27% as I said. We don't expect that trend to change a whole lot, meaning the trend of choppiness. However [it appears]. But at the end of the day, we're still pleased that it drove an increase in our backlog in our Buildings Group by 10.5% or so, which is good. Of course, our backlog doesn't reflect the backlog that we have in CENTRIA, and we'll be talking about that next quarter.

Winnie Clark - ***UBS - Analyst***

Okay. Great. That helps. And then you talked a little about some end market performance. Any notable weak spots by end market? And then maybe if you could give us some color from a geographical perspective, that would be great.

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

So as I mentioned in the script, the softness is certainly in oil and gas. And as I said, in our backlog it went down to 2.4%. But other end markets, and they are quite broad as I said.

What we find is that we're talking about a real cross-section of the economy -- commercial warehousing, retail. We're seeing considerable amount of growth in grocery stores. We're seeing manufacturing continue to be quite a large part of what we do. And garages. And the whole range of government. I mean, which includes both local and state. Churches are up and recreational is actually quite strong as well.

Winnie Clark - ***UBS - Analyst***

Maybe just on geography, you mentioned I think the Northeast has been quite strong, and as well as the south. Anything changing on a geographic perspective?

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

South central, Southeast, and the west is picking up some. The Northeast, particularly in the New England area, was really quite strong early, and it's not bad now but of course it's disrupted like crazy by the snow.

Winnie Clark - ***UBS - Analyst***

Okay. Great. Maybe if I could sneak one quick one on CENTRIA. Been a part of the portfolio for a couple months. Sounds like integration is progressing well. Are you feeling more optimistic about the synergy opportunity there? And also curious on what sort of opportunities you have to drive sales synergies as well?

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

One of the things we are seeing is their prospects are increasing. It's clear that they are later -- I should say earlier in the cycle of recovery and, therefore, are a year or two behind us in terms of the recovery. But boy, we like what we see. It's a fabulous team across the board, and we're very, very pleased. The integration's going well. They were a private company. Now they're a public company.

So that's changes, as you can imagine, to all the things we do in terms of monthly reviews and forecasts and all that kind of stuff. But it's moving along really very well.

Winnie Clark - ***UBS - Analyst***

Great. Thanks so much and congratulations on a strong execution quarter.

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

Thanks, Winnie.

Operator

Our next question comes from Lee Jagoda with CJS Securities. Please proceed with your question.

Lee Jagoda - ***CJS Securities - Analyst***

Hi, good morning.

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

Good morning, Lee.

Lee Jagoda - ***CJS Securities - Analyst***

Just going back on steel pricing, I know you said -- you mentioned that gross margin in total shouldn't be affected because of the natural hedge. On a segment basis, is there any pull in one segment and push in another that kind of evens it out? Or is it even by segment as well?

Mark Johnson - ***NCI Building Systems Inc - CFO***

Sure. You know, there is a variance between the segments. They do operate in opposing directions. That's what creates the natural hedge, if you will. And what we tend to see is expanding margins in our buildings group and contracting margins in our components and coatings group.

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

When steel prices go down. And the reverse when steel prices go up.

Lee Jagoda - ***CJS Securities - Analyst***

And then switching gears to CENTRIA, do you happen to have the Q1 pro forma as if it were part of your business and their growth on a year-over-year basis at CENTRIA?

Mark Johnson - ***NCI Building Systems Inc - CFO***

We have this similar concept when we acquired Metl-Span. We very quickly integrated the business into our operations, and it became very difficult for us to separate the performance of the pre-acquisition operations from the combined operation. So it's not going to be our intention to break the results for CENTRIA out separately and speak to those. So we don't provide that information.

Lee Jagoda - ***CJS Securities - Analyst***

Okay. And then one more, Mark, and maybe I'll hop back in queue. The amortization that's going to be hitting related to CENTRIA in the next few quarters, is that going to hit the segment margins for components or corporate? And how do you expect that on a quarterly basis for the balance of the year?

Mark Johnson - ***NCI Building Systems Inc - CFO***

Sure. I gave guidance in the CFO Commentary on this point. We expect to see the amortization be approximately between $4 million and $4.5 million in the second quarter, and I would expect that level of amortization to continue through the end of the fiscal year before it drops down. The reason that it's elevated initially is because there's some very short-lived intangible assets that are accounted for through purchase accounting that get amortized over a very short period, like nine months.

It will continue in that $4 million to $4.5 million range for the rest of 2015, per quarter, and then drop down to around $2 million, $2.1 million going forward from that point. Those costs will be reflected in the component segment because that's where CENTRIA currently is. We are currently evaluating the segments and if we do elect to change our segment reporting, which we may or may not do, we would give some advanced thoughts on that and disclose historical information on segments before we get to our next Earnings Release.

Lee Jagoda - ***CJS Securities - Analyst***

Terrific. I will hop back in queue.

Operator

Our next question comes from Trey Grooms with Stephens Incorporated. Please proceed with your question.

Drew Lipke - ***Stephens Inc. - Analyst***

This is actually Drew Lipke on for Trey. My first question kind of goes back to if you look at organic growth in the quarter, look like it was up a little over 1%. You guys have done a fantastic job driving margin expansion, and a lot of that's come from the commercial discipline that you've put across. Can you talk a little bit about sort of the competitive environment that you're seeing? And particularly as it relates to the buildings group, where I think volumes there were down around 7%.

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

Yes. So what we see is kind of a continuation of last year, in that we are focused on value and quality, and have set that up so that, that really is the way that we're working with our customers and looking for those opportunities, and the market's been quite good to us in that respect. We clearly have been able to increase our value, but the commercial discipline is really one part of it.

I got to tell you that increasingly, we're seeing the value of the manufacturing and supporting the notion of value is totally kind of moved that equation. And that, coupled with the supply chain and really getting even more focused on delivery of materials and all aspects of supply chain management are really the story. And I think going forward, you're going to hear us talking more and more about manufacturing supply chain management and commercial discipline.

Drew Lipke - ***Stephens Inc. - Analyst***

Okay. So I guess as a follow-on to that, I guess you saw 90 basis points of improvement from that production and logistics efficiency improvement, looks like Don Riley's done a very good job there. Can you maybe talk about what inning we're in on that front? How much more room you see to go, there?

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

So, John Kuzdal's the one that did that. Don Riley is at bat right now. He's off to a great start, I hasten to add. Every time I think I know that we've kind of been able to draw a kind of -- a box around what the possibilities are, Kuzdal and the guys come up with something else that is -- it is just within the context of, as we continue down the path, we find more and more opportunities to do small things. But small things that really do add up.

So as I've said a bunch of times and I mean this very sincerely that before we started this process on the reorganization of manufacturing, I thought that we had only had opportunities that were marginal -- that were on the margin. I'm now convinced, and more convinced all the time, that it's much more fundamental than that. So we look forward to the next few months and it's one of those things that as we do things like we did, we'll tell you all about it.

Drew Lipke - ***Stephens Inc. - Analyst***

Okay. And then just one last one from me. Now that you have had CENTRIA kind of in the fold for the last five weeks or so, and as you kind of talk about that mid-cycle EBITDA range of $280 million to $350 million, how has CENTRIA adjusted that range in your opinion?

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

Well, I tell you, it's just like some of our initiatives have maturities that are later in the cycle recovery. I think that's where CENTRIA is. I think that we will see their markets continue to recover during the course of this year. The collaborative sales process that they have is different than all other parts of our business and they are fabulous with this, really incredibly strong. What that means is that the prospects and how they're working them now will build their backlog and when we share that with you, it's a considerable number. And that then becomes work that they will ship over the next couple of years. Their backlog gives them much longer visibility than our backlog does.

So my point is this, is that we're really happy with where they are. We're really happy with the integration and getting used to being part of a public company and that will continue and will pay big dividends at mid-cycle, in mid-cycle which we know is 1.3 billion square feet. We're heading in that direction. What year we get there, whether it's 2018 or something like that, which McGraw-Hill was kind of forecasting. That will play out very well for where our CENTRIA folks will be.

Drew Lipke - ***Stephens Inc. - Analyst***

Okay. Thanks, Norm.

Operator

Our next question comes from Robert Wetenhall with RBC Capital. Please proceed with your question.

Collin Verron - ***RBC Capital Markets - Analyst***

This is actually Collin filling in for Bob. With the CENTRIA acquisition, can you speak about its revenue contribution, EBITDA contribution in terms of seasonality? Is it going to follow a similar [suit] to what your legacy business has, where it's 60% to 90% of EBITDA in the back half of the year?

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

It's at least as seasonal as we are. It may even be more seasonal. It's kind of like when you think about it, they're in bigger projects, and those bigger projects kind of start as soon as the weather is good enough, but they go on a lot longer. And often times the finish work CENTRIA does is later in the process. So it gives us, we think, a little buffering to some of our cycles, but at the end of the day it is a great product and they do some amazing things.

Collin Verron - ***RBC Capital Markets - Analyst***

Great. And for the Building segment, in the second half, you guys really started to see a price increase due to mix and pricing initiatives, then you saw a corresponding decline in volumes. Are you expecting the back half of 2015 to see some volume growth, given that you're going to have some pretty easy comps on the volume side?

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

That's a good question, and the answer is yes, we are. I think that when you look at their backlog up 10%, and if we're able to continue that pace of growth even though we've said publicly that we don't expect our -- we expect the market to be mid-single digits. If the team in Buildings can continue to be very disciplined and continue to sell value, we think there are actually increasing opportunities in the market, and that's what we're looking for.

But I think it would be wrong for you to think that we're not going to increasingly see a very real contribution from both supply chain as well as from manufacturing. Part of this notion about manufacturing is, when you talk to the operating guys is that -- holy smoke, they are able to sell value because our service levels out of our manufacturing plants are so improved. And I tell you, there's no better way to differentiate ourselves than that.

Collin Verron - ***RBC Capital Markets - Analyst***

Great. Thank you.

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

You're welcome.

Operator

Our next question comes from Will Randow with Citi. Please proceed with your question.

Scott Schrier - ***Citigroup - Analyst***

Hi, good morning, this is Scott Schrier, in for Will. I want to talk about coatings and the margins there. What was the effect of the lower steel prices on those margins, there? And then what was the effect of mix? And what gives you comfort that you said later in the year, the mix will return to more of a normalized state where you'll have the better margins?

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

Steel prices really had no impact at all. It really came down to -- I'll be frank, some poor decisions. We made some poor decisions on particular jobs and market opportunities that we thought were going to be beneficial to us, and they weren't. And we ended up making adjustments before the end of the year. Those adjustments are in place.

We are seeing success on the restart, and when we look forward, we see that our team there, led by Dan Happel, will be producing the historical normal results by our second half. And we can see it in the kinds of work that we're now looking at and getting opportunity to win. So that will be coming down the pike.

Scott Schrier - ***Citigroup - Analyst***

Great. And then if I can ask possibly the Buildings question a different way. Obviously you had very strong margin growth year on year. And what's the breakdown of that between just overall -- just pricing and then the complexity angle of it? And given that if you have capacity left in the pipeline, can you kind of take on the higher complexity projects and also fill up your capacity a little bit with some of the more simple projects, albeit at a lower margin?

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

That's really -- that's actually a very good question. And the reason why it's very good is oftentimes we don't get a chance to speak about the difference in the complexity range. The lower complexity work we are getting really very much more into an automated stage, and have really done some interesting things which make our builder network better able to actually take on the smaller jobs, which they would normally not be that interested in. And we can deal with those he very effectively at lower margins because that's what that market kind of sells at. But do very well with it, because we're much more efficient in the way that we process those orders. So, we're kind of doing that already.

It's no question about the fact that we've seen in the last six months or so an increase in complexity of work, and the kind of engineering capability that we have is best suited for that kind of -- what we refer to as design/build approach. Where we're working with the general contractor and our builder to come up with an approach that is better and more effective for them. And so from that standpoint, we do see opportunities. But I want to tell you that the work that John Kuzdal and the team have done on the manufacturing efficiencies do give us the capacity to take on more work. But we're loathe to do so in something that doesn't reflect the commercial discipline that we think is ultimately important. So we're going to try to continue down the path with team discipline, but also exploit those opportunities that we have the chance to.

Scott Schrier - ***Citigroup - Analyst***

Great. And if I can get one last one in. I wanted to follow up on Winnie's question on geographies, and more specifically, what are you seeing as far as demand in the oil producing states? Not so much on the oil and gas side, but just, say, non-res?

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

Sure. When you think about Marcellus Shale, which is one of the largest geographic oil and gas plays in the world, it actually resembles the North Sea. It's an amazing opportunity for us. When we look -- when I look at those numbers, I can see Marcellus Shale, that area, which is more of a rural approach, is down. And in fact, all of the oil and gas areas are down, with the exception of Permian. The Permian Basin is actually -- continues to do well. What that reflects is the Permian is much more mature. So there are lots of other things that go on in the Permian besides just oil and gas.

When we look at building -- when we look at building activity in Houston and Oklahoma, it continues to be pretty good. Our team here has done a nice job. In fact, their first quarter, the brands that are here were very strong. But it's clear that, that is a result of recognizing that the oil and gas opportunities are fewer and fewer and will continue to be fewer and fewer, and I'm pleased already to see that other aspects of the economy are up. So we'll see how it plays out. But it's certainly in the -- it's maybe even a little better than I thought it was going to be in terms of the broader economy compensating for the down move in oil and gas.

Scott Schrier - ***Citigroup - Analyst***

Great. Thank you very much, and nice quarter.

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

Thank you.

Operator

Our next question comes from Brent Thielman with DA Davidson.

Brent Thielman - ***DA Davidson - Analyst***

How are lower steel prices you're seeing now changing how you bid projects today on the Building systems side of the business, if at all?

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

They generally -- steel is a part, a big part of their sales, but their sales are driven more from a standpoint of delivery, of timing, of the complexity of the building, the value of the engineering. So, there are other things that go into that equation besides just the steel. It's clear that the -- whatever the input costs are, whether they be transportation, steel, or something else, are part of the market. But the market responds in different ways, and it can be a selective area of supply and demand. It can be the complexity of the work that fewer of us can do.

So it's hard to take a broad view of trying to homogenize what the impact is. At the end of the day, we continue to really try to price the value of what we're selling, and the value we can create for our builder and the end market user. That's kind of where we're at.

Brent Thielman - ***DA Davidson - Analyst***

Okay. And the potential to he see some substitution for other methods of construction, I know it's early, but in the past how long does it take before you start to see clear-cut evidence of that, as steel costs come in at least relative to other materials?

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

What you find is that -- this is I think really important to people that are newer to the story. We see volatility in some description every year that has more to do with seasonality in terms of steel prices. Okay? It is the situation where steel either amplifies to a very high price and the market perceives that it's going to take -- it's going to come down, it's going to take longer to get back to more normalized levels. You will see then some pressure and some opportunities to replace things like tilt-up wall. But if the market believes that the steel prices are going to recover as we do by later in the year, then you find that opportunity to displace is not quite as sustainable. But there's no question the fact that what we look for are products that can compete more favorably, and tilt-up wall is a great example.

That's a great product. It's fast, it's cheap and cheerful. It's not very robust in terms of insulation. It's kind of crappy in that respect.

But, when we match up with insulated metal panels and can offer an inside wall, outside wall, -- I mean, sorry, plus the insulation, wow, we're beginning to look at a product that when someone is taking on a building for that, that has life cycle costs, like they're going to own it, they're much more interested in buying our product. So we're looking for opportunities to displace that's for sure, but I got to tell you, we're not simply waiting for steel prices to go down or do other things.

Brent Thielman - ***DA Davidson - Analyst***

Sure. Okay. And then not to dwell on the short-term here, but in terms of kind of progression of Q2 and others have talked about the challenges around the country, did you still see growth in February, or was it flat or down? Any color there?

Norm Chambers *- NCI Building Systems Inc - Chairman, President, & CEO*

That was the point I tried to make. When we looked at February of last year, and we looked at the weather conditions, actually right until the 9th of March, it was a really crappy period, and when we looked at the amount of disruptions we've had in that same period, it was actually more this year. Last year we struggled like crazy.

This year, we had year-over-year -- it's a flash report, but it's indicating year-over-year growth. Not as much as we would have gotten or expected had we hadn't had the weather, but I'm quite pleased that we were still able to show the year-over-year growth, and that's why we are confident that the second quarter will continue in that vein.

But it will be undoubtedly less than the first quarter. Because first quarter had great -- first quarter had really great weather, and just a kind of subset on that, when I tried to compare back to a period that was similar to see how much was the difference in the weather, what's interesting is the first quarter 2012 compared to the first quarter here is very similar in terms of the weather. And this first quarter was better than the first quarter of 2012 by volume being 18% up, revenue being 29% up, and operating income being up 98%. So I kind of feel really good that it wasn't just the weather, that we were doing some other things besides.

Brent Thielman *- DA Davidson - Analyst*

That's good to hear. One last one if I could. In terms of returning kind of net debt leverage, Mark, I think you said 2.5 times -- correct me if I'm wrong, over the next two years. Would you prioritize that over doing additional deals at this point?

Mark Johnson *- NCI Building Systems Inc - CFO*

Well, I think we're always interested in doing the right things that drive value for the various stakeholders. But it obviously sets a fairly high hurdle. A new deal has to look really, really accretive, very valuable in order for it to compete with that.

Brent Thielman *- DA Davidson - Analyst*

Okay. Thanks, guys.

Operator

(Operator Instructions)

Our next question comes from Sam McGovern with Credit Suisse. Please proceed with your question.

Sam McGovern *- Credit Suisse - Analyst*

Hey, guys, thanks for taking my questions. Just to follow up on the last line of questioning, in terms of leverage. I know you guys mentioned that in March you guys paid down about $10 million of the term loan. Should we expect in terms of cash flow in the near term, you guys will just continue to chip away at the term loan, or do you guys just expect to build cash?

Mark Johnson *- NCI Building Systems Inc - CFO*

I think you will see us demonstrate our commitment to debt reduction throughout the remainder of 2015. I wouldn't try to put a specific guideline out there for that. I just think you'll see that in our actions.

Sam McGovern *- Credit Suisse - Analyst*

Got it. And then, as you guys sort of make your way towards that debt target, the leverage target that you guys have put out there, we should expect that to not just come from EBITDA growth, but actual debt reduction over time? Just to confirm that.

Mark Johnson *- NCI Building Systems Inc - CFO*

Absolutely, it's a combination of both.

Sam McGovern *- Credit Suisse - Analyst*

Got I it. Thanks so much. I'll pass it along.

Operator

Our next question comes from Lee Jagoda with CJS securities.

Lee Jagoda *- CJS Securities - Analyst*

A couple more from me. You were saying that through Q2 thus far you're seeing growth. Is that in terms of volumes? Tons? Revenue? Can you kind of give us a little more detail?

Norm Chambers *- NCI Building Systems Inc - Chairman, President, & CEO*

So what I'm saying, it's consistent with what we're focused on, which is focused on the bottom line. Okay? So what we're seeing is a result of manufacturing and supply chain and commercial discipline, we are having year-over-year growth even in the face of weather conditions that are more adverse than last year. Okay? That's in the flash report. That's what it is. So we're pleased about that.

Lee Jagoda *- CJS Securities - Analyst*

Okay. And then just on the components side, do you have the mix of single skin versus insulated metal panels, comparing this year versus last year? And then the mix in your backlog going forward?

Norm Chambers *- NCI Building Systems Inc - Chairman, President, & CEO*

Well, there's no -- very little components in our backlog. And that would be -- our insulated metal panel piece is what probably brings that -- is that 7%. So the insulated metal panel piece from the components is actually in our consolidated backlog, which is up 7%. Okay. And the buildings backlog is up 10%.

So what I will tell you is that our legacy components business was, as I hope I said at the end of the year, was the best performing business brand in all of our brands for the second half of 2014. It continues to do very well in a fragmented market, where the team over there led by Bill Coleman is doing a first class job in terms of both sales and growth and profitability. And I'm really pleased, because that's one of the more difficult places we have because it's a fragmented marketplace.

Lee Jagoda *- CJS Securities - Analyst*

Sure, and then one last one on the building side, and I'll be done. Given that most of the higher value, more complex building projects have typically -- typically have longer lead times and they'll be in backlog for a while, how do you deal with price escalators, or price concessions based on steel? Are you able to pre-buy or buy steel better on those projects? How do we think about that dynamic in Q2, Q3 and Q4, assuming steal prices stay around current levels?

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

Sure. On most work, we are able to manage the inventory turns with what we have in backlog, and we have within our contracts and backlog the ability to change our prices, based on steel price going up. Okay? So we have some protection there.

I will tell you that the relationships we have with our builder network, and our best builders have been with us on average for 30 years, we end up in a conversation. But over the years since steel prices got to reach some volatility, which is now 11 years ago, our dealer network is much better at dealing with this as well. So there's not quite the angst.

My point is, that we deal with that pretty effectively. When it comes to big, complex work, if there is a lot of steel to buy and that job is out there, 6, 9, 12 months, we will oftentimes contract so that we do not take steel price risk. In certain circumstances, we've actually gotten the end user to pre-buy steel for the job, and to free issue that. We go about that in a variety of different ways.

Lee Jagoda - ***CJS Securities - Analyst***

Great. That's very helpful. Thank you.

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

You're welcome.

Operator

Our next question comes from Gregory Macosko with Montrose Advisors. Please proceed with your question.

Gregory Macosko - ***Montrose Advisors - Analyst***

Yes, good morning.

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

Good morning, Mr. Macosko

Gregory Macosko - ***Montrose Advisors - Analyst***

Nice margins. Very well done, there.

Could you talk a bit about Tennessee? Tennessee, there's completed some restructuring, there. Are we pretty much done with that in terms of margin improvement? Or is there -- I realize there's always ongoing improvement going to happen, but could you talk about any projects of that magnitude, going forward?

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

Well, we really are very sensitive about this, both from a competitive perspective and just until we're really certain something really does pencil out, make a lot of sense. There were just so many opportunities for us to actually look at our distribution of plants and to think about them as if we were starting with a clean sheet of paper as opposed to being a Company that merged in 1998 with component plants and building plants.

And as all kinds of things from simply shifting equipment from one area to another and plant and utilizing it different way, to thinking about our supply chain too, in the case like in Tennessee where it made sense for us, where we had three plants within 150 miles to consolidate. Right? So John Kuzdal and his team are looking at all aspects of that to really determine what's best for us to have a manufacturing platform that best fits what we see for market growth now and in the future.

Gregory Macosko - ***Montrose Advisors - Analyst***

And then with regard to CENTRIA, do you see any consolidation or even expansion with regard to the sales force by joining -- when CENTRIA comes fully integrated?

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

I tell you, it's because their business is very different, we don't see a lot of synergies in terms of cost reduction on kind of front office or back office, because they're very distinctive. We do see some really good synergies in terms of some of the supply chain aspects, some really good ones. And we see some others in terms of leveraging our sales channel rationalization. We think there's some really good opportunities within the sales channels in terms of products and utilizing our plants in a much more effective way. So that looks good to us. And of course there's been a level of consolidation in that part of the industry, which we'll see how that plays out.

Gregory Macosko - ***Montrose Advisors - Analyst***

And then finally with regard to the second quarter, you mentioned that sounds like you're reasonably pleased with how things are going in terms of the growth rate. Yet it's a little bit slower than the first quarter improvement, and you explained that. Is any of that affected by the steel pricing that you mentioned, that when steel prices come down, I guess customers delay, et cetera. Are you feeling any of that? I would assume that would be somewhat of a short-term issue.

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

I don't think we'll see any effect on steel prices in Q2. Maybe a bit on the tail end. But I just don't think it's going to materialize. And again, I think that if the market perceived that the US economy was actually slowing and, therefore, non-res was slowing further, right? Then I think you might see some more systemic change. Okay? But that's not the case. That's not the case. So we think we'll see normal levels of seasonality.

Gregory Macosko - ***Montrose Advisors - Analyst***

Thank you, Norm.

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

Thank you.

Operator

Thank you. At this time I would like to turn the call back over to Management for closing comments.

Norm Chambers - ***NCI Building Systems Inc - Chairman, President, & CEO***

Great. We thank you for participating in the call and we look forward to speaking to you in the not too distant future.

Operator

Thank you. This does conclude today's teleconference. You may disconnect your lines at this time, and have a great day.