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NCS - Q2 2014 NCI BUILDING SYS INC Earnings Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen. Thank you for standing by. Welcome to the NCI Building Systems Inc. second quarter earnings conference call.

(Operator Instructions)

This conference is being recorded. I would now like to turn the conference over to Ms. Layne de Alvarez. Please go ahead, ma'am.

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 second quarter of FY14. To access a taped replay of this call, please dial 1-888-203-1112 and enter the passcode 1277255 and the pound sign when prompted. The replay will be available approximately two hours after this call, and will remain accessible through June 18. The replay will also be available at the Company's website, www.NCIbuildingsystems.com.

The Company's second quarter results were issued yesterday afternoon in a press release that was covered by the financial media. In keeping with SEC requirements, I 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 filed yesterday. Forward-looking statements speak only as to the date they are made. We undertake no obligation to update any forward-looking statements, beyond what is required by applicable securities law.

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.

Norman Chambers - NCI Building Systems Inc - Chairman, President & CEO

Good morning, everyone, and welcome to our second quarter 2014 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 of Investor Relations. Our second quarter earnings were released yesterday afternoon, so I hope you have had time to review our results and commentary.

Before I give a brief overview of the Company, I would like to make a few points to assist investors to better understand the effect of the widely reported winter weather on our second quarter results. First, our first two quarters are our seasonally weakest. Relatively small changes in volumes, mix or cost, either positive or negative, have a disproportionate effect on our earnings and EBITDA.

Second, while our revenue grew on a year-over-year basis, we estimate the weather impact reduced our top line between \$8 million and \$10 million. Third, we estimate the weather-related disruptions to our operation, supply chain, and product mix negatively impacted our gross margin by approximately 130 basis points. As a result, the combination of the reduced revenue and the impaired margins negatively impacted our EBITDA by more than \$5 million.

Fourth, on a positive note, as the conditions began to improve, our margins sequentially recovered each month, strengthening 130 basis points from February to March, and an additional 90 basis points from March to April. And finally, sequential monthly improvement has continued into May. As volumes improve in our seasonally strongest second half, we expect margin expansion to continue.

As a seasonal business, we know our earnings are back-end loaded, which is why we are not discouraged by our performance in the first half of the fiscal year during one of the most severe winters in recent memory. In fact, we are energized by the earnings potential as the result of actions we have taken.

As the weather improved in April, shipments, bookings and backlog rebounded. May's bookings in the buildings group jumped 28% year-over-year, and our backlog continued to grow through May. The significant pick up in bookings combined with the value pricing we are achieving on incoming orders gives me confidence that in the second half of the fiscal year, we can deliver growth and offset our year-over-year first half deficit.

Our end markets improve or decline with positive or negative changes in the economy. Therefore, the US economy must continue to improve, albeit even if slowly to support our optimism. My confidence is buoyed when I think back to the last recovery in 2004, and remember that our legacy single skin business led the way, reflecting a broader economic recovery. In the second quarter of this year, our single skin legacy business recorded double-digit growth, and our shipped volume achieved levels not seen since 2008.

We are also just beginning to benefit from our substantial investment and our sales and service initiatives, and expect to achieve accelerated growth in the second half of the year. We remain committed to our position as the price leader across all of our divisions. Competition is fierce, but we believe we will maintain our position as the business partner of choice, because we are intently focused on providing superior products and service to every customer.

The manufacturing initiatives begun last quarter in the buildings group continue to bear fruit. Even with seasonally lower Q2 volumes, operating leverage was evident in five of our eight building plants, and centralized scheduling improved manufacturing plant loading. Many of the challenges that we face in the first half of the year will diminish, and we expect to achieve operating leverage across all of the divisions in the second half of FY14.

Leading indicators for non-residential construction continue to signal growth for the second half of the year. The April Federal Senior Loan Survey indicated an easing of lending standards, and stronger demand for commercial and industrial loans. The industrial vacancy rate that registered 11.1% in the first quarter continued to decline for the 14th consecutive month, with 80% of all major industrial markets -- 80% of all industrial Markets reporting positive absorption.

The manufacturing sector expanded in May for the 12th consecutive month, according to the latest Institute of Supply Management Survey, and the New Orders Index has signaled growth in new orders for 12 months running. The ABI Mixed Use Index which declined in January, February, and March, recovered into positive territory in April.

The index has been above 50 for 16 of the past 21 months, forecasting an increase in US construction spending. Taken together, the conditions exist for the economic recovery to build and sustain momentum beyond the second half of FY14.



Before I hand it over to Mark for a more detailed review of our financials, we expect in the not too distant future, when the non-residential markets again return to 50 year mid-cycle levels of 1.3 billion square feet that 2014 will be viewed as an important step in achieving our performance goal to generate between \$280 million and \$350 million in EBITDA, which is four to five times our 2013 EBITDA level. Our mid-cycle EBITDA goal can be delivered in part by successfully executing our manufacturing, pricing and growth initiatives. These initiatives can multiply the positive effect of a modest mid-cycle recovery in the non-residential market.

Now Mark will speak to our numbers, and then we will be happy to take your questions.

Mark Johnson - NCI Building Systems Inc - CFO

Thanks, Norm. In our press release and in the CFO commentary, both of which are available on our website, we have provided a discussion of the key elements of our second quarter financials. Now I will take a few minutes to add some additional color to the results.

First let me comment on our consolidated revenue and the seasonality of our business. We were pleased to report a 4.2% year-over-year increase in revenue during the second quarter, driven by volume growth in certain key businesses and our value pricing strategy. Each of our three segments was able to achieve year-over-year growth in revenues.

In addition, we were able to generate these higher revenues, despite the fact that non-residential construction was down during our fiscal second quarter, particularly for low-rise construction. Although some of our product lines and therefore our sales mix, continue to be negatively impacted by severe weather during the quarter, we are achieving growth in certain key areas which we believe validates both our growth initiatives, and our expectations for continued recovery in new non-residential construction activity. I will describe these growth areas, when I overview each of our segments momentarily.

As many of you know, our business like many in the construction industry is highly seasonal. Historically, we have typically generated between 55% and 60% of our annual revenue in the last half of the year. Accordingly, and as a result of higher utilization of operating assets, we generally have earned between 60% and 90% of our annual adjusted EBITDA in the last half.

One of the key determinants of the level of seasonality we see in any given year, is the severity of the winter weather and its impact on construction site conditions. Therefore we believe it is reasonable to expect, that given the severity of the weather earlier this year, the effect of seasonality on our revenue and earnings should be closer to the higher end of the historical ranges.

Looking now at our gross margins, we were able to achieve sequential improvement from our first quarter, primarily as the result of value pricing improvements in our buildings and components divisions; however, similar to this year's first quarter, our gross margins were impacted by the severity of the weather conditions in both periods. One small measure of the magnitude of the weather variation versus the prior year is the increase in the number of plant closure days to 22 in this year's second quarter, from only 2 in last year's quarter.

As I discussed in detail last quarter, the impact of severe weather on our business during the seasonally slow periods was pronounced. In summary, weather-related impacts include: lower than expected shipments due to poor job site conditions; disruptions to our typical product mix; less efficient manufacturing operations due to plant closures; material shortages and job rescheduling; higher material costs due to unplanned supply chain disruptions; and higher operating costs including utility expenses and chemical usage in our insulated panel plants. Altogether, we estimate that the combined impact of these items reduced our gross margin by approximately 130 basis points.

Our ESG&A costs for the quarter were \$2.3 million higher than a year ago, primarily as the result of our continued investment in growth initiatives in our components division, and sales and marketing programs in our buildings and coating segment. Offsetting these increases, we are achieving our targeted reductions in our corporate ESG&A expenditures which declined \$2.3 million from the prior year, including a \$900,000 reduction in non-cash stock compensation charges. I am pleased to say we are just now beginning to see the benefits of the growth initiatives we have been investing in, and expect these costs to be progressively further leveraged in succeeding quarters.

Our adjusted EBITDA declined \$4.2 million from \$10.6 million last year, to \$6.3 million in the current quarter. This decline is primarily attributable to two items. First, the approximately 130 basis point decline in our gross margins or about \$3.6 million, due to the change in product mix and other weather-related impacts on our efficiency. And second, the incremental spending in growth initiatives and marketing and sales programs which totaled \$2.8 million. Offsetting these costs, we reduced our corporate costs by \$1 million exclusive of non-cash items, saw improvement in our foreign currency gains and losses, and benefited from value pricing in buildings and components.



Now I will briefly review our segment results. Our building segment third-party revenues were \$144.6 million, and represented 47% of our consolidated revenue for the quarter. This segment's total revenue grew 0.9% over the prior year, and declined 1.9% sequentially.

The sequential decline and only slight growth over the prior year is a direct result of the comparable winter weather conditions that effected both first and second quarter periods, and its impact on job site preparation. Operating income declined by \$4.2 million from the prior year driven by lower margins on weather-related inefficiencies, and \$1.2 million higher costs from marketing and sales programs. In addition, our engineering and drafting expenses were \$800,000 higher than a year ago, due to the increased level of approval work and job complexity in our backlog, which should ultimately lead to higher margins in future periods as those projects are completed and shipped.

Despite these unfavorable results, we began to see the expected improved pricing on jobs shipped during the quarter, reversing the previous trend and expect to see this trend continuing in the last half of 2014. Bookings, which had been lackluster early in the quarter rebounded in April with an 8% year-over-year increase, and again in May, with a 28% year-over-year increase.

Our metal components segment third-party revenues were \$135.7 million, and represented 44% of our consolidated revenues for the quarter. This segment's total revenue grew 5.4% over the prior year and declined 2% sequentially. Importantly, we noted mid-teen year-over-year volume increases in our legacy, commercial and industrial components products. This is an important indication of a broader base non-residential construction recovery, and also serves to validate the growth investments we have been making.

The improvements we saw in these markets were offset by weather-related declines in agricultural end markets predominantly in the Northeast, and commercial and industrial insulated metal panels which negatively impacted total revenue growth and our product mix. Our components segment operating income declined by \$0.6 million from the prior year, primarily as the result of the unfavorable change in product mix, and \$1.2 million incremental investment in growth initiatives to expand market penetration of our legacy component products and distribution channels, and improve our sales and service capabilities.

Our metal coating segment third-party revenues were \$25.5 million, and represented 9% of our consolidated revenue for the quarter. This segment's total revenue grew 9.1% over the prior year, and was flat sequentially. Third-party external revenue grew 16.5% as a result of our new Middletown facility which became operational in January of last year.

Despite the increased revenue, our coating segment operating income declined by nearly \$860,000 from the prior year. Production efficiency and material costs were unfavorably impacted by weather-related disruptions and temporarily higher utility costs. In addition, sales and marketing costs increased by \$300,000 due to investments in marketing and sales programs to further brand and differentiate our products and services.

Now I will turn to some highlights on our cash flows and balance sheet. We ended the quarter with \$12.5 million in cash and equivalents, down from \$77.4 million at the end of last year, and down from \$16.6 million sequentially.

During the first half of this year, we used approximately \$30.5 million in cash for operations, compared to \$3.8 million last year. This is consistent with our typical historical pattern, where we invest in our working capital in the seasonally weaker periods following the fourth quarter peak. The cash investment this year is higher than last year, mainly due to the timing of accounts payable payments between our seasonally stronger fourth quarter and our seasonally weaker periods.

Keep in mind that we generate the bulk of our operating cash flow in the second half of our fiscal year, and this is likely to be even more seasonally weighted to the second half as discussed earlier. We used a net of \$8.7 million for capital expenditures during the first half, compared to \$12.7 million last year, benefiting from insurance proceeds to offset repairs in our Jackson setting facility.

We used approximately \$25.5 million in financing activities in the first half of this year, compared to \$11.1 million in the prior year. This increase resulted primarily from the repurchase of approximately \$20 million of common stock, at the end of the secondary completed in January of this year, compared to a \$10.4 million reduction in long-term debt last year.

Now I will provide a brief overview of our debt leverage and liquidity. Our net debt leverage at the end of the quarter remains low at 3.7 times, compared to 2.8 at the end of last year's second quarter. Our net debt leverage also fluctuates with seasonality, as our cash balances tend to be higher in the last half of the year. We also maintained strong and flexible liquidity with an undrawn \$150 million revolving ABL facility, which based on the borrowing base calculation had availability of \$115.5 million at the end of the second quarter.



Now before we answer your questions, I want to remind you that in the CFO commentary available on our website and filed as an 8-K, we have provided specific expectations for our third quarter for ESG&A expenses, interest expense, effective tax rate, the weighted average diluted share count, and capital expenditures. And now, we will be happy to take your questions.

QUESTION AND ANSWER

Operator

Thank you, sir.

(Operator Instructions)

Our first question come from Trey Grooms with Stephens.

Trey Grooms - Stephens Inc. - Analyst

Hey, good morning.

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

Good morning, Trey.

Trey Grooms - Stephens Inc. - Analyst

Norm, thanks for breaking out the April and May bookings numbers. It is very helpful. I know it is early, but can you comment at all on the trends you are seeing, as we have gotten into I guess, the early innings of June here? Has that continued?

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

Yes. So one of the things that we always like to have a fairly consistent view of our expectations for a given quarter, particularly our seasonally stronger quarters. And we know that we will generate the greatest amount of our profit in the last month of the quarter, because we are 4, 4, 5. So we expect to see our activity grow throughout the quarter, May, June and July. And certainly, the preliminary numbers for May look consistent with our expectations for the third quarter. We really have seen, the tail end of April, a recovery and improvement in our bookings, in our backlog and our shipping schedule. So it is difficult for people to grasp, when they look at how bad the first half was and the weather, but I have got to tell you, things look to be stacking up where we expect them to stack up in the second half.

Trey Grooms - Stephens Inc. - Analyst

So to put another way, I guess, you have taken the guidance you have given, I guess for the end market demand. I believe you have said in the most recent, the prior quarter, sorry, that you expected that end market demand could be up mid to high single-digits. I think in this press release, it said mid-single digits. So is that just primarily a result of the second quarter coming in worse than you had originally thought, and that the back half is shaking up at least from where you sit today, looks like it could be shaping up as expected? Is that the way to read that?

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

Yes, we expect the second half to be as we expected. And it is consistent -- we think it is consistent with the growth in bookings and backlog. Of course, that is in the buildings group. And when we talk about what we are seeing in the other parts of our business, that is pretty doggone important. Because while I -- one can think I am reaching, by talking about 2004, I have got to tell you, there is some sense that our components group sells more broadly to the market. And when we see that legacy



business, Trey, as you know which has been sputtering at best, really pick up some steam, I have got to tell you that our guys and gals in the components group are feeling pretty good about what they are seeing.

Trey Grooms - Stephens Inc. - Analyst

Well, that is encouraging. Shifting gears to margins, Mark, maybe this one is for you. Looking at the margins, gross margins for the quarter 19.5%. Thank you for bridging that for us. That is helpful, with the 130 basis points reduction that you said came from product mix and other weather-effected inefficiencies including material, manufacturing, transportation and so forth.

How much of this would be re-occurring into the current quarter? And I guess, as a segue, Mark, how should we be thinking about gross margins, as we get more into the more important back half of the year? I know Norm mentioned margin expansion, but just wondered if you could quantify?

Mark Johnson - NCI Building Systems Inc - CFO

Sure. So we talked a lot about the 130 basis points from the weather-related impact, and that is across four real segments. It is across the mix of the business that we ship. It is across the freight and the efficiency with which we can get freight at the right cost, and it effects the efficiency of our operations, the manufacturing. So it is pretty pervasive, and we don't see any of that continuing into the third or fourth quarter. We have that behind us. We began to see that dissipate in April, and we don't foresee that in June at all. So that gives me good confidence that we won't see that conversation in the future.

And we have consistently said, and we consistently expect, progressive improvement in our gross margins based on two fronts -- well, three fronts really. First of all, the increased operating leverage we will experience in the last half as we always do. Second, the inroads we have made on value pricing have been very significant. We expect to be seeing benefits of those. And then, there are the dissipation of this weather conditions.

Operator

(Operator Instructions)

Next we will go to Lee Jagoda with CJS Securities.

Lee Jagoda - CJS Securities - Analyst

Hello, good morning. Good morning. Can you hear me?

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

Good morning, Lee.

Lee Jagoda - CJS Securities - Analyst

So last year in Q3, for buildings, you were impacted by some shipping delays that slipped into Q4. This year, I would think you would see the benefit of not only the easy comparison, but the benefits of some better pricing, and likely some pent-up demand just because of the weather. You kind of -- you care to comment any further on the growth rate expectations for Q3 specifically?

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

I think that you have hit on a couple of very real differences between our expectations for this Q3 versus the past year. And I, and our expectations are very high for our buildings group, in terms of all of the work they have been doing, and I mean, really working very hard as you would expect both in terms of pricing and with regard to efficiencies. And I mentioned, Lee, just a couple of things that are very different from last year to this year. And that is the whole central scheduling, and what that



means to our ability to reduce the amount of overtime by scheduling more effectively through the whole quarter. And that was really non-existent last year, and is very prevalent this year. And so, we are very encouraged about that.

The -- even in a very short period of six months, the improvements that we made in our manufacturing, where five of our eight building plants have shown levels of operating leverage at utilization rates below 40%, that we would have historically never seen until we were somewhere closer to 70% utilization. Now we still have three of the plants that we are kind of working on to improve that, but it is -- we are very encouraged, and we have set higher expectations for the team over in the buildings group.

Lee Jagoda - CJS Securities - Analyst

All right. And then, just as a follow-up, Norm. Assuming the industrial renaissance that everyone is anticipating over the next three to five years in the Gulf states actually occurs, particularly in the energy and chemical space, can you talk about the role that NCS products play in the construction of those plants? And then, the percent of revenue that that represents today, and where that could trend over time?

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

Yes. So what we know -- and you know I was in oil and gas for most of my adult life -- that the oil and gas marketplace isn't cyclical so much in terms of the economy, but we will see expenditures that are consistent with their expectations on what utility prices are going to be. So there can be some movements from year to year. But I will tell you that we have invested in some additional human resources focused specifically on upstream, midstream and downstream oil and gas, and we can participate and do participate in all those. And certainly, both our components group and our buildings group can participate in refineries and finished products, and our painting lines. So the activity opportunity for us in oil and gas is real, is significant, and being based in Houston is a plus.

So we still have found, because of the spread of our activity is very diverse, that I think that we have yet to see oil and gas be above 10% of our revenue. But I would think that we could see that increase. And I hope that it is not at the expense that other parts of our economy are not increasing, because our view is that we are seeing a broader recovery. So my hope is that the oil and gas will continue to be additive to our total revenue picture.

Lee Jagoda - CJS Securities - Analyst

Thanks very much and we look forward to seeing you at our conference next month.

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

Great, sir. See you then.

Operator

And now we will go to Winnie Clark with UBS.

Winnie Clark - UBS - Analyst

Good morning.

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

Good morning.

Winnie Clark - UBS - Analyst



Hoping you could talk a little bit about pricing. Can you give us some color on the impact that you realized in the quarter, and what pricing -- and last quarter you talked about 190 basis points of pricing in the backlog. Are you still running at about that level, and do you still hope you can benefit -- that can benefit you at about that level in the second half?

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

Yes. So we are running at better than 200 basis points of improvement in our backlog and margins. And there is kind of two important gateways to actually realize that 200 points, plus something above it. The first is managing the flow of the work from backlog into production, and doing that in a way that is responsible and reflective of the relationships we have with our builders, and changes in deliveries, and times that they have. That has to be very carefully managed, to remain sure that we don't leak any of the margins.

And the second piece is, this thing I was beating the drum on just recently, is that the improvements in our manufacturing that we are seeing are really fundamental to not just preserving the margins that we have won through hard work, working with our customers and their end-users to increase our pricing, but also, we have the chance through manufacturing to yet improve on that performance. Okay?

So my point being that I don't want you to think that the pricing is a walk in the park. It is a challenge that our sales force really have to work at. They have to constantly try to find where we can add value that, that value is perceived by our customer, and plus their end use. And they have done a first class job of doing that, a very, very real job in doing that. So long-winded, we expect to see all of that margin improvement to come off the tail pipe.

Winnie Clark - UBS - Analyst

Okay, that helps. Thank you. And then, just in the low-rise construction starts, I believe you said last quarter they were down 5%. What was the trend in the second quarter? And then, what gives you kind of confidence that we are going to be at a mid-single-digit growth rate for the year?

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

Yes. So that is a good question, and I think that it really falls into what occurred. So when we look at the second quarter, actual non-res starts were just slightly positive at 0.4%, but low-rise was down 4.7% in volume. Okay? And when you think about that -- when you think of the first six months of our year, November bookings on a year-over-year basis, which kind of reflects the market going forward, were positive. And then we were negative on a year-over-year basis for the months of December, January, February and March, and didn't see a pick up until April. So we had this period in the middle which, by the way coincided with the US economy dropping from an expected 0.1% growth to a 1% decline. Right? So it really was hand-in-hand.

So then we say, gee, what did occur is that, is that we saw a marked change in bookings, from the last two weeks of April, very strong bookings, right through to May, very strong bookings. And that is without really, price erosion -- I mean, that is just activity-based. I would suspect that our competitors saw the same thing. So we are seeing those trends are continued through May and into June. So our expectations are, that with the level of growth we are currently seeing, that we will end the year overcoming the first part deficit to show mid single-digit growth in volume in non-res markets for the year.

Mark Johnson - NCI Building Systems Inc - CFO

And by volume, he means square feet.

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

Yes, square feet, sorry, square footage. New construction starts.

Winnie Clark - UBS - Analyst

Okay, great. Thank you very much.



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

Okay.

Operator

And now we will go to Will Randow with Citi.

Scott Schrier - Citigroup - Analyst

Hello, good morning. This is actually Scott Schrier in for Will. Thanks for taking my questions. First, I wanted to ask about -- you mentioned solid inquiries. And are you noticing any differences in terms of the trends, as the urgency of getting bids, the competitive nature of the bidding environment, your win rate, and also which end markets are you kind of seeing more strength or unexpected weakness in the bidding process?

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

Yes, that is a good question. And we always try to dig the current data to try to see if it is stacking up to our expectations for the year, both geographically right down to the counties and end markets. And I will tell you that the manufacturing warehousing piece continues really to be quite strong. Oil and gas certainly showing strength over the past year, which was down from the previous year, so we should see some uptick. And I would say that there are regions of the country that were showing considerable growth, and the Northeast being one, I am particularly talking about New England, was slower than they have been for a while.

But I will say that, that when I think about our business across all fronts, I am seeing in the coating business, more opportunities in appliances and HVAC which we think is quite positive. When I look at components group, and I see that the spread of legacy products which go to more retail, really some institutional, some much smaller kinds of activities and to see the growth there, is really very encouraging. And then the buildings group, while it is focused more, slightly more on pricing and value, nevertheless their bookings and uptake in their business and inquiries reflect a larger types of projects. Which again, kind of speak to an improving sense, an improving new sense of optimism. So I hope that helps you. It is what we are seeing.

Scott Schrier - Citigroup - Analyst

Great, thanks. And my follow-up is I wanted to touch more on the backlog. I know it has been hit on, and the margins in that segment, and I know you said there was a \$5 million hit to EBITDA. Are you able to quantify, one, how much was in the buildings? And going forward, I know there is questions about pricing and value pricing inefficiencies, but can we expect any changes as far as the operating leverage that we look at in the business?

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

So Mark will add some color to this, but I just want to correct one thing. So the \$5 million hit really had very little to do with the backlog, except that work that we would have hoped to have manufactured in the period was pushed out largely due to work site conditions. Okay? And work that we had expected to book in the months that I talked about in the call before, December, February -- sorry, December, January, February and March were down year-over-year. So our bookings were not at the levels that we expected to see during that period, picked up in April and May and continue in June. So when I look at the backlog of the buildings group being up, that is pretty solid, and that was at the end of April. But when we had a quick look at the first month of our third quarter, we continued to see bookings improving, and we saw the backlog grow as well.

Now, let me get right to the first part of your question. One of the things that is clear to us is, we are seeing a heightened level of urgency, coming up on the season for people to say, gee, that I need space in your manufacturing schedule because I need this building at X date. And frankly, that is -- we like to deal with those kinds of urgencies. That is a positive. Both from the standpoint that it helps us better schedule our plants, and also it helps us differentiate the level of service by being able to accommodate our customers. Mark, do you want to add something?



Mark Johnson - NCI Building Systems Inc - CFO

Sure. I was going to try to break that 130 basis points that we described in our operating efficiency down into the segments for you. So that 130 basis points equates to somewhere around \$3.6 million. And you can split that across our segments at about \$1.8 million in the building segment, a little short of \$1 million in the components segment, and around \$800,000 in the coating segment.

Scott Schrier - Citigroup - Analyst

Great. Thank you very much.

Operator

Now we will go to Brent Thielman with D.A. Davidson.

Brent Thielman - D.A. Davidson & Co. - Analyst

Hello, good morning.

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

Good morning.

Brent Thielman - D.A. Davidson & Co. - Analyst

Norm, were there any specific end markets -- as you got into April and May that have gotten worse, or declined versus the prior year in terms of bookings?

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

I would tell you that one of the markets that we find challenging is kind of in the Southeast, is the Georgia, the general Georgia area, and that historically has been, because there is a population of very good small local builders there. And so, our buildings group is challenged at times to get what we consider to be our share of the action there. But by the same token, on the flip side, our components group sells to a lot of those small builders. So we kind of benefit on that side, so it is kind of a mixed story. The Northeast, and New England in particular, really showed early recovery, and has staggered -- gotten a little bit slower through the winter and into this part of the year. And we would expect to see that improve, because of the seasonality was a bit more pronounced there.

Brent Thielman - D.A. Davidson & Co. - Analyst

Okay. So it is more from a geographic kind of point of view versus building types?

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

It seems to be more geographic than end market specific. Yes, it does.

Brent Thielman - D.A. Davidson & Co. - Analyst

Okay, great. And then just as a follow-up, maybe one more for you, Mark. In components, could you give us the costs associated with the ramp up of the Richmond facility? I think there was some specific costs there, and do you expect sort of similar level going into Q3? I didn't see that in the CFO commentary.



Mark Johnson - NCI Building Systems Inc - CFO

Sure. So there is more than one thing going on in the components segment. And what I was speaking to in growth initiatives was an incremental \$1.2 million that was spent in ESG&A. And the total debt we are spending on these growth initiatives was about \$2.8 million in the second quarter, and that \$2.8 million is now driving about \$5 million of incremental revenue. This is the first real quarter where the incremental revenue is now starting to be achieved, and we see that cost there being progressively more leveraged going forward. But that, those numbers that I am speaking to are several different initiatives, the architectural panel in Richmond, Virginia is only one of those. And on the ESG&A front, that is only about \$340,000 of that expense.

Brent Thielman - D.A. Davidson & Co. - Analyst

Okay. Thank you.

Operator

And now we will go to Bob Wetenhall with RBC Capital Markets.

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

Good morning.

Operator

Mr. Wetenhall, your line is open. Okay. Moving on, we will go to Alex Rygiel with FBR Capital Markets.

Alex Rygiel - FBR Capital Markets - Analyst

Thank you. Good morning, gentlemen.

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

Good morning.

Alex Rygiel - FBR Capital Markets - Analyst

Norm, can you talk a little bit about the May bookings again? How much of that is, what you would call catch-up, versus how much of that feels like underlying strength?

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

Boy, that is a \$64,000 -- I would say that the one thing that became clear in the tracking of inquiries which precede our winning a job and booking it, is that there were a number of jobs on the horizon, that did not get bid and booked in the first half of the year. So I am not ever quite sure whether that is catch up, or whether that is just a timing piece of the business. I will say that there were clearly some jobs, and specifically every Tuesday we kind of recount these jobs, that have really reflected a hesitation, and then a pent-up kind of demand pick up.



But I would tell you, I still think from the anecdotal information we have, that at least half, if not more in the early part of May was literally new work, and it wasn't a pent-up demand. And I say that -- that is a rough estimate. It may have been as low as 25% was pent-up demand, demand that really should have been in the first half of our bookings.

Alex Rygiel - FBR Capital Markets - Analyst

And is there anything interesting occurring within the size of bookings? Is the average size any larger or smaller than maybe you have seen in the past?

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

Well, we look at our bookings on a weekly basis, and we look at the complexity from one to ten, ten being most. And it historically, is a bit of a bell curve with the four, five and sixes in the middle, and biggest part of our -- and I would say that bell curve is changing slightly in shape, that we are seeing and have seen success with our express buildings, which are smaller.

And we have seen nice success in the growth of that level of work, which is quite good, because it is stuff that moves very quickly through our manufacturing, and we have seen a pickup in the more complex work. And so, what we had probably seen in the first half of the year was a more reticent kind of mid bell curve, in other words, the four, five to sixes were a bit less than we would expect. But that seems to be balancing out now in a more normal way, which I think is a good thing.

Alex Rygiel - FBR Capital Markets - Analyst

Thank you very much.

Operator

Our next question will come from Dan Oppenheim with Credit Suisse.

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

Good morning.

Michael Dahl - Credit Suisse - Analyst

Hello, this is Mike Dahl on for Dan.

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

Hello.

Michael Dahl - Credit Suisse - Analyst

I wanted to start with some of the comments on the outlook. And so, appreciate the seasonality here, but it is 60% to 90% of EBITDA in the back half, or it translates into a pretty wide range. And I know Mark, you commented that you expect it to be towards the higher end of normal seasonality, but the comment is still out there that it is 60% to 90%. So what is driving -- what is the thing that is keeping you guys from actually formally kind of increasing that range, what are the biggest swing factors here? Thanks.

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



Well, the biggest swing factors for the second half of the year --

Mark Johnson - NCI Building Systems Inc - CFO

His question was, what is causing us to not increase the range, or increase the upper end of that range given the -- (Multiple Speakers).

Michael Dahl - Credit Suisse - Analyst

Yes. Well, if you think it's towards the higher end of the normal 60% to 90% and we are midway through the year, and you have got some positive commentary on the trends you are seeing in the business, that is still a really wide range.

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

Yes.

Michael Dahl - Credit Suisse - Analyst

So what are the biggest swing factors then?

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

Well, again, I think that as I said -- not so much as a caveat, but as -- I mean, I am not sure that there were many that expected to see the US economy step from what was going to be a very modest growth of 0.1% down to a full 1% negative. That coincides with exactly what we saw in terms of our bookings, as I think I said. We are year-on-year monthly negative, in other words negative comp monthly year-on-year for December, January, February, and March.

So my point of this is that, our belief is that the US economy is recovering. That we will not see a negative GDP in the second quarter or the third quarter or the fourth quarter. But if that were to occur, then that affects our range, right? That affects our range. So I think that when we look forward, we see a very robust opportunity for us in the second half. And that is exactly what we believe we are seeing in the bookings, we believe we are seeing in the backlog, and we expect to continue to see.

Michael Dahl - Credit Suisse - Analyst

So just to be clear, absent any deterioration in the overall economy, you are very comfortable with the higher end of that?

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

Yes.

Michael Dahl - Credit Suisse - Analyst

This -- (inaudible).

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

Yes.

Michael Dahl - Credit Suisse - Analyst



Okay, thanks. That's helpful. And then, just shifting gears back to the complexity question. How should we think about the timing of some of the higher complexity projects that are getting bid and booked today or in May?

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

Well, I mean, there is no question that higher complexity utilizes more of our resources and takes longer. But I -- we have a -- we have on our Tuesday call in the buildings group, we have a very good transparency of all the jobs that are in, and how they are falling in the schedule. And I was impressed with the -- not -- I wasn't on the Tuesday call, but the week before -- that 92% of the jobs are coming out of our engineering and drafting and going to manufacturing on time. So my point being, that I don't think that would have been the case in any year in the past, which means our ability to convert an order through the process of engineering and drafting, and then get it to be able to ship has fundamentally improved.

Now that doesn't change the fact that some end users sites are really dictated to have, particularly up North, are dictated to have things installed in Canada and whatnot in the ice season, when the ground is firm. And so, there will be some of those kinds of things. I think the other part of it is that when you look at the complexity in some of the mining facilities that we look at, you see oftentimes disruptions due to environmental requests that could throw off a scheduled date. So in complexity, does seem to run a higher risk of us having delays. But I will tell you that we really welcome that work, because it is a very important part of building up our backlog.

Michael Dahl - Credit Suisse - Analyst

Okay. Thanks, and good luck in the quarter.

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

Thank you.

Operator

(Operator Instructions)

We will next go to David Cohen with Midwood Capital.

David Cohen - Midwood Capital - Analyst

Yes. I would like to go back to the prior questioner's question regarding this range for EBITDA, which you have been consistent on. But [mathematically], you have put out there a range, or if -- just the math is, you did \$14.3 million of first half EBITDA. So that is either 40% of the full year or just 10% of the full year, by virtue of the complement of your 60% to 90% range. So that leaves a range for the full year EBITDA that is a mile wide, with the high end being \$140 million. Is this Company going to do almost \$130 million of EBITDA in the back half? I find that hard to buy into.

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

Sure, that is hard to buy into. That would mean that we see growth vastly exceeding our expectations.

David Cohen - Midwood Capital - Analyst

Right. But that is the math that occurs if the first half is 10%, and the back half is 90% of your annual EBITDA.

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



Correct. Yes, that is the math.

David Cohen - Midwood Capital - Analyst

Yes.

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

Right.

Mark Johnson - NCI Building Systems Inc - CFO

Yes, I think we were confirming, that we would be more towards the upper end of that range. We weren't confirming any precise number within that range.

David Cohen - Midwood Capital - Analyst

And is there some point at which you would consider greater precision around the financial objectives of the business on an annual basis? Or is this messaging likely to be the -- just this is your messaging, and as you look into next year, this is going to be the same type of messaging?

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

So one of the things that those with any bit of messaging is our ability to actually deliver that. Right? I mean, we don't want to either understate or overstate what we think the future is going to hold. But to be sure, in the first half of the year, it is a son of a gun to get it right. We are easily disrupted, particularly at levels that are 40% lower than the previous beginning of the cycle -- at the cyclical recovery in 2004. So volumes are very much still in a depressed mode.

So our sense is, we as the market recovers, we will I am sure get better at providing you and others with insights as to where -- I mean, as to where we think we are going to be. But I will tell you, within the recovery, we are still a ways off from having that level of confidence for a given quarter. We think that the second half of this year will produce results that are consistent with our expectations, which would show year-over-year growth. And that is what we are working towards.

David Cohen - Midwood Capital - Analyst

All right. Thanks for taking my question.

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

Yes, thank you.

Operator

Now we will go to Dana Walker with Kalmar Investors.

Dana Walker - Kalmar Investments - Analyst

Good morning, there. Can you folks address some of the earnings drags that you saw in the coatings group in first half of the year, and whether they will persist? You mentioned utilities, and you mentioned the spend related to growth initiatives amongst a couple?



Mark Johnson - NCI Building Systems Inc - CFO

Yes. So one of the primary impacts on the coatings group that was a drag, was the interruption to their plant activities due to weather delays. They had several plants that were forced to shut down by the utilities because they were using utilities to heat homes. And in addition to that, the utility costs were higher. So you mix all of that together with a very, very efficient operation, and you introduce that kind of activity, it becomes a less efficient operation.

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

Plus there was -- (Multiple Speakers) -- go ahead.

Mark Johnson - NCI Building Systems Inc - CFO

I was just going to say -- but outside of that, the biggest single driver for the challenge to them is the disruption to the supply chain, which drove some unforeseen costs into our steel costs, that they had to therefore pass on and when they sell packages of steel. And so, there was margin compression. And then finally, I mentioned the incremental costs they are incurring for some marketing and sales programs. Part of that is around marketing and branding the Middletown, Ohio facility and the rest of their sales initiatives.

Dana Walker - Kalmar Investments - Analyst

Which of these do you foresee persisting?

Mark Johnson - NCI Building Systems Inc - CFO

Well, I think that we have gotten through the steel issue, and I don't foresee any of the disruptions to the plant operations. So that part will not continue. We will spend a little bit of the \$300,000 on marketing in the quarters ahead of us, but not -- less than half of that amount, so less than half of the \$300,000.

Dana Walker - Kalmar Investments - Analyst

And Mark would you comment again, maybe I didn't quite get this, when you talk about weather disruption, are you under some obligation when there is a call upon power, that you need to shut down so that that power can go somewhere else?

Mark Johnson - NCI Building Systems Inc - CFO

Yes. We don't see that very often, but there is a couple of places where we do see that, Ohio being one of them, where the utilities can literally say we need the power to heat homes, and therefore you need to have a plant shutdown day.

Dana Walker - Kalmar Investments - Analyst

Okay. Second question, final question, can you talk about the tone in your insulated panel business year-to-date, and what you foresee in the back half of the year?

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

Yes. So I will tell you that the level of cold storage continues to be quite good, and the level of shipments of a commercial industrial have been weaker than a year ago. But by the same token, we have seen an increase in C&I applications of insulated metal panels that flow through our buildings group. So overall, we have seen a continuation of growth in commercial industrial, but it has been slower in the first half of the year than last year, and we think that was more to do with weather. So we are expecting the insulated metal panel group to have a stronger second half of the year for sure, and they are working very hard at that.



We, again, have been pushing them with other parts of our business to value price. And sometimes in certain markets that they find that as challenging, as some of our other folks do, but nevertheless we think it is important, and we are going to continue to do that.

Dana Walker - Kalmar Investments - Analyst

Norm, has there been any change in the capacity available to the market, particularly in the commercial and industrial side?

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

There hasn't -- so there has been a bit of increase, in other words, if you are talking about insulated metal panels?

Mark Johnson - NCI Building Systems Inc - CFO

Yes.

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

Okay.

Dana Walker - Kalmar Investments - Analyst

Yes.

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

So the -- yes, one of our competitors brought on a line in Arkansas late last year.

Dana Walker - Kalmar Investments - Analyst

Very well, thank you.

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

Great. Thank you.

Operator

All right. We will go back to Bob Wetenhall with RBC Capital Markets.

Desi DiPierro

Great. Thanks for taking my question. This is Desi filling in for Bob.

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



How are you?

Desi DiPierro

Good. When you think about your mid cycle guidance, do you have any assumptions embedded in there with regard to your ability to grow faster than the overall market as you have historically, or could that be a source of upside? Also, what sort of incremental EBITDA margin are you using to arrive there?

Mark Johnson - NCI Building Systems Inc - CFO

Sure. Effectively the way we have progressed that is using our fair share of the market as the primary under component. So when you think about the market recovery and we maintain our fair share of that, that is the foundation. But then we have very specific initiatives, insulated metal panels being one and there are others, where we expect to grow faster than the marketplace just because they are new investments to us. So it is a combination of both of those. There is a really good page in our investor presentation. I don't have it in front of me, but it is --

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

It is 31.

Mark Johnson - NCI Building Systems Inc - CFO

It does a pretty good description of reconciliation, of how we think about that incremental margin. But I believe it is a 23% incremental margin, is what is used.

Desi DiPierro

All right.

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

Wait --

Desi DiPierro

Great.

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

It is just more in line with historical levels, than it is any extraordinary improvement.

Mark Johnson - NCI Building Systems Inc - CFO

Yes.

Desi DiPierro



All right. And then, second question on pricing, which you -- I touched on a few times, and you pointed out that gross margin performance benefited from about 40 basis points of prices. Is that impact -- do you think that could accelerate, or is 40 basis points on the gross margin line what we should be thinking about for the balance of the year?

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

Well, my view is that it should increase.

Mark Johnson - NCI Building Systems Inc - CFO

It should increase -- 40 basis points is what we are currently recognizing out of the 200 basis point discussion we were having earlier, where we have seen improvement in the pricing in our backlog. So we should expect to see that incrementally improve.

Desi DiPierro

Great. Thank you.

Operator

At this time, there are no further questions. So I would like to turn it back over to our speakers for any additional or closing remarks.

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

Assuming there is anybody still left on the call, I want to thank you very much for joining us, and look forward to the third quarter call. Thank you.

Operator

Ladies and gentlemen, that does conclude today's NCI Building Systems second quarter earnings call. We thank you for your participation.

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