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NCS - Q1 2016 NCI Building Systems Inc Earnings Call

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PRESENTATION

Operator

Greetings and welcome to the NCI Building Systems first-quarter 2016 earnings conference call.

(Operator Instructions)

As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Darcey Matthews, Vice President of Investor Relations. Thank you. You may now begin.

Darcey Matthews - *NCI Building Systems, Inc. - VP of IR*

Thank you, Rob. Good morning and welcome to NCI Building Systems' call to review the Company's results for the first quarter of FY16. The Company's first-quarter results were issued last night in a press release that was covered by the financial media.

In keeping with the SEC requirements I'd like to advise that during this call we will be making forward-looking statements that 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 we filed last night. We undertake no obligations to update any forward-looking statements beyond what is required by applicable securities law.

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

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

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

Good morning, everyone, and welcome to our first-quarter 2016 conference call. Joining me this morning are: Mark Johnson, our Chief Financial Officer; Todd Moore, our General Counsel; and Darcey Matthews, our new Vice President of Investor Relations. We're pleased to welcome Darcey to our team. Darcey has a strong capital markets and investor relations background, and I'm sure she'll be reaching out to you over the next several weeks.

Our first-quarter earnings were released last night. I plan to give a few brief comments before I hand the call over to Mark who will offer some color on our first-quarter financial performance. After that we'll be happy to take your questions.

I would start by conveying four messages that have been unfolding over the past several quarters. First, I'm pleased to report that our first-quarter financial performance continues the trend that we started 21 months ago, marking the seventh consecutive quarter of year-over-year improvement in gross profit margin and adjusted EBITDA. Our performance is the direct result of both the reorganization that we started just over two years ago and our focus to add new talented leaders from outside our industry to join our industry veterans to form a more focused and competitive team.

Second, and maybe more importantly, our first-quarter performance improved largely as planned and was the result of focused execution across our commercial manufacturing supply chain operations. We were able to deliver on internal and external expectations despite operating in an environment of a declining nonresidential market and falling steel prices, cyclical headwinds that have historically challenged us. Our organization, particularly the commercial manufacturing supply chain operations, are now better integrated, enabling us to collect, analyze and take data-driven actions with better clarity and speed, to both anticipate and mitigate cyclical headwinds.

Third, I'd like to highlight an item that we have mentioned before but deserves some attention, our coatings strategy. As you may remember, our internal demand from our components and building business segments benefits the coatings segment by base loading the coating plants. Since the second quarter of 2015, we have expanded our operating margin in this segment by approximately 400 basis points, led by an improving non-family customer mix and by leveraging our internal demand. This has led to increased plant utilization, including a 16% increase in the first-quarter internal volume processed through our painting and coating plants.

Fourth, we are very pleased that the growth of our insulated metal panels product lines contributed 25% of our first-quarter sales and 41% of the EBITDA.

As far as our consolidated financial results are concerned, we achieved our best first-quarter performance since 2008, delivering a 48% year-over-year improvement in adjusted EBITDA. We expanded our adjusted EBITDA margins by 180 basis points as we continue to take advantage of the operating leverage created by volume increases that drive greater capacity utilization. The significant contributors were our buildings group and legacy single-skin component brands, which generated a combined third-party volume increase of 8.7%, excluding the impact of the CENTRIA acquisition.

Now, before Mark dives into the numbers, I'd like to share some thoughts about 2016. Our overriding objective continues to be the expansion of our gross margins through our internal initiatives of commercial discipline, manufacturing efficiencies, and supply chain operations. Given our internal talent and available resources, we expect to improve our performance to further mitigate the cyclical and steel volatility impacts on our results, while capitalizing on new market opportunities to grow our business.

That said, we do expect the market may have further choppy periods during 2016, given the current subdued growth in nonresidential construction and the constrained economic recovery. I must say that the choppiness I reported last quarter has somewhat abated. We have seen book volumes increase in January and February, quoting activity is strong, customer sentiment is good.

Additionally, the leading indicators that correlate most closely to the actual volumes of low-rise new construction starts are the ABI Mixed-Use Index, residential new starts, and the leading economic indicator. When taken together, these indices point to single-digit growth for low-rise construction in 2016, with much of that growth occurring in the second half of our FY.

Regardless, we remain committed to managing areas we can control and growing faster than the low-rise market. We are focused on achieving year-over-year improvement quarter by quarter in order to create a better valuation for the benefit of all stockholders.

Now, Mark will take you through the first-quarter numbers in more detail.

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

Thank you, Norm. As a reminder, we have provided a review of our first-quarter 2016 financials in both the earnings press release issued yesterday and the CFO commentary posted on our website. I'll now take a few minutes to add some additional insight to those results.

As Norm mentioned, the first quarter of this year included similar conditions that we have faced over the past several quarters. Steel prices, measured by the three-month average CRU index, have fallen by approximately 26% from last year's first-quarter level, and the nonresidential construction market continues to be choppy. That being said, our 2016 first-quarter performance was the best first quarter we have experienced since the downturn in 2008, meeting our expectations and benefiting from the past two years of improvement initiatives and investments in our insulated panel product line.

Adjusted net earnings for the quarter were ahead of the street consensus and were significantly better than last year's first-quarter results. The key drivers of the improved results were both volume growth and margin improvement. We achieved underlying volume growth in all of our buildings and components product lines, which led to improved operating leverage.

Further, we continue to realize the positive results of optimizing our manufacturing footprint and production efficiency, combined with the integration of our supply chain with both our commercial and manufacturing operations. Accordingly, our gross margin expanded by approximately 190 basis points during the quarter to 24.2% of sales, and our adjusted EBITDA was a new record high for a first-quarter period since the downturn began in 2008.

Our reported net income in the first quarter was $5.9 million or $0.08 per diluted share, compared to a loss of $0.3 million or zero cents per share in last year's first quarter. We endeavor to separate special items, whether positive or negative, from normal operations to increase the transparency and understanding of our operating results. These items generally stem from our efforts to improve our business, either through strategic combinations or restructuring existing operations to improve customer service and lowering our continuing cost base.

Both years included a few special items, which are reconciled in the tables accompanying the release. The net impact of the special items on the 2016 first quarter added about a penny to our diluted earnings per share.

On the positive side, we incurred aftertax gains of $2.3 million related to a bargain purchase gain from the acquisition of an insulated panel plant in Canada and a gain on sale of an industrial facility in California. These items were offset by aftertax charges totaling $1.3 million for restructuring and severance costs and strategic development expenses related to acquisitions that have now been completed. Last year's results were impacted by $2.6 million of similar charges.

Now to our operating results. In the 2016 first quarter our consolidated revenues increased by approximately $47 million or 15% from the same period last year. This was on the high end of our expectations that we presented during our fourth-quarter earnings call. The CENTRIA acquisition contributed $45 million of this growth.

Even while we remain committed to maintaining commercial discipline across all of our product lines, the passing through of lower steel costs to our customers reduced our revenues by approximately $15 million as compared to the first quarter of the prior year and, as a result, the reported increase in our revenues is not reflective of the higher underlying increase in business activity. Adjusted for CENTRIA, pro forma year-over-year external volumes, measured in tons, rose by a total of 4%, including a 6% increase in our building segment and an 8% increase in our components segment.

Still, the growth in our sales volume is particularly notable given the currently reported 10% decline in low-rise nonresidential construction starts according to the most recent Dodge reports. While these numbers tend to be subsequently adjusted, based on past adjustment activity, we expect the final reported starts would be flat to slightly down on a year-over-year basis. As you know, our revenues have historically been highly sensitive to changes in the low-rise market and we are committed through our initiatives and investments in our insulated metal panel product lines to outperforming the market growth for low-rise nonresidential construction activity.

Despite the continued headwinds in the first quarter, our adjusted operating income almost doubled from the prior year to $16.7 million, while our adjusted EBITDA for the quarter of $29.1 million increased by nearly 48%. These positive results reflect our growth in underlying volumes, margin expansion, and supply chain gains.

We are pleased with the level of booking activity we are seeing in January and February, though the bookings for the preceding several months have been choppy. We continue to expect to see growth in bookings over the course of the year, particularly when looking at underlying tonnage volumes. Our buildings backlog ended the quarter at $305.6 million or 6% higher than the year-ago period.

In January, we announced Board authorization for a $50 million stock repurchase program. During the quarter we used cash to buy back approximately 386,000 shares at a cost of $3.9 million. Through March 3 we have spent an aggregate of $11.3 million to repurchase a total of 1.1 million shares at a weighted average price of $9.96. This leaves approximately $38.7 million available for future buybacks under our stock repurchase plan. We manage the business for the long term and will continue to return value to shareholders through share repurchases from time to time, depending on market conditions.

Now let's take a brief look at some items on our balance sheet. We ended the quarter with a cash balance of $73.8 million, compared with $99.6 million on November 1, 2015, reflecting a net use of cash for debt reduction, stock repurchases, capital expenditures and a small plant acquisition.

During the first quarter we paid down another $10 million of long-term debt. Our net debt leverage ratio at the end of the first quarter was 2.6 times, basically flat sequentially. And we continue to work towards the preacquisition level of 2.2 times.

Turning to our outlook, we have continued to outperform the low-rise construction markets and delivered meaningful year-over-year improvements in both gross margin and adjusted EBITDA during the first quarter. We expect the successful execution of our restructuring efforts to generate between $15 million and $20 million of annual cost savings in phases over the next 36 months.

Our streamline management and operating structure and ongoing efficiencies should propel internal growth and position us well for any improvement in the macro environment. And while the current market data continues to show subdued activity in nonresidential markets, the leading indicators for nonresidential construction activity continue to indicate positive growth for FY16.

We began 2016 with a solid backlog that reflects steady demand for higher margin architectural and insulated metal panels. Over the course of this year, we will continue to look for opportunities to trim costs, eliminate redundancies, and align our capabilities with our customers' needs. We expect to deliver our eighth consecutive quarter of year-over-year improvement in gross margin and adjusted EBITDA in our second fiscal quarter.

We expect our second-quarter revenue to range between $350 million and $370 million. And our gross profit margin is projected to range between 22.5% and 24%, as we enter the slower part of the construction cycle and face the typical disruptions from seasonal weather.

Finally, with the first quarter behind us, we remain confident that 2016 will be a better year than 2015 in terms of both gross margin and adjusted EBITDA. And similar to past years' seasonal trends, we expect our second-half performance in FY16 to be stronger than the first half.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question today is coming from the line of Mike Dahl with Credit Suisse. Please go ahead with your questions.

Matthew Bouley - *Credit Suisse - Analyst*

Hi. This is actually Matthew Bouley on for Mike. Thank you for taking my questions. You discuss some of the mix leading indicators for non-res activity, but it sounds like you're currently still seeing some healthy bookings, and you've continued to outpace the market in terms of volume. So, if we were to see some further slowness in end-demand, just what are your thoughts on continuing to outgrow the market? And if you're seeing lower steel prices, perhaps making your product more attractive versus other categories. What else are you doing to address the slowdown and continue to outgrow the market? Thank you.

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

One of the things that is the case is that most of our distribution channels, particularly for our components group, our insulated metal panel group, and our buildings group, are oftentimes generalists. By that I mean they participate in all forms of the non-res market, which is dominated, as you know, by commercial, industrial and institutional activities.

For instance, this past quarter we saw that the commercial and institutional piece was up really quite well when we look at our shipments for the quarter, and industrial was down. We found that the mountain areas, New England, the Pacific and the south Atlantic areas did well, and particularly the West Coast and south Atlantic in particular.

My point is that we benefit, as you know, from having lots of small customers that work throughout the country in local markets and tend to take advantage of whatever aspect the economy is providing opportunities. So that's a big thing.

I think that, and I haven't seen the most recent data, but it would not surprise me that metal buildings and components are probably increasing share of the non-res market to some extent, and that is a direct result of the low prices. Now, as Mark said, we expect to see the price of steel increase during the course of this year. Mark may add some more color to that. But that's an important part of what's going on, as well. Mark, do you want to just talk about what's happening with steel?

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

Sure. Year over year today steel for our first quarter was down about 26% as measured by looking at the CRU. While steel prices are increasing, they're off their bottom by as much as 8% right now. The year-over-year comparison actually looks worse when you get into Q2. So, you'll actually see us go to as much as 30% lower year over year in the second quarter but sequentially it will be marginally higher. We expect to see those increases continue throughout the rest of the year and don't really know how much legs they'll have under them.

Matthew Bouley - *Credit Suisse - Analyst*

Okay. That's really helpful. Thank you. And then I just had a question on ESG&A. You obviously came in below guidance in the first quarter and you called out the accelerated cost reductions and elimination of some expenses. So, just wondering if you could elaborate a little on what those were and the magnitude and you how we should be thinking about those items as it pertains to your 2Q guidance. Thank you.

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

Within the broader context of the cost reductions that Mark mentioned over the next 36 months, we continue to work a plan, to work through it. And we will explain to the market on the calls after we do the things that we think we're going to have an opportunity to do. But it's early stage and we think, as Mark said in December, that the real benefits from our initiatives will likely start to show up in 2017.

Matthew Bouley - *Credit Suisse - Analyst*

Okay. Thank you very much and good luck.

Operator

Our next question is coming from the line of Trey Grooms with Stephens. Please go ahead with your questions.

Trey Grooms - *Stephens Inc. - Analyst*

Hey, good morning. And congrats on the good quarter. The first thing, just as a follow-up to the last question, on the ESG&A, you noted the acceleration of cost reductions from restructuring and elimination of some planned cost. Both of these things seem sustainable, so I'm just trying to get my hands around the guidance for the ESG&A for the second quarter as a percent of sales ticks up some versus what we saw last quarter. Just trying to understand the puts and takes and what's moving that around.

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

Sure. Historically, the second quarter does show a tick-up in ESG&A expenses because of the timing of various marketing expenditures throughout our Company. We're anticipating that same level of step-up from Q1 to Q2, not unlike what you've seen in years past. It's hard to pick it out of last year's number because we made the acquisition of CENTRIA at the end of the first quarter, so you can't see it. But if you look back at past seasonal periods, you'll see that there's almost always that level of step-up from Q1 to Q2.

Trey Grooms - *Stephens Inc. - Analyst*

Okay. So, it's seasonality more than anything.

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

Trey, it's really the meetings that we have with our brands and their customers which are a really important part of the longevity of those relationships.

Trey Grooms - *Stephens Inc. - Analyst*

Got you. Okay. And then, Norm, you touched on the fact that you guys do touch all types of different low rise. You mentioned commercial was good, relatively good, industrial relatively weaker. Can you dive into that in anymore detail on the commercial side, where exactly you're seeing the relative strength?

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

When I look across, it's in the geographic areas that I mentioned, the south Atlantic in particular, the Pacific. The West Coast is really doing quite well. New England continues to do well and the mountain areas continue to do well. And, surprisingly, I was looking at the numbers, and we actually saw for the first time in a long time a little pick-up in the activities to the shale areas. And that, I think, is a reflection that the shale production continues to some extent and it comps back against last year, which was really very slow. I don't want to have anybody read more into that than it deserves.

But, again, I won't say we're opportunistic but we certainly have distribution channels that really do move with what's available. Our storage business, private storage business, is strong, continues to be strong. We're very active there and we benefit from that.

Trey Grooms - *Stephens Inc. - Analyst*

Okay. Thanks for that. Then on the EBITDA guidance, it implies a pretty wide range. Can you talk about the puts and takes behind that? What would be the primary drivers behind where we see the margins and EBITDA then sort out in the quarter? What could drive you toward the high end of the margin range versus the low end as we sit here a month or so into the quarter?

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

Trey, as you and others have coached us, we don't give weather reports. So, we try to capture in a range all the things that we've historically seen in recent years that could affect us. For instance, we're having four days of stormy rain here in Texas. We had a terrible rainy year last year that took us into, really, April and May and early June.

So, all we're trying to do is we know that the second quarter is our most vulnerable in terms of the amplitude of what can happen. So, we want to keep the range in a way that is sensitive to what could happen. But I would say that, generally speaking, weather would probably be the biggest concern, the biggest driver of that range.

Trey Grooms - *Stephens Inc. - Analyst*

Got you. And last one, if I could. The Canadian plant that you guys bought, I think it was a small insulated panel plant, can you give us a little more detail around that and thoughts on why the Canadian market now and any details around the acquisition, if you could.

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

So again, it was opportunistic. It came about as a result of an acquisition at our largest competitor, the largest insulated metal panel player in the world had done. And then had a situation where there was redundancy in plants and they had to exit that plant. And we're very pleased and fortunate to have had a chance to buy it at a fair price. It really complements our ability to service the Northeast part of the United States, which is a growth area in insulated metal panels, and the northeast part of Canada, as well. So, we're very pleased to have that and the team is bringing that online.

Trey Grooms - *Stephens Inc. - Analyst*

Great. Thanks a lot, Norm. Good work and good luck.

Operator

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

Dan Moore - *CJS Securities - Analyst*

Good morning. Thank you. This is Dan Moore filling in for Lee. Did want to just follow up on the last question, as well. Are you willing to give us a sense for, between the purchase price and any incremental investment, the total investment you might need to get the Canadian insulated metal plant up and running?

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

I can tell you that if you saw how it was booked, we actually had a gain on the purchase as the market is broken out. And it certainly will end up being a very economic plant from the standpoint of the cost of purchasing it as well as the cost of bringing it up to speed.

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

The costs will not be material to bring that line into our production requirements.

Dan Moore - *CJS Securities - Analyst*

That's helpful. And wanted to just touch on third-party coatings, the modest volume decline, was it largely end-market demand or are you perhaps being a little bit more selective on third-party business, as well?

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

We're certainly being selective. The team here is doing a really outstanding job across the whole coating business, and really shown some discipline. We have this benefit of consuming as much as 50% of the output from those plants and, therefore, our decisions to look for partners for third-party sales are really important, that we attract the right kind of companies that have long-term commitments and appreciate the quality that we can provide.

Dan Moore - *CJS Securities - Analyst*

And as a follow-up, is that selectivity likely to weigh on purported growth, at least on the top line? Do you expect to continue to rationalize the third-party business a bit more going forward?

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

I think we're in exactly the place we want to be in terms of having clear opportunities and targets, and we continue to follow that. We're probably less concerned about the growth rate in terms of third-party sales and really more important and focused on the quality of that earnings stream.

Dan Moore - *CJS Securities - Analyst*

Our other questions have already been asked. Thank you very much.

Operator

The next question comes from the line of Matt McCall with BB&T. Please go ahead with your question.

Unidentified Participant - - *Analyst*

Good morning, everybody. This is Ruben in for Matt. Norm, you touched on the ESG&A. This is a follow-up on the first question. You mentioned the $15 million to $20 million, starting to recognize that in 2017. Were the cost reductions and the elimination of planned expenditures this quarter, was that in addition to those expenses or was it part of the restructuring initiative? And can you quantify at all what the savings were and how you expect them to play out the rest of this year?

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

We have some reductions in costs that have played out through our ESG&A lines, and that's part and parcel of the restructuring efforts that we have ongoing. Those cost reductions are in addition to the $15 million to $20 million that we've quoted in our past Earnings Release. We executed a little faster on those initiatives than we had planned for 2016, so we will see some continuing benefits from those, but that is considered in the guidance ranges we gave for ESG&A for Q2.

Unidentified Participant - - *Analyst*

Okay. Perfect. And then one other one, the steel impact, you mentioned CRU down 30% in Q2 at today's level. Can you touch on what the dollar amount of headwind you're expecting from steel in Q2 and maybe the rest of the year at today's levels?

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

Sure. I can speak to Q2. I won't endeavor to speak to the rest of the year because that remains to be seen. For Q2, similar to Q1, we'll expect a range of between $12 million and $18 million of top-line headwind impact on revenue as compared to the prior year. So, very similar to what we saw in Q1 in dollar magnitude.

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

One of the things that Mark has said and written about that I think is likely to be the way it does play out is that, while we don't know how the steel prices will hold, we do know that the steel mills are absolutely focused on getting the prices up. But even with what we've seen to date, all that would do is actually lessen the impact of the steel cost in Q3 and Q4. We don't see a situation, we would certainly like to see one, but we don't see a situation where the price increases actually make up for all of the cost reductions that we're seeing over the last -- it's been 18 months. Mark, do you --?

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

That's right.

Unidentified Participant - - *Analyst*

One quick follow-up. Does your purchasing decision-making change at all with the tariff talks and the recent steel moves? Or do you stick with your natural hedge and just continue doing what you've been doing?

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

I got to tell you that the natural hedge has always been a plus to us, but the heck of it is our supply chain group is doing an awesome job. We are really active and it's all part of this notion about really integrating supply chain manufacturing, commercial, and being able to make data-based decisions, move quickly and do things.

I would be surprised with the tariff situation that you would see us purchase the amount of foreign steel that we normally do in the past, which is anywhere between 15% and 20% of our steel. I would imagine that, that would not be the case this year.

Unidentified Participant - - *Analyst*

Okay. Great. Thanks for the color. Congrats on the quarter.

Operator

Our next question is from the line of Alex Rygiel with FBR. Please proceed with your question.

Alex Rygiel - *FBR & Co. - Analyst*

Thank you. Good morning and nice quarter. Norm, I understand your commentary about the macro forecast. You've talked a little bit about the expectation for choppiness. But I was wondering if you're seeing or hearing anything in particular from certain customers that have led you to believe that 2016 is just going to be another choppy year. Or is it the macro of weather and geographic variances in demands that's keeping you at this view of 2016 being choppy?

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

I will tell you that by the nature of our customers, they tend to be optimistic until the moment they're no longer optimistic. And that is supported, from their perspective and ours, by the quoting activity. And quoting activity, as I said, is strong. Customer sentiment is good.

So, my slightly muted view is really more from the macro perspective of not knowing how things are going to react to whatever occurs in the marketplace. I hope I'm wrong, I hope that the choppiness abates completely. But I think it would be wrong for us to plan that way. It's like the seals line, which is, our easiest day was yesterday. We shouldn't expect things to get easier.

Alex Rygiel - *FBR & Co. - Analyst*

That's very helpful. And then, Mark, you referenced that in 2016 you're going do be looking to trim some costs and eliminate redundancies. Can you give us a little bit more detail or color around maybe a few of the obvious opportunities that you're pursuing?

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

Those are part and parcel to the efforts we disclosed in the last couple of quarters. That $15 million to $20 million is the predominant issue that we're talking about. We will be talking about those and speaking to those as they occur. We have responded to this question in the past and indicated most of the benefits we expect to see, really you won't see them until the beginning of 2017.

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

And, Alex, everything we're doing is about efficiency and improving our competitive ability and doing that in a very thoughtful way. There's opportunities and they're best to be spoken about after we do them as opposed to signaling them before we do.

Alex Rygiel - *FBR & Co. - Analyst*

Very helpful. Thank you very much.

Operator

Our next question comes from the line of Robert Wetenhall with RBC Capital Markets. Please proceed with your questions.

Robert Wetenhall - *RBC Capital Markets - Analyst*

Hey, good morning. Wanted to touch base, Norm. It sounds like your favored product in the universe is insulated metal panels. I'm not too familiar with the product and I was hoping you could walk us through why you highlighted that in your prepared remarks and what the product does for NCS.

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

What the product does, it does amazing things because it makes us more competitive against other traditional forms of construction. With the acquisition of CENTRIA and Metl-Span and the internal distribution systems we have, both from our builder network, which focuses almost entirely on the industrial, commercial and institutional part of the market, which is the largest part of the market, the part of the market that's underpenetrated in terms of insulated metal panels, it gives us a great opportunity. That plus the distribution systems that we have on our components group.

The external focus that both CENTRIA and Metl-Span has, and the work that Don Riley has done a great, great job in terms of clarifying the channels. For instance, we're focused on the cold storage piece, which Metl-Span has always been very strong in. And Metl-Span is best positioned to assist us with distribution through our internal networks for the industrial and commercial and institutional piece.

But the CENTRIA group is amazingly well-positioned for the high end architectural, and that has given us access to a new market that we have not been in. And the team there is doing a first-class job. Their business acquisition skills are phenomenal. I don't want to sound like Donald Trump but, man, I'll tell you, it's amazing. They're going to do well for us. They're building their quotes and their backlog and we're going to see good things out of them.

So, I'm, as you can tell, really excited about that. But that complements our legacy businesses. If you look at the components group, which is the most fragmented business we have, those guys keep knocking the ball out of the park. Their delivery, their focus on customers, it's just been extraordinary.

The buildings group continues to show strength in the organization, their ability to put product out, to be responsive and to make money. So that's probably more than you wanted to know but that's the way I view it.

Robert Wetenhall - *RBC Capital Markets - Analyst*

That's helpful. And I'm just trying to understand. It seems like this is your eighth consecutive quarter of positive momentum, which is great to see. You got a lot of new moving pieces with CENTRIA. I was going to ask Mark, given all the mix shifts in products and the variance in demand, how do we think about incremental margins moving forward after CENTRIA and all the changes in the portfolio and the new focus on insulated metal panels? And also wanted to ask, what's your steel price assumption for your 2Q gross margin guidance of 22.5% to 24%?

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

Mark will answer most of that but I want to just, rather than tell you where I think we're going to go, I'll tell you where we've been. On a year-over-year basis, our EBITDA percentage increased in insulated metal panels by 290 basis points. That organization is not only growing but it's increasing their profitabilities. Mark, do you want to talk about some of the things?

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

Sure. Speaking to the impact that insulated metal panels is having on our consolidated gross profit margin, I endeavor to break out the mix impacts in the CFO commentary. And for this most recent quarter specifically we had about a 40 basis point improvement in gross margin that was the result of the changes in mix, including and predominantly, the insulated metal panels improvement.

Talking to the steel price assumptions, we basically are assuming that the steel prices will increase about 8% sequentially from where they are in the first quarter, which will be down year over year by as much as 30%.

Robert Wetenhall - *RBC Capital Markets - Analyst*

Got it. But just going back, and I understand your comments about gross margin and it's very consistent with your prepared commentary. What I'm trying to ask, and I don't think I asked it the right way, what are the incremental margins that you expect going forward in each of the businesses? Because you've obviously had a shift, you have a more profitable product line, so I'm assuming that your incremental on each dollar of sales that you generate is going to be a lot better than it was historically and I'm just trying to think about the best way to model that out. Do you have a range of incrementals you could give us for each of the businesses?

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

Again, we don't want to get quite that detailed, Bob. I think that when we look at where a lot of the models are, we think that the range going forward for the rest of the year is a target that makes sense to us. And I'll say that we don't want to get too far over our skis. We're still working on a lot of things. So I think we'd rather talk about it as we do it.

Robert Wetenhall - *RBC Capital Markets - Analyst*

Got it. That's totally reasonable. And if I could just ask one final one. You guys have put out some mid-cycle targets historically and I wanted to get your view, Norm, where do you think mid-cycle comes out? You guys have emphasized the strong earnings power of the Company in a stronger market. How are you thinking about that now? Thanks very much and good luck.

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

Thanks, Bob. Again, as you know, I'm trying to stay out of the aspirational speak until we build a solid, solid performance quarter on quarter so people can gain a better view of what the trajectory is for the future. And our expectations about where we think we're going to go are a direct result of the performance we're seeing on quarter on quarter. And we still have high expectations for the future. I will tell you that we're probably equally focused on combating the cyclical nature of our business and end up with a product mix we have, including insulated metal panels, of being less cyclical but still benefiting from whatever recovery that we see in the marketplace.

Operator

Thank you. Our next question is from the line of Scott Shrier with Citigroup. Please go ahead with your questions.

Scott Schrier - *Citigroup - Analyst*

Thanks for taking my questions and nice quarter. Clearly you've been outperforming the market and doing well in challenging conditions, but I wanted to ask you, on the Dodge starts data, what you're saying it's going to be down 10% on adjusted in 1Q, 2016. Over the last six months when you were going through the bidding process, did you look in the market and did this kind of decline, was it evident in the bidding process? And if so, did you start to maybe look at projects differently, whether it's change your views on price versus volume going forward? And if the bidding activity is a predictive indicator of the Dodge starts data, where are we at now and what is it saying the starts data or the environment might look going forward?

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

Very insightful question. One of the things that we do see that's particular to the buildings group, because the visibility we have there in terms of quoting activity and backlog is really helpful to us. When we look back to when the ABI mixed practice slipped below 50 for five consecutive months, we now realize that, that forecasted the choppy quoting and booking activity that we have seen through the fourth quarter and into the first quarter.

And also it is, we believe, predictive as we've seen, in January and February, volumes start to increase. And the reason why we stay focused on volumes is it's a better view of what's going on in the market and our position in the market. So, that's an important part to us.

The leading indicators forecasted pretty well that the first quarter would be negative. We also know historically that the adjustments in Dodge data are considerable. It wouldn't surprise us that the adjustments in future periods bring this 10% down to, at best, flat or slightly down.

And that would be more consistent with our forward-looking indicators, which showed something like 1.5% to 2% down in the first quarter in terms of new construction starts, measured in square feet at five stories and less, which is low-rise construction. So, we're gaining, if you will, more confidence in our forward-looking indicators, being more predictive than really any indicators that we've had in the past.

Scott Schrier - *Citigroup - Analyst*

Great. Thanks for the color. And I wanted to ask you on the margin question a different way. Can you just talk about the internal natural hedge that you discuss, how it's holding up. And I know you don't want to talk too much to margins, but what we're seeing how the operating leverage in the coaters, is lower steel prices going to impact them or is the operating leverage going to win out and we're going to see these elevated margins where they are relative to last year? And the same for the other segment.

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

The internal hedge is helpful, but I'll tell you that the supply chain management group, and Dan Ronchetto and the team have done an absolutely first-class job of really amplifying that effect. When Mark laid out in the CFO piece, he laid out what we thought the benefit that our EBITDA received from both supply chain and manufacturing, because they go hand in hand. So, I will tell you that the combination of the two are beneficial and continue to be beneficial.

Scott Schrier - *Citigroup - Analyst*

Got it. And if I could ask a last one, Mark, how are you thinking about capital allocation between the buybacks and possible further M&A and debt paydown? And how much cash do you want to keep on the balance sheet comfortably?

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

Sure. We remain committed to what we've said all along and that is we prioritize debt paydown first, and we anticipate paying down approximately $40 million this year. We paid down $10 million in the first quarter. And then we had our Board make available to us $50 million to conduct stock repurchase programs as opportunities presented themselves. And we availed ourselves of that opportunity recently at very attractive prices for our shareholders. And we will continue to be opportunistic with that.

Scott Schrier - *Citigroup - Analyst*

Great, thank you.

Operator

Thank you. Our next question comes from the line of David Cohen with Midwood Capital. Please go ahead with your question.

David Cohen - *Midwood Capital - Analyst*

Thanks, my questions have been asked and answered. Thanks.

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

Great, thank you.

Operator

Our next question is from the line of John Chung with Oak Hill Advisors. Please proceed with your questions.

John Chung - *Oak Hill Advisors - Analyst*

Can you comment a little bit about the decline in third-party sales again in coating? I believe you mentioned that you were being more selective. Can you just expand on what that means? As a second question, in light of what steel prices have done, have you been able to maintain your margin per ton in this environment, the dollars per ton?

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

I'll answer the last question first. I think that we're always focused on the dollars per ton and probably less focused on what that percentage is. And that is done in a really disciplined way. You realize that we bid literally thousands of jobs, and our buildings group will probably bid anywhere between 30,000 and 35,000 jobs this year. So there's a lot of opportunity for us to get feedback in the marketplace and see things. The discipline that Don and his team have brought has really been extraordinary good.

And I think the first part of the question, again, the coating is, I think, unfortunately a little difficult for the market to understand. And I don't want to be demeaning in any way but the Company was formed in 1998 by the merger of the buildings group and NCI with the coating and components group in NBCI. And that relationship was based on the fact that our downstream businesses, which is the components group, which include insulated metal panels, and the buildings group use the same steel.

So the opportunity for us to be able to have just-in-time delivery, queuing up the products that we want, really is an advantage for us managing our steel inventory. We'll turn that inventory nine times a year. And that gives us great power, which our supply chain management have really,

really been taking forward to a new level. But I don't think we would be in the coating business for the fact that we use that steel and it really advantages us. And that team does a great job.

Therefore, I don't want to make it sound that we're not concerned about third-party sales. We are. That team is held accountable for third-party sales. But we want that accountability to be very disciplined and focused on the customer mix that makes the most sense. That's important. So, we're aggressive in pursuing good opportunities but we certainly don't mind walking by opportunities that are less good.

John Chung - *Oak Hill Advisors - Analyst*

Got it. In light of that, it sounds like maybe you walked away from certain business that was not going to be margin accretive or good margins, and so that's what led to the level of decline?

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

Correct, correct.

John Chung - *Oak Hill Advisors - Analyst*

And then in terms of maintaining the dollars per ton, have you been successful in doing that in this down-drift in steel prices?

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

It's a competitive marketplace. We're not shotgunned approach. We're very rifled in our approach in terms of looking at opportunities and what our competitive spot is. We, I will tell you, excel in certain things. Our express buildings have been a really great plus, again. A shout out to Don and his team and all the folks in the buildings group have just done a first-class job advantaging our position there.

We're really strong on the higher-end activity, which really takes into account our really good engineering skills, and the middle, which is the complexity of four, five, six and seven, is a very competitive spot. And we've got to realize that we need to be competitive in those jobs, and we are.

John Chung - *Oak Hill Advisors - Analyst*

Do those comments related to building group apply also to the coating business in terms of being able to maintain that discipline and EBITDA per ton?

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

It's a little less the case because we have package sales which include us providing the steel and the paint, and we have tolling. It's a combination of the two. We have a chance to bring more money to the bottom line at lower percentage of margins on a higher cost basis in package sales. And package sales are something that we're attracted to and like to see that mix being in the 50/50 range with tolling ideally.

John Chung - *Oak Hill Advisors - Analyst*

Got it. Thank you very much. This is very helpful.

Operator

Our next question is from the line of Gregory McCasu with Mantrus Advisors. Please proceed with your question.

Gregory McCasu - *Mantrus Advisors - Analyst*

Thank you. I am quite familiar with the insulated panel business. Could you talk about the long-term profit goals on that? Clearly, the margins improve significantly. Would you expect insulated panels to be the highest margin product within NCI? And are they at this point?

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

I'll tell you that each of the sales channels is slightly different. The cold storage is great because they're long runs but it's a product that's fairly standard. Our distribution and our footprint of our plants really helps us. The relationships that Metl-Span has are very good.

The margins there are generally a little lower than the higher growth opportunity that we see in industrial, commercial and institutional applications. That, Gregory, is really a wonderful spot for growth, both in revenue and in profitability over the long term.

And then complementing that is the high end architectural piece. CENTRIA just does a fabulous job. Their sales force is superb. Their dealer network is outstanding. And the team there is really building a good book of business that is, as you know, are longer. Our backlog in buildings generally gives us about six months or so of visibility. And in the high end architectural that's more like probably 9 to 12 months of visibility.

Gregory McCasu - *Mantrus Advisors - Analyst*

Good. So what you're saying, Norm, is, I think, that the mix within insulated panels affects the profitability, and as there are shifts there the margins may shift, as well.

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

Yes. So they shift, but I'll tell you that we're very pleased with the opportunities we see in the industrial, commercial and institutional to displace other building materials, traditional building materials, with a product that has energy efficiency, that's superb, that easily meets and beats the energy codes and the codes in various parts of the United States. That product is very important. And we are, I say, hugely advantaged because of the distribution network that we have through the builder networks that we serve.

Gregory McCasu - *Mantrus Advisors - Analyst*

So, effectively, as product moves from components or wherever, the profit in that group is lower, and as that shifts into insulated panels the margins will be better for that same sale, effectively.

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

Yes, but I'll tell you, I want to also say that our legacy business, which is the most fragmented part of our business, has historically been considered the family jewels. And they continue to be the family jewels in the sense that they are able to grow the top line as well as the profitability by really focused on service and getting it done for the customers.

Gregory McCasu - *Mantrus Advisors - Analyst*

Good. Thank you very much.

Operator

Thank you.

(Operator Instructions)

The next question is from the line of Sam McGovern with Credit Suisse. Please proceed with your question.

Sam McGovern - *Credit Suisse - Analyst*

Hey, guys, thanks for taking my question. You talked a little bit about this earlier in the Q&A. With $30 million left to pay down the term loan this year, and then the buyback that you guys plan to continue to execute, with the growth of the business you guys are getting closer and closer to that 2.2 times target. I wanted to talk a little bit more about how you guys see that target over the long term. Should we expect over time you guys continue to pay down term loan once you've achieved that 2.2 times? And where in the cycle do you want to be at that 2 times? Is that something where, is that the mid-cycle target or are you guys comfortable later in the cycle being that kind of leverage?

Norm Chambers - *NCI Building Systems, Inc. - Chairman and CEO*

I think that the 2.2 times is a place to be that resonates powerfully with Mark and I because of what we went through in 2009. We want to be very thoughtful about our debt, particularly as the cycling continues. Our view is, even though the market's been flat, down a little bit, we still think that the, if recovery, slow as it is, will continue for some time.

But we want to definitely be in a position where we can maximize our cash and have the optionality to do a bunch of different things. So, it's all about performing in a way that the balance sheet supports that flexibility.

Sam McGovern - *Credit Suisse - Analyst*

That's great. Thanks so much. I'll pass it along.

Operator

Thank you. There are no additional questions at this time. I would like to turn the floor back to Darcey Matthews for closing comments.

Darcey Matthews - *NCI Building Systems, Inc. - VP of IR*

Thank you, Rob. We thank everybody for joining us today. Our second-quarter conference call is currently scheduled for June 8. In addition, the Company will be participating in the Stephens 8th Annual West Coast Conference on March 17 in San Francisco and the BB&T Commercial and Industrial Conference on March 24 in Coral Gables, Florida. We hope to see you there. Thank you very much.

Operator

Thank you. Ladies and gentlemen, thank you for your participation. This does conclude today's teleconference. You may disconnect your lines at this time, and have a wonderful day.