THOMSON REUTERS

FINAL TRANSCRIPT

Q3 2017 NCI Building Systems Inc Earnings Call

EVENT DATE/TIME: 09/07/2017 09:00 AM GMT

CORPORATE PARTICIPANTS

Darcey Matthews *NCI Building Systems, Inc. - VP of IR*
Donald R. Riley *NCI Building Systems, Inc. - CEO, President & Director*
Mark E. Johnson *NCI Building Systems, Inc. - CFO, EVP and Treasurer*

CONFERENCE CALL PARTICIPANTS

Lee M. Jagoda *CJS Securities, Inc. - Director*
Matthew Adrien Bouley *Barclays PLC, Research Division - Research Analyst*
Reuben Garner *Seaport Global Securities LLC, Research Division - Associate Analyst*
Robert C. Wetenhall *RBC Capital Markets, LLC, Research Division - MD in Equity Research*
Scott Evan Schrier *Citigroup Inc, Research Division - Senior Associate*

PRESENTATION

Operator
Greetings, and welcome to the NCI Building Systems Third Quarter 2017 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. Please go ahead.

Darcey Matthews ***NCI Building Systems, Inc. - VP of IR***
Good morning, and thank you for your interest in NCI Building Systems. Joining me today for the call are Don Riley, our CEO; and Mark Johnson, our CFO.

Please be reminded that comments regarding the company's results and projections may include forward-looking statements that are subject to risks and uncertainties. These risks are described in detail in the company's SEC filings, earnings release and supplemental slide presentation. The company's actual results may differ materially from the anticipated performance or results expressed or implied by these forward-looking statements. In addition, management will refer to certain non-GAAP financial measures. You will find a reconciliation of these non-GAAP financial measures and other related information in the earnings release and supplemental presentation located on our website.

Our third quarter earnings were released last night. This morning, Don will provide some key highlights about the business and our views for the remainder of the year; then Mark will provide details regarding our third quarter financial performance and our guidance for the fourth quarter. After that, we'll be happy to take your questions.

And now I'd like to turn the call over to Don.

Donald R. Riley ***NCI Building Systems, Inc. - CEO, President & Director***
Thanks, Darcey, and good morning, everyone. I'd like to open by saying a few words about Hurricane Harvey and aftermath. I would like to thanks everyone for their prayers, well wishes and offers of assistance for those impacted by this horrific event. Anyone wanting to help at this point, the best way is to contribute or volunteer. We have been guiding people to the American Red Cross or Catholic Charities, both are well-known organizations with specific funds established to help victims of Hurricane Harvey on the subsequent flooding. Additionally, we are setting up an employee disaster relief fund to assist NCI employees who suffer a loss due to any natural disaster now or in the future. While Hurricane Harvey has deeply affected all of us, and some have experienced significant loss of property at this point, we are not aware of any serious injuries to our employees or their families.

In the Houston area, we have 3 of our 35 manufacturing plants, 2 of our 9 Metal Depots and our corporate headquarters. These facilities have been minimally impacted and are now fully operational. Again, please keep everyone impacted by this horrific event in your prayers and thoughts as our area begins the long recovery process.

Now let me start by providing a high-level summary of what we're going to cover today. First, our unrelenting focus on taking cost out today and in the future. Second, we are seeing a low single-digit growth in our legacy businesses and are managing these businesses based upon that view. Third, we missed our third quarter revenue expectations and are lowering our expectations for the fourth quarter due to lower-than-anticipated volumes in our legacy components business and the potential dampening impact of Hurricane Harvey. And fourth, the IMP business continues to grow at a double-digit growth rate, continuing our strong success in the IMP business and in our ability to drive adjacent products through our legacy channels.

Now looking at our third quarter results. While revenues increased year-over-year, we experienced a revenue shortfall of approximately $20 million from our expectations due to further softness in our legacy Components business. This represents a variable contribution margin impact of $4 million to $5 million in the third quarter. The hesitation in legacy bookings that we mentioned in our June call lasted longer than anticipated and contributed to the shortfall. Based on current activity levels, we expect this possibly continue into the fourth quarter. These lower volumes negatively impacted manufacturing utilization and slowed the timing of higher steel costs flow-through. Importantly though, we effectively managed due to the rising steel prices during the quarter and expect our fourth quarter gross margin will show sequential improvement. Thanks to commercial discipline, cost control and improved manufacturing efficiency, even with the lower volumes, we were able to deliver an adjusted EBITDA that is within our original guidance range. This demonstrated the strength and value of the cost initiatives we have undertaken, and we'll continue in these areas to improve operating leverage.

Operationally, our third quarter performance was driven by the strength of our insulated metal panel sales in the Components segment. IMP sales grew 18% versus last year's third quarter, with margins expanding by 140 basis points. This performance was driven by sales execution, product mix improvements, commercial discipline and increasing demand. We expect these growth trends to continue into 2018, driven by increased adoption and higher penetration of IMP in the marketplace. This is supported by IMP's performance versus increasingly stricter energy codes and improving understanding by architects, contractors and end customers of the total life-cycle value proposition. These trends can be seen in IMP representing 27% of our consolidated revenues and 39% of our third quarter EBITDA.

The sales of IMP and commercial door products through our legacy distribution channels increased in Q3 by 109% and 20%, respectively, over prior year. This further demonstrates the power of NCI's legacy distribution channels to drive adjacent and complementary products. We expect to see a continuation of strong growth for these product lines for the remainder of 2017 and beyond, which will allow us to continue to outperform the marketplace we compete in.

Turning the focus to the fourth quarter. The third quarter finished strong, but the softness we experienced from April forward leads us to believe that the fourth quarter will be softer than we had previously anticipated. The majority of the change in our view is associated with our legacy Components business and the temporary impact of Hurricane Harvey. We expect the fourth quarter to be sequentially better than the third quarter, both at the top line and at the margin level, even with recent events. We expect revenue to grow as a result of our positive backlog and current activity levels. And we anticipate NCI will finish the year below 2x than the ratio of debt to EBITDA.

While our leading indicators continue to point to year-over-year growth for low-rise nonresidential starts of 3% to 6%, we have noted a divergence in the growth rates of extremely large low-rise structures over 500,000 square feet versus smaller structures within the 2017 year-to-date numbers. Our legacy businesses tend to focus more on these smaller structures less than 500,000 square feet, which are growing at a slightly slower rate. We have seen these divergences before, and they generally moderate over time.

We anticipate, based upon current backlog activity and leading indicators, we will experience low to moderate growth at the lower end of the 3% to 6% range over the next 12 months for our legacy businesses if this divergence continues. Our IMP business will continue to grow at a double-digit growth rate. While external leading economic indicators give us 12 months of visibility to low-rise nonresidential growth rates, within each segment, our internal indicators, like backlog and bookings, give us varying levels of visibility. As we've shared previously, we have a 30-day view on our legacy Components business, a 3- to 6-month view on our Billings business and a 6- to 12-month view in our IMP business.

Our commitment to aggressively reduce costs and continuous improvement in an important part of my focus becomes critical in a lower growth environment. We are on track for delivering the manufacturing and ESG&A cost reductions we have been highlighting quarterly. While we're progressing well on these cost initiatives, I have accelerated $7 million to $9 million of annualized ESG&A actions, previously planned for 2018 into the fourth quarter of 2017. As a result, by 2017 fiscal year-end, we will be materially ahead of our planned reductions from an annualized run rate perspective.

Looking longer term and to the Investor Day on October 12 in New York, I'm excited to showcase our management team and how we're going to continue to drive the company's performance. We'll be sharing our aspirational goals for the next 3 years and will emphasize a strong commitment to cost management and a focus on greater than market growth in our adjacent product lines. My 3 key areas of focus going forward are: advanced manufacturing, where investments in automation and process innovation will further drive down our operating costs, improve margins, quality and service and enhance capacity utilization, increasing our long-term flexibility; continuous improvement, where we will take advantage of the great work that has been done in manufacturing and delivering their cost reductions with Lean and Six Sigma and drive that across our entire business, further reducing operational back-office costs and simplifying the business; and NCI Solutions, where we will showcase our growth strategy around insulated metal panels and our ability and core competency in driving adjacent products through our legacy distribution. I look forward to answering your questions at the end, and I will now turn the call over to Mark for a review of our third quarter financial results and fourth quarter guidance.

Mark E. Johnson ***NCI Building Systems, Inc. - CFO, EVP and Treasurer***
Thank you, Don. As is customary, we have provided a review of our 2017 third quarter financials in both the earnings press release issued yesterday and the quarterly supplemental presentation posted on our website. Now I'll add some additional insight to our results.

While our revenues grew year-over-year, they came in below our expectations and the guidance we have provided. We were able, however, to keep most other metrics, including EBITDA within our guidance range despite the deleveraging impact of lower volumes. This is due in large part to successes with our ongoing cost-reduction efforts and disciplined resource management, which enabled us to achieve gross margins and EBITDA that were within our guidance range.

Total revenues for the third quarter rose 1.5% year-over-year, which was largely driven by realizing better pricing and growth in insulated metal panels, partially offset by lower volumes. As a reminder, in our prior quarter conference call, we noted that the expectation that the seasonal pattern, which was unusual in fiscal 2016 as the result of rapid price increases, would normalize in fiscal 2017. The impact of this pattern shift is to reduce the year-over-year growth rate in this year's third quarter while increasing the year-over-year growth rate in the fourth.

Our gross margin was 24.5%, which was down by about 3 percentage points from a year ago, but up 50 basis points from the 24% gross margin reported during the second quarter of 2017. While we benefited from cost reduction actions and improved sales mix this quarter, which was driven in part by the 18% growth in our IMP products compared to last year, this was more than offset by passing through higher steel prices and less favorable operating leverage due to lower capacity utilization. Importantly, we successfully crossed over the threshold in the steel cycle, where by the end of July, on a dollar for dollar basis, incremental steel costs are being passed through with an incremental margin and are not expected to represent a year-over-year margin headwind in our fourth quarter.

Operationally, we continue to make progress in the implementation of our Lean manufacturing processes as well as the rationalization of our manufacturing capacity and have completed the actions planned for 2017. We remain on target to achieve our overall improvement goal of $15 million to $20 million, of which $6 million was realized in fiscal 2016 and an incremental $6.5 million is expected to be realized this year.

The SG&A expenses decreased versus the prior year as a percentage of revenue by 110 basis points and came in well below the low end of our guidance range. This marked improvement was broad-based as all 3 operating segments saw lower ESG&A cost and was achieved despite higher cost at the corporate level as we centralized certain activities. The reduction in our cost structure due to our ongoing efficiency initiatives enabled a material improvement in the ESG&A cost despite higher revenues. This quarter, with total revenues up about 1.5%, ESG&A costs were down nearly 5%. We have made meaningful progress toward our total ESG&A cost savings goal of between $15 million and $20 million, of which $6 million was realized in fiscal 2016 and an incremental $3.5 million in fiscal 2017. Given the slower-than-anticipated revenue growth, we have effectively accelerated $7 million to $9 million of our annualized cost-reduction activities into the fourth quarter of fiscal 2017. So we will be entering 2018 with an annualized run rate reduction of between $16.5 million and $18.5 million. This further ensures that we are on track for our longer-term target to reduce our annual ESG&A cost as a percentage of revenues to less than 16%. We look forward to sharing our thoughts on future opportunities in this area at the upcoming Investor Day.

With respect to our operating segment performance, I have included commentary for each segment in our supplemental information available on our website.

Before turning to our outlook, I'll make a couple of comments regarding our balance sheet and cash flow. Although I mentioned this during our previous call, I'd like to again reiterate that in May, we amended our existing term loan facility to extend the maturity date to 2022 and reduce the effective interest rate by 25 basis points. This facility has $144 million outstanding, which remains unchanged from the second quarter. We anticipate that through the end of our fiscal year, we will not be making additional principal payments on this facility to avoid the temporary 6-month prepayment penalty that was part of the amendment.

We used approximately $7.3 million of operating cash flow during the quarter, primarily as a result of investments in working capital, due in large part to seasonally higher activity levels and temporary timing fluctuations for accounts payable. As a result, we expect strong operating cash flow in the fourth quarter, which is a common seasonal pattern for us.

Turning now to our outlook. Consolidated backlog is up 5.1% sequentially and 4.2% year-over-year to $580.7 million. As previously mentioned, we expect that the business will exhibit the typical seasonal pattern with a sequentially better fourth quarter unlike like last year, which was an anomaly. Based on our leading indicators, we continue to expect 3% to 6% in underlying growth in new low-rise starts measured in square feet for fiscal 2017. However, our guidance anticipates that in the short term, the underlying growth in the very large projects, which are not typically metal buildings, but have been an area of interest for insulated metal panels, may outpace the smaller projects. We expect the IMP products to continue to be a strong driver of order growth and margins through the rest of this fiscal year. Steel costs should not be a year-over-year headwind on our consolidated margins during the fourth quarter, as we continue to execute on our cost rationalization program and as the cycle plays out to our businesses.

Also as mentioned, we have accelerated our cost-reduction initiatives and we expect further cost control to be effective in fiscal 2017, even though the bulk of these activities will be realized in fiscal 2018.

And finally, the revised fourth quarter and annual EBITDA ranges include an estimated impact of $3 million to $8 million related to the potential temporary disruptions at customer job sites from Hurricane Harvey, which may affect their ongoing projects or ability in the short term to accept deliveries. For this reason, the guidance ranges given for this quarter are wider than we have typically provided. Based on these factors, for fiscal 2017, we expect revenue will range between $1.75 billion and $1.78 billion. We now expect that adjusted EBITDA will range between $162 million and $176 million for the fiscal year.

For the fourth quarter, we estimate consolidated revenue will range between $470 million and $500 million, with adjusted EBITDA ranging between $48 million and $62 million. In addition, gross margins are expected to improve sequentially in the fourth quarter due to higher capacity utilization and no expected headwinds from escalating steel costs. As a reminder, we have provided additional guidance for the fourth quarter in the supplemental presentation posted on our website.

And now we will open the call for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question today is coming from Matthew Bouley from Barclays Bank.

Matthew Adrien Bouley ***Barclays PLC, Research Division - Research Analyst***

Glad to hear that everyone at NCS is okay after the hurricane. So I guess just starting on that, the near-term impact that you've called out from Harvey in the fourth quarter, is there any potential for NCS to eventually benefit from the rebuilding in Houston after that near-term disruption? Are you seeing constraints on labor? Or just how do these events typically play out in terms of volumes?

Donald R. Riley ***NCI Building Systems, Inc. - CEO, President & Director***
Matthew, that's a great question. And typically, what we see is a short-term dampening due to job sites, skilled labor, ability getting to locations, transportation, but we do see that these play out over time in incremental work as the recovery, repairs, rebuilding begins to occur.

—

Matthew Adrien Bouley ***Barclays PLC, Research Division - Research Analyst***
Okay. Got it. Thank you for that. And then I guess as a follow-up, just asking about the legacy Components business. I mean, why do you believe the legacy business is under performing at this point? Is there something structurally changing within the usage of that product? Or is there some type of cannibalization effect you're seeing with IMP? Just what kind of line of sight do you have to recovery in that product category?

—

Donald R. Riley ***NCI Building Systems, Inc. - CEO, President & Director***
Sure. Great question on both fronts. Relative to the cannibalization from insulated metal panels, at this point in time, we don't see that as a factor inside of the legacy businesses. We do anticipate as we get increased penetration of the insulated metal panel product that, that will occur. But we also view that as a favorable thing for our business as, again, single skin is 1 piece of steel and insulated metal panels are higher margin, higher value, 2 pieces of steel going in, but a higher end product. So over the long haul, we see the continued growth. In insulated metal panel business, we view that as favorable. But again, we don't see cannibalization occurring on a short-term basis. Relative to what's going on in the marketplace, fundamentally, what we see is the hesitation, as we highlighted in our June call, continued. And it continued through the third quarter, and we anticipate it will continue into the fourth quarter. We have accounted for that in our guidance for the fourth quarter. And what we're really seeing is customer optimism ebbed and flowed during this period. We are seeing more optimism coming out of them again. As we noted earlier, they had to process a bulk of the work coming out of the first half before they could move on with their backlog. And then what we started seeing as the hesitation continued is that, as these customers are predominantly small businesses, we heard more about concerns over what's going on with health care reform, concerns over what's going on with tax reform, hesitation on making investments in these small businesses and the continued concerns over skilled labor. But we still do see in our leading indicators, as we commented on, low-rise non-res is in the 3% to 6% range over a 12- to 14-month horizon, and we believe that what we're seeing is this low slow growth that we have been talking about and that our businesses are going to perform over time in line with what we're seeing in the marketplace.

—

Operator
Our next question is coming from Bob Wetenhall from RBC Capital Markets.

—

Robert C. Wetenhall ***RBC Capital Markets, LLC, Research Division - MD in Equity Research***

Don, congrats on the new role.

—

Donald R. Riley ***NCI Building Systems, Inc. - CEO, President & Director***
Thanks, Bob.

—

Robert C. Wetenhall ***RBC Capital Markets, LLC, Research Division - MD in Equity Research***
I wanted to ask you guys, this quarter caught me off -- by surprise. It was weaker than I was thinking based on last quarter's results, and it sounded like the trend was your friend. What are the assumptions right now for price and volume in fourth quarter revenue guidance?

—

Mark E. Johnson ***NCI Building Systems, Inc. - CFO, EVP and Treasurer***
Sure. Thanks, Bob. So first of all, with respect to price, we have price increasing sequentially from the third quarter. That's pretty much flowing through as expected. The underlying volumes, particularly in the single-skin business, which we've spoken to, have been lighter than what we had in our view at the end of the last quarter. And that same level of hesitation that occurred in the third quarter is now projected through the fourth quarter, which basically translates into low growth in volume for the full fiscal year for both the Buildings group and the Components group.

—

Robert C. Wetenhall ***RBC Capital Markets, LLC, Research Division - MD in Equity Research***
So how do you make sense of the fact that some of the construction put in place stayed at that just kind of that 12-month outlook you're talking about of 3% to 6% growth, and it seems like your volume side of the equation is behind that? I mean, how can the disconnect happen? How do you explain that?

—

Mark E. Johnson ***NCI Building Systems, Inc. - CFO, EVP and Treasurer***
Yes, the -- fundamentally, there's shifts and turns from time to time in the structures that are being built. Most recently, in the last 2 quarters, or I should say the third quarter and our expectation for the fourth quarter is that some of the growth in the low-rise construction is going to be in larger structures. Structures that we may not play in with our traditional products, but will be opportunities for insulated metal panel products.

—

Robert C. Wetenhall ***RBC Capital Markets, LLC, Research Division - MD in Equity Research***
Got it. That's helpful. So it's kind of like a mix issue in terms of where the demand is going, if I understand you correctly. Let me ask you a big question, because, like I said, congrats on the new position. And maybe you could give me a little preview of the Investor Day. Are you anticipating a change in strategy from kind of the direction Norm had put the company in? How should we think about, on a transformational basis, what you're looking to do and the levers you're going to pull?

Donald R. Riley ***NCI Building Systems, Inc. - CEO, President & Director***

That's a great question. Fundamentally, where Norm has positioned the company well through the manufacturing consolidation, focusing on the supply chain, execution, getting the commercial organization aligned, and we're now going to focus on just taking that in building momentum in a -- on a going-forward basis in 2018 and beyond. And what you're going to see is a very strong focus on cost and efficiency within the business and then focused areas associated with growth that we know we can drive home. So we're excited about the potential around advanced manufacturing, which builds on the great work that the manufacturing organization has done in getting their footprint aligned, but now focuses on how do we drive improved margins, quality, service and enhanced performance out of those businesses through automation in our frame areas, automation in our trim production, through automation in our door business, and through IMP process improvement. And we're going to cover that in more detail in October, but we have line of sight to all of those areas. We're excited about the ability and opportunity on that, and we're going to be bringing the key individuals who are right in the middle of the execution for that. And again, these are intensive labor areas and also areas where we feel that we can find material opportunity and quality improvements in service. Another big area of focus is going to be in -- around continuous improvement. The manufacturing team has done a great job on delivering their bottom line results that we've asked them for relative to manufacturing cost reductions. But we also see a big opportunity in driving that across the whole business, and we're really excited about the potential of that. We're actually going to have the individual there in October who is running that program for us, who drove it in manufacturing. He's going to be driving across the whole company. We've actually already trained in the last 3 to 5 months over 100 individuals in these continuous improvement processes. We had a really exciting session with 25 individuals on identifying key projects, and we have visibility to a lot of great opportunities inside of the business that we're going to be giving you all visibility into. And then the third area is this concept of adjacency. And as we shared the numbers, we're excited about the insulated metal panel business and where that is headed, the double-digit growth that we're seeing and the 140 basis point improvement in margin that we got out of that. But what's really important in the underlying numbers there is we're seeing increased penetration of that product in the marketplace. So we're starting to get into some of the more traditional areas and see that expansion of how that product is being adopted, but we're going to be talking about how we're going to focus on increasing that expansion and adoption rate, every 0.5% percentage that we can get into traditional areas and have them embrace through the architects and contractors and the end-customer community that product is great. And so we're going to share with you how we see that focus going. As we shared in our numbers today, we continue to see strong growth through our legacy businesses on that front. So we have a lot of exciting things to cover. It's not a revolution. It's an evolution building on the great work that's been done in manufacturing and the commercial organizations and the cost work that we've done in the manufacturing ESG&A. And what I'm excited about as we can see our way through to that next level of cost improvement at the gross margin ESG&A and bottom line.

Robert C. Wetenhall ***RBC Capital Markets, LLC, Research Division - MD in Equity Research***

So if I'm hearing you correctly, you kind of got a content with a uninspired top line environment just because you're seeing only modest growth rates, but you see opportunity to improve the P&L by streamlining production through advanced manufacturing that should derive a gross margin benefit. Are there any like big CapEx costs associated with this? And if maybe Mark could just comment on the balance sheet. The stock's up 20%. You have a clean balance sheet. What are your thoughts between capital allocation between reinvesting in the business and share buybacks?

—

Donald R. Riley ***NCI Building Systems, Inc. - CEO, President & Director***
Sure. We are going to lay out in October the capital investments. Right now, the current view is that we're going to be within the typical ranges that we have seen over history, of 1.5% to 2% in that investment in capital. We anticipate that will be in line. But where we see opportunities for material returns, we may push ourselves slightly past that and in areas where we have high degree of confidence that we're going to deliver the -- a really short-term horizon result.

—

Mark E. Johnson ***NCI Building Systems, Inc. - CFO, EVP and Treasurer***
I was going to say, with respect to your question on stock repurchases and capital allocation, historically, we've been relatively opportunistic with that. I would expect we would maintain that view going forward. The allocation priorities we have continued to be the same. Our first priority is to fund our internal initiatives, some of those items that Don was just walking through. Our second priority is to make sure we maintain our net debt ratio at less than 2.5, and then opportunistic share repurchases as appropriate, and then acquisition opportunities as they develop.

—

Robert C. Wetenhall ***RBC Capital Markets, LLC, Research Division - MD in Equity Research***
Got it. I just thought with the share price at its current level, it was kind of a good opportunity. Just for Mark, a housekeeping and then I'll pass it on. Your ESG&A guidance for 4Q suggests that dollars spend is going to be flat to slightly up year-over-year. And are you putting into the fourth quarter forecast for guidance some onetime costs? How do we think about the ESG&A in rising in light of some of your comments about pursuing cost-reduction initiatives?

—

Mark E. Johnson ***NCI Building Systems, Inc. - CFO, EVP and Treasurer***
Sure. With respect to the guide for ESG&A cost, one of the fundamental things that's occurring is we allocate our incentive compensation to the periods in which earnings are produced. So we have an incremental amount of incentive compensation, typically in the fourth quarter when it's seasonally structured that way, which we would expect this year. But the underlying reduction in costs continues to be the same as they were in the third quarter.

—

Operator

Our next question today is coming from Lee Jagoda from CJS Securities.

Lee M. Jagoda ***CJS Securities, Inc. - Director***
So just looking at the gross margin impact from rising steel prices and price discipline as you guys put it in the supplemental presentation, just trying to understand whether that was all related to the inability to pass through rising steel costs or if there was negative margin also in there, either from the lack of price discipline or from another market participant causing you guys to have to go along?

Mark E. Johnson ***NCI Building Systems, Inc. - CFO, EVP and Treasurer***
Yes. Fundamentally, the pricing performed as we had expected and was not out of line with the trajectory. The flow through of inventory, though, obviously with the lower volumes, didn't flow through in the same pattern as we would have anticipated and there are various layers of steel cost purchase at different points that flows through. And so we're not burning through some of the higher layers as quickly as we would have liked. So that flows through as not as high margins in the fourth quarter as we otherwise would have had.

Lee M. Jagoda ***CJS Securities, Inc. - Director***
Okay. And then you obviously broke out the Harvey impact to EBITDA and you kind of went through your manufacturing facility footprint and everything in the Houston area. Can you speak to sort of the Southeastern corridor in Florida? What's your exposure looks like there and whether your guidance includes any potential conservatism for the storm we're about to get?

Donald R. Riley ***NCI Building Systems, Inc. - CEO, President & Director***
Yes. At this point, we haven't accounted for the potential impact of Irma on the Southeast part of our business within our guidance, and we do keep our thoughts and prayers with those that are already being impacted by it and those who are about to be impacted by it as we can understand that firsthand. I would anticipate that we would see, assuming it follows the paths that are being talked about that we will see a similar potential short-term impact with a long-term upside potential. But the reality is we don't know what the track's going to be and we don't have a way to predict what's going to occur at this point.

Lee M. Jagoda ***CJS Securities, Inc. - Director***
But can you go through sort of -- if you have 3 of the 35 Metal Depots or manufacturing facilities in Houston, what your exposure looks like in Florida and the Carolinas?

Donald R. Riley ***NCI Building Systems, Inc. - CEO, President & Director***

Yes. From that perspective, we don't have any exposure.

—

Operator
Our next question is coming from Matt McCall from Seaport Global Securities.

—

Reuben Garner ***Seaport Global Securities LLC, Research Division - Associate Analyst***
This is Ruben on for Matt. So you guys talked about your leading indicators pointing to -- still pointing to 3% to 6% in the short term. Obviously, your volume guidance is a little bit lower than that. Can you tell us, have you ever seen a divergence that big between your leading indicators and near-term volume? And maybe what gives you confidence that it's going to bounce back and maybe tie in with the mix impact between those different sized buildings will be as we move into fiscal '18?

—

Donald R. Riley ***NCI Building Systems, Inc. - CEO, President & Director***
Sure. I'll provide some insight and then Mark can join in. We have seen throughout our history, looking back past the few years where we have seen flattening out like this. Our -- the leading indicators that we've been following do show 3% to 6% out to the 12- to 14-month horizon. As we look into our internal perspective, we look at backlog and bookings. And as we have shared in the backlog numbers, our backlog currently supports the low growth pace that we were seeing. As we have shared, our visibility in insulated metal panels is a 6- to 12-month horizon and we see continued positive growth on that front. In the Buildings business, I think we're up approximately 5% in our backlog in that business, and we've had favorable bookings as compared to the market for the last 3 quarters. And then in the single-skin business, which is where we've seen, we have the least amount of visibility, it's a 3- to 4-week window, we have accounted for the low slow growth in the guidance that we've provided there. And the current pace that we're seeing in the order book supports that pace. So that's why we're supportive of the view that we've laid out.

—

Mark E. Johnson ***NCI Building Systems, Inc. - CFO, EVP and Treasurer***
Yes. And with respect to historical experience, we see variations all the time in the short-term trend relative to what the leading indicators are indicating. Historically, those leading indicators have been extremely good on annual chunks, but not great in near-term projections, because there are so many other variables in play, not to mention some of the ones we've had recently, weather and politics being some of the bigger ones.

—

Reuben Garner ***Seaport Global Securities LLC, Research Division - Associate Analyst***
Okay, great. And then one more for me. The -- on Houston, your guidance talked about the potential EBITDA hit in Q4. If I back into it, and I just want to make sure my math's right, it looks like maybe more than half of your revenue short -- or guide down in the fourth quarter is -- could be tied to that Houston

region, which is temporary. Am I doing the math right there?

Mark E. Johnson ***NCI Building Systems, Inc. - CFO, EVP and Treasurer***
Yes, that's approximately correct.

Operator
(Operator Instructions) Our next question is coming from Scott Schrier from Citi.

Scott Evan Schrier ***Citigroup Inc, Research Division - Senior Associate***
As a follow-up to kind of Wetenhall's question on the Investor Day preview, Don, I was just curious if you can give -- maybe back up some higher level thoughts about the cycle and how you look at the non-res construction cycle and where we are now, how you think about leverage and M&A and more of your bigger picture views on the business as you take the helm.

Donald R. Riley ***NCI Building Systems, Inc. - CEO, President & Director***
Okay, so that's s pretty broad question there. So we'll pick it up at a high level. So overall, we continue to see low slow growth in the business and where our visibility takes us is out to 12 to 14 months, and we continue to see 3% to 6%, and our bookings and backlog continues to support that. So that's the degree of visibility we have. The businesses seem to support that. The customer base seems to support that, and that's the view that we have built into our guidance for the year, anticipating that we will see throughout 2018. From a broader perspective as we're going to share in Investor Day, from a strategic direction, we're excited about that our manufacturing costs are on track with the direction that we've set. And that our ESG&A costs are on track with the direction that we've set. And we accelerated some ESG&A actions, which are not reflected in Q4, but they will be realized on a go-forward basis in 2018. So that keeps us on our strategic path to getting below 16% as our longer-term goal for ESG&A, and it keeps us on our strategic path to getting to the EBITDA percent of sales that we want to have for the company. And we're seeing that in our sequential gross margin improvement. And where we see it in this low growth environment, what is really important, and I'm excited about the potential, is a strong commitment and focus on our cost structure and areas that we see we know we can impact through advanced manufacturing. We see a lot of opportunities across every single one of our areas of business for automation and increased discipline impacting our cost structure and our quality and our service. And then we see a lot of opportunity in continuous improvement and simplification across our back office. And as you've heard Norm talk about before, the footfalls, and there's a material benefit to the company. And I've sat in with the teams working on that already, and they're really fired up and excited. And we will have the individuals who are leading these initiatives present on Investor Day, so you can look them in the eyes and see firsthand their passion for these areas. And then we'll talk about this concept of adjacency and the impact it's having on our IMP and door business and where we see future opportunities for that. Our priorities are, as Mark has called out, maintaining our CapEx and focusing on

those areas with high returns and then our debt position, which we're really excited about where that's headed, and then keeping dry powder for opportunistic share repurchase. And then we will -- in the short term, be opportunistic in acquisitions. But over the long term, we're going to be focused on how we drive in more adjacency in the business and get into the broader envelope in the cycle, where we are in the build cycle.

Scott Evan Schrier ***Citigroup Inc, Research Division - Senior Associate***
And as a follow-up, Mark, I wanted to ask about your comments on cash flow. It's been soft this year, and you talked about the working capital use and that we're going to have a ramp-up in 4Q. Is there any way to think about the magnitude, maybe as a -- on a percentage of EBITDA, of how much cash flow we expect to generate and how you think about your capacity to implement the buybacks?

Mark E. Johnson ***NCI Building Systems, Inc. - CFO, EVP and Treasurer***
Sure. We've had seasonal patterns very similar to this in the past where material amounts of working capital are generated in the fourth quarter. And given the seasonal pattern we expect this year and the run-up in working capital we've had through the end of the third quarter, I would expect to produce significant amounts of free cash flow in the fourth quarter. And that's something you can look back at past periods and see that pattern pretty clearly. So I had anticipated that, for this year, our net investment in working capital, given the increase in steel prices, would be somewhere on the order of $20 million to $30 million. And I still anticipate that, that will be the case by the end of this year. So that speaks to $30 million to $40 million being generated out of working capital in the fourth quarter.

Operator
We reached the end of our question-and-answer session. I will turn the floor back over to Darcey for any further or closing comments.

Darcey Matthews ***NCI Building Systems, Inc. - VP of IR***
All right. Thank you, Kevin. The team is going to be attending the RBC Conference in Las Vegas on September 13, and then we will be at the Zelman Conference in Boston on September 14. And as was mentioned, we will be hosting an Investor Day in New York on October 12 to provide additional details on some of the initiatives Don mentioned, introduce the broader management team and provide our aspirational views for the next several years. If you're interested in receiving more information about our Investor Day, please feel free to contact me. And again, we thank you for your time and appreciate your interest in NCI. Thank you.

Operator
Ladies and gentlemen, thank you for your participation. That does conclude today's teleconference. You

may disconnect your lines at this time, and have a wonderful day.
