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Cornerstone Building Brands, Inc. (CNR)

Q2 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and thank you for standing by. Welcome to the Cornerstone Building Brands 2Q 2021 Earnings Call. At this time, all participants are in a listen-only mode. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to Tina Beskid, Vice President of Finance and Investor Relations. Please go ahead.

Tina M. Beskid

Vice President-Finance and Investor Relations, Cornerstone Building Brands, Inc.

Good morning, and thank you for your interest in Cornerstone Building Brands. Joining me today are Jim Metcalf, Chairman and Chief Executive Officer; and Jeff Lee, Executive Vice President and Chief Financial Officer. 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 other investor presentations. 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 investor presentation located in the Investors section of our website. Please note, we will be referencing our investor presentation throughout today's call.

Today's call is copyrighted by Cornerstone Building Brands. We prohibit any use, recording or transmission of any portion of the call without our expressed advanced written consent. Throughout this presentation, management may also refer to pro forma financial results. Such pro forma results give effect to the completed acquisition as if such acquisition was consummated prior to the periods presented.

With that, I would like to turn the call over to Jim.

James S. Metcalf

Chairman & Chief Executive Officer, Cornerstone Building Brands, Inc.

Thank you, Tina. Good morning, and thank you for joining us. Before Jeff and I review our second quarter results, I'd like to discuss the press release that was distributed this morning. I have decided to retire as CEO of Cornerstone Building Brands. It has been a privilege to serve our company since its inception and to work with the most dedicated and talented employees and leadership team in the industry. I am proud of the tremendous accomplishments we have made as a company.

Over the last year, I've been working closely with our board of directors to identify my successor. After a thorough process, I'm pleased to announce that Rose Lee will be joining the company to succeed me as Chief Executive Officer beginning on September 6 of this year. I will remain as Executive Chairman of the board through March of 2022 and ensure a seamless transition.

Rose has an impressive background. She has held multiple senior leadership positions at DuPont, most recently serving as President of the Safety and Construction Business and at CertainTeed, where she led businesses for the residential end markets. I am honored to have Rose join Cornerstone Building Brands as we have pivoted to growth from integration. As Rose and I work through the transition, we will continue to focus on driving value creation for our shareholders.

Now turning to second quarter, the second quarter was another strong quarter for Cornerstone Building Brands as we faced headwinds from commodities, freight and labor inflation. Our commitment to execution and value creation for all stakeholders resulted in record net sales and adjusted EBITDA, contributing to an outstanding first half of 2021.

During the quarter, demand for residential and commercial products continued to be robust. Net sales increased approximately $308 million or 28% over a COVID-impacted prior year due to volume growth and price. Compared to a healthy second quarter of 2019, net sales increased 6.5%. Several solid underlying fundamental drivers indicate that these market conditions are more than a temporary rebound, providing increased confidence in our outlook for next year, especially for our commercial end markets.

We achieved record second quarter adjusted EBITDA of $190 million, an 18% improvement over last year and an 8% improvement over 2019. As expected, we experienced margin compression versus the prior year as a result of increasing costs from commodities and other manufacturing inputs. In response to this dynamic inflationary environment, we continue to take price actions across all of our businesses. We are committed to price discipline and expect our actions will offset inflationary costs for 2021.

Additionally, material and labor shortages persist, driving up costs to serve our customers. We are attacking these challenges and remain focused on our service value proposition, solidifying our position as partner of choice for our customers. As a result of our stronger earnings and financial discipline, we reduced our net debt leverage ratio to 4.6 times, approximately a half turn better than the second quarter last year. Jeff will be providing more details about our recent actions to strengthen our balance sheet and advance our capital allocation strategy.

Now, if you could turn to the slide 4. We have taken several actions to advance our growth strategy and drive sustainable value creation. Sustainable value creation is critical because it allows us to deliver shareholder return, while establishing a foundation to support our long-term growth aspirations. Our portfolio is large and has tremendous breadth and depth.

To deliver long-term value, we must participate in categories where meaningful growth exists. So we continually evaluate our portfolio taking actions that will result in a more focused and simplified portfolio. As a result, we unlock the potential to maximize top line growth and profitability. Additionally, these actions strengthen our financial flexibility and position the company to advance towards our net debt leverage target of 2 to 2.5 times that we've referred to over the past year or so.

Turning to slide 5. Our portfolio optimization is rooted in our core growth strategy and leverages areas where we have a competitive advantage. Let me touch on each one. First, our portfolio innovation, we have leading products solutions with deep market exposure across our segments. Maintaining a focus on the customer, we look for opportunities that will enhance our delivered value with an expansive portfolio of products to meet our customers' evolving needs.

A scale player, we are the largest exterior building products company in North America. We must grow our categories to grow our business. We look to enhance our geographic profile and drive category growth in large deep markets. Serving our customers with channel strategies that provide tailored solutions is our value proposition. By leveraging our integrated supply chain and delivering a differentiated customer experience, we become a long-term partner of choice for our customers.

And finally, as a cost-advantaged manufacturer, we look to leverage our scale in procurement and our manufacturing processes. Generating fuel to invest in our business requires a continued focus on cost discipline and productivity gains.

Our approach to optimizing the portfolio places a focus on high-growth, high-profitability businesses. For example, we've announced a divestiture of our Insulated Metal Panels and our DBCI Roll-up Door businesses. These transactions fit within the framework I just discussed.

For Cornerstone Building Brands, both businesses had limited channel strategies, cross-segment customer opportunities and scale leverage. The sale of these businesses frees up resources to focus on our highest growth opportunities. Additionally, the divestitures unlock immediate value by monetizing strong assets at an attractive multiple. We expect the proceeds of approximately $875 million after-tax. The proceeds will be used towards investments where we see the greatest potential to drive growth and also to pay down debt.

We're very excited about the recent acquisition of Prime Windows and Cascade. These acquisitions advance our strategy to grow in the large, deep residential windows market strengthening our market leadership position in vinyl windows and doors. Additionally, the acquisitions expand our manufacturing presence across the rapidly growing West Coast region and enhance our tailored solutions for our customers.

We believe our recent portfolio activity will strengthen our long-term growth potential by providing a greater focus in redeploying investments to our highest growth opportunities. We are confident in our ability to generate value because our businesses are well-positioned in great categories and our leadership team is aligned on delivering.

Turning to slide 6. We are excited about the growth opportunities ahead of us. The company embraces a continuous improvement culture focused on optimizing costs and building greater brand equity to fuel growth, solidifying us as a cost-advantaged manufacturer. Our relentless drive for exceptional results and superior execution have generated strong results. These actions provide the fuel needed to advance our growth strategy.

Our investment approach is now organic and focused. We're using our efficiency gains to reinvest in the business. We're simplifying our portfolio so we can leverage unique customer insights in our scale more quickly and broadly across the categories.

Additionally, we are intently focused on investing for growth in the business through capital expenditures that are focused on automation and other organic growth initiatives, which we believe will deliver the highest return for our shareholders. Finally, we are focused on positioning for growth with an emphasis on deleveraging our balance sheet.

As a result of our profitable growth and strategic divestitures, we expect to improve our net debt leverage by 1 to 1.5 turns from the end of last year. We have prioritized leverage improvement over the last few years, providing the financial flexibility for a more balanced approach to capital deployment. We remain committed to our balanced capital allocation strategy, driving sustainable growth for our business and continued returns for our shareholders.

Now, I'd like to turn the call over to Jeff.

Jeffrey S. Lee

Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Cornerstone Building Brands, Inc.

Thanks, Jim, and good morning. Our drive for exceptional results led to another quarter of strong financial performance. As Jim discussed, Cornerstone Building Brand is a company guided by our strategic priorities. By focusing in our business strategy every day, we create a platform from growth and long-term value for our customers, shareholders, employees, and the communities where we live, work and play.

Starting on slide 8, we continue to experience a strong pace of incoming orders across all of our products. The US housing activity remains robust with second quarter housing starts averaging 1.6 million units on a seasonally adjusted basis and total permits averaging 1.7 million units. The backlog of single-family homes yet to be started grew in June to the highest level since October of 2006. Repair and remodel activity also remained strong in the second quarter, supported by rising home equity, lower interest rates and an aging inventory.

Our near-term and long-term outlook for the residential market remains very favorable and we are well-positioned to capitalize on those market trends. Momentum in non-residential construction demand continues to be favorable. The Architectural Billing Index reported that the current pace of billings growth remains near the highest levels ever seen in the index's history. In addition, inquiries surged to an all-time high and firms reported their highest backlogs in two years with an average of 6.5 months.

Our long-term outlook for the commercial business is favorable. The market for non-residential construction typically lags behind housing cycles by 18 to 24 months. Also non-residential construction spend is tied to private and public capital spending patterns, interest rates, government funding and consumer demand.

The supply chain and labor disruptions are slowing the pace of recovery, while increasing commodity costs and other input costs are pressuring margins. Increased commodity freight and labor costs coupled with manufacturing inefficiencies resulting from the supply chain disruptions continue in the second quarter. We are working closely with our key suppliers to avoid or minimize the impacts. In response to this dynamic inflationary environment, we have increased prices across all of our businesses.

As Jim talked about portfolio optimization is an essential component of our growth strategy, we believe we have a meaningful opportunity to lead within our key product categories, enhancing our position in large, deep markets.

Turning to slide 9, pro forma net sales were approximately $1,406 million, 28% higher than pro forma prior year with favorable price and volume contributing almost equally. We generated $190 million of pro forma adjusted EBITDA, $29 million more than pro forma second quarter of 2020, with all segments contributing favorable volume and pricing mix net of inflation. Pro forma adjusted EBITDA margin was 13.5%, as we expected a 110 basis points lower than pro forma prior year.

Across all of our segments, production constraints for commodities such as PVC resin, steel, and aluminum have resulted in shortages and steep cost increases. In response, we raised prices across our portfolio, which did offset substantial impacts to our financial results. We expect pricing mix to remain favorable and offset these continuing cost impacts.

Operational excellence is fundamental to our business model and market leadership position. We continue to transform our cost structure and improve the way work gets done. We realized approximately $30 million of structural cost savings during the quarter which helped to mitigate additional cost we incurred to serve our customers, such as expedited freight and overtime. We continue to experience the return of volume-related near-term costs in both cost of goods sold and SG&A.

Overall, the second quarter was an excellent quarter for us. I'm proud of our team's outstanding job in successfully managing through the dynamic market environment and capitalizing on the strong market conditions.

Now let's look at our business segment results. Turning to slide 10. Overall financial performance for the Windows segment was strong. Second quarter pro forma net sales were approximately 33% higher than pro forma prior year, with strong volumes across all sales channels driving increased volume of approximately 23%. Pro forma adjusted EBITDA increased approximately 18% over the prior year, primarily driven by higher volume.

As mentioned, along with the positive market momentum, we have experienced supply chain disruptions and are faced with labor challenges. We continue to make substantial investments in automation technologies to improve our production and logistical efficiency, enhancing our position as a cost-advantaged manufacturer.

We are taking actions to advance our strategy and position towards long-term growth. We recently completed the Prime Windows Systems acquisition and reached an agreement to purchase Cascade Windows. These transactions expand our market opportunities in the vinyl window and door markets. We intend to continue investing in the Window segment through organic growth and strategic acquisitions to drive margin improvement and expand our geographic reach, while remaining committed to our net debt leverage goals.

We have long-tenured customer relationships across the channel we serve. Also, we have been a key supplier to a majority of the nation's top homebuilders and retailers for close to a decade. Our goal is to be the supplier of choice in the exterior building products industry with the best and most innovative products offering marketed through our well-respected and trusted brand portfolio.

Turning to slide 11. In the Siding segment, second quarter net sales were approximately 27% higher than prior year with strong order momentum into wholesale and retail channels driving increased volumes of approximately 12%. Adjusted EBITDA increased approximately 26% over the prior year primarily due to increased volume of 20% and favorable price index net of commodity and other inflationary impacts.

As mentioned along with the positive market momentum, we have experienced supply chain disruptions and are faced with labor challenges. Despite these challenges, strong performance from both the US and Canadian regions delivered an all-time high adjusted EBITDA. We are also investing in the Siding segment. We intend to drive organic growth through product innovation and new product development in attractive adjacent product lines. We remain optimistic about the market recovery and positive momentum in the residential end markets, which will create long-term sustainable growth for Cornerstone Building Brands.

Moving on to our Commercial segment on slide 12. Net sales in the second quarter of 2021 were $458 million, approximately 23% higher than the same period last year, driven by disciplined price actions to mitigate rising steel costs. July bookings were 8% higher than the prior year and backlog tons were up over 25%. However, raw material shortages are constraining volumes in this business. We remain on allocation from our suppliers limiting our output to levels similar to the second quarter. Additionally, the current supply environment has led us to make spot market purchases, which carries a higher cost but allows us to serve our customers.

The Commercial segment generated adjusted EBITDA of $68 million, approximately 19% higher than the prior year. We have been effectively managing the impacts of rising steel costs. For the quarter, price and mix outweighed inflation by $21 million due to the rapid response by the team. We expect these dynamics and the effect of margin compression to continue in the near-term.

Positioning towards long-term growth, we have taken actions to advance our strategy within the Commercial segment. As discussed, we announced the divestiture of the Insulated Metal Panels and Roll-up Door businesses. We have developed a broad multichannel distribution platform covering an extensive network of wholesalers and especially distributors, independent dealers, architects, builders, contractors and big box retail.

We believe our strategy enables us to minimize channel conflict, reduce our reliance on any one particular channel and reach the greatest number of end customers. This strategy will position us to further our growth in large deep markets, maximizing our financial performance. Our focus simplified portfolio builds greater brand equity, fueling growth for value creation.

With the sale of the proceeds, we will improve our leverage accelerating towards our target of 2 to 2.5 times and strengthening our financial flexibility to fuel accretive growth opportunities.

Turning to slide 13. I'd like to make a few comments about our guidance. We anticipate closure on all of the announced strategic actions within the third quarter. As such, our projections include these impacts as if they occurred at the beginning of the quarter. Additionally, we have provided pro forma third quarter 2020 measures as a comparison.

We expect pro forma net sales to be between $1,385 million and $1,435 million, an approximate 20% increase versus pro forma prior year at the midpoint with volume price and mix contributing equally. Strong market momentum within the residential and commercial end markets, positive price index, coupled with unprecedented backlog support our revenue guidance. We expect adjusted EBITDA to be between $180 million and $195 million.

The midpoint of our outlook implies an adjusted EBITDA margin of 13.3% and anticipates inflationary costs offset by price in dollars. We are intently focused on investing in the core business through capital expenditures, organic growth initiatives and inorganic opportunities, which we believe will deliver the highest returns for our shareholders. We anticipate that full year 2021 capital spending to be between $100 million and $120 million.

Finally, we are focused on positioning for growth with an emphasis on deleveraging our balance sheet. As a result of our profitable growth and strategic actions, we are able to accelerate our leverage ratio. We expect that by year-end we will be able to reduce our leverage by 1 to 1.5 times over last year. This reduction is about a half a turn better than originally anticipated. We remain committed to our balanced capital allocation strategy as we move forward.

Our second quarter performance demonstrates our drive for exceptional results and passion for superior execution. Our solid foundation and the actions we have taken to strengthen our industry leadership are positioning Cornerstone Building Brands for growth.

And now, I'd like to open up the call for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And your first question comes from Lee Jagoda of CJS Securities.

Lee Jagoda
Analyst, CJS Securities, Inc. Q

Hi. Good morning.

James S. Metcalf
Chairman & Chief Executive Officer, Cornerstone Building Brands, Inc. A

Good morning, Lee.

Jeffrey S. Lee
Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Cornerstone Building Brands, Inc. A

Good morning, Lee.

Lee Jagoda
Analyst, CJS Securities, Inc. Q

So, first and foremost, Jim, congrats on the retirement. I assume there'll be a Labor Day retirement weekend bash, so I'll keep an eye out for that invite.

James S. Metcalf
Chairman & Chief Executive Officer, Cornerstone Building Brands, Inc. A

Okay. Look for the fireworks, Lee. Thank you. Really appreciate it.

Lee Jagoda
Analyst, CJS Securities, Inc. Q

Okay. So, just want to start with a question we've been getting from a lot of our clients around earnings power of the business by segment. And maybe if we sit here today and look at all the actions that have been taken. If you were to rank order the segments in terms of runway for potential margin improvement from either a [ph] gross or (25:33) EBITDA margin perspective, how does that look today?

James S. Metcalf
Chairman & Chief Executive Officer, Cornerstone Building Brands, Inc.

A

Yeah. Lee, thank you for the question. And what I would say is it would be the Windows segment. As you know, we're the largest and we've just made another acquisition. We have the number one position in windows with a strong brand. And we have a nice diverse customer profile for our windows, the large big-box retailers of repair and remodel customers, the distributors and wholesalers.

But we think that's probably the biggest opportunity for EBITDA growth. It has the biggest upside we feel. For example, when we acquired Silver Line very early in the integration, Silver Line windows EBITDA were mid-single digits and we've now improved that to low-double digits and even better. We think there's also some opportunities. We have a great track record on the windows business on when we make an acquisition on the synergies and cost-outs. So, I think our track record, there's upside there.

And also that's where we're putting a majority of our automation in. I've talked in the past our window plants, legacy window production line has about 30 associates. When we invest in automation, it takes it to somewhere around 12 to 15 associates, but also improves your throughput, your efficiencies, and your costs.

So, we think that segment of all of our segments has the best upside opportunity. We're putting a lot of resources on continuous improvement in our windows business. So, we think that would be at the top of the list.

Lee Jagoda
Analyst, CJS Securities, Inc.

Q

And then just sticking with that Windows segment. With all the acquisitions you've made and I know you are the market leader in vinyl windows, how do you think about your market share in windows or vinyl windows, however you want to measure it, and how much is out there to be acquired in terms of tuck-ins that are potentially available?

Jeffrey S. Lee
Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Cornerstone Building Brands, Inc.

A

Yeah, Lee, I'll answer that one. So, our market share position as we communicated in the past is just around 25%. And we continue with some of these very strategic acquisitions. Prime Windows, for example, was a geographical play. But it also added capacity for us inside of the space and gave us the capabilities as we look at multi-family and some of the airport type of windows. So, it was an important acquisition for us.

As you move to Cascade, it furthers that western expansion for us as a company. And we're excited about it. We're excited about that acquisition. We're excited about the opportunity that we have to leverage that national footprint as a company which we think is a real competitive advantage for us with our large customers in retail, national homebuilders. And so, it's really getting that geographical play between the two of them and added capacity.

As we think forward about potential acquisitions, we'll continue to be very strategic and look for areas where there might be a gap inside of geographies or product capability perspective. We feel good right now about our national presence. We feel good about what we've been able to do over the last couple of years and now looking forward at some maybe those very specific type of acquisitions to fill a very targeted need.

Lee Jagoda
Analyst, CJS Securities, Inc.

Q

Got it. And then just one last one and I'll hop back in the queue. Just as it relates to the divestiture activities, is there anything left in the portfolio that you would view as non-core to the strategy or a potential sale candidate at this point, just given we got rid of IMP and now the Roll-up Doors?

James S. Metcalf
Chairman & Chief Executive Officer, Cornerstone Building Brands, Inc.

A

We consistently look, Lee, at our portfolio. We feel right now we have a balanced portfolio that has focused on deep markets. And when we talk about deep markets, for example, the insulated metal panel overall market is about a $1.5 billion market compared, for example, siding is a $2 billion market, windows is a $9 billion market. So that was one of the reasons where – we want to participate in those deep markets.

But we feel really good with our commercial business with buildings and components. Both of those markets are very deep markets. For example, in components, we have a – we're the leading market share leader, but it's a very fragmented market. So we feel there's opportunities in our components business to possibly do some tuck-ins there. So we're really looking at our commercial business of where we can grow it through M&A and through organic growth.

So right now, we feel that we've done a pretty thorough analysis of the overall portfolio, and we have a nice balance with commercial, residential and repair and remodel. So at this point, we're in pretty good shape, but we're always looking at it of what is core and what is non-core as we go forward.

Lee Jagoda
Analyst, CJS Securities, Inc.

Q

Great. Thanks very much. And congrats, again, Jim.

James S. Metcalf
Chairman & Chief Executive Officer, Cornerstone Building Brands, Inc.

A

Thanks, Lee.

Operator: Thank you. Your next question is from Matthew Bouley of Barclays.

Matthew Bouley
Analyst, Barclays Capital, Inc.

Q

Hey, good morning. Thanks for taking the questions. I'd like to pass my – pass along my congratulations to Jim as well on retirement and great run over the years.

James S. Metcalf
Chairman & Chief Executive Officer, Cornerstone Building Brands, Inc.

A

Thanks, Matt.

Matthew Bouley
Analyst, Barclays Capital, Inc.

Q

Maybe that's a good topic to start out on actually. I haven't met Rose Lee in person yet and will look forward to hearing from her directly. But curious from your perspective, Jim, if you could kind of speak to some of the early playbook that she may have, the 90 or 180 days plan on ramping the business. And then just curious, any additional high level thoughts on why she's the right leader for the next phase of Cornerstone? Thank you.

James S. Metcalf
Chairman & Chief Executive Officer, Cornerstone Building Brands, Inc.

A

No. That's great. And thank you for your kind comments. As I mentioned in our prepared comments, we worked very diligently with the board and the search committee and really looked at the numerous candidates. One of the things we wanted in as my successor is as we've pivoted from integration to growth, someone that has a strategy and a mind for that top line growth as well as being able to bring in innovation. Innovation is a core value that Rose has talked a lot about and has a track record.

She's been in the industry. She knows how to deal with our customers. She's very, very strategic on where the company will go in the next 1,000 days. And really, we've had numerous conversations about our current strategy. And she really loves the direction that the company is headed. I will be working, as I mentioned, hand in glove with Rose on a very smooth transition, making sure that she is comfortable with the direction we are headed and where there's some small tweaks.

Obviously, she's going to be running the show here, but we're really excited about her background, her experience not only at DuPont but also at CertainTeed, where she was in building products and dealt with some of our common customers. So, she's not going to be a stranger to a lot of our customers. And I think that's her strategic background that she's had. She's really going to help us accelerate the growth engine. And that is something that we've focused over the last three years on integration and cost-out and synergies. And I think we've made some great progress in pivoting to growth as well as how we can invest in technology and invest in automation. That's something that – the skill set that she brings from DuPont.

So we are really excited. I'm personally very excited about her joining us, and I think she will – she'll be a wonderful, wonderful CEO and a great addition to Cornerstone leadership team, and she will be very anxious to meet you.

Matthew Bouley
Analyst, Barclays Capital, Inc.

Q

Wonderful. Thank you for that color, and absolutely looking forward to it. Second one, if I could, I guess drill down on the near-term a little bit here. So I'm looking at the Q3 guide and what you're implying around gross margins. It still seems like there's some pressure assumed in the next quarter. It looks like you're positive on price net of inflation at least in Q2. So I'm just curious then what bridges you there in Q3. Is it labor or just other manufacturing efficiency or just – where else is the pressure coming from and how are you thinking about price versus cost in that margin guide? Thank you.

Jeffrey S. Lee
Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Cornerstone Building Brands, Inc.

A

Yeah, Matt. Good question for us. You're right. We are getting price over inflation as a company and a real core competency for the company as we put some real discipline in place across our segments to make sure that we are capturing that price over inflation. We live in an interesting environment where we're not able to ship everything that we'd like to based on some of the supply constraints that are in place, and we're also living in an environment where we have a shortage of supply on labor. And so that combination is difficult to manage. We have to make sure that we retain and maintain as many of the employees as we can within our manufacturing base, and at the same time, work with some of the supply constraints that are there.

So that causes some natural inefficiencies as we're trying to make sure that we are staffing appropriately for the demand that we see, right? All of our demand is coming in very strong across all three segments right now, including the Commercial segment which has pivoted over the last couple of quarters to growth in our bookings in a tonnage basis. So we're seeing strong demand across the company and we're spending some extra money to make sure we service our customers. And that's really the key message is, we've got some extra freight expense that we're putting in place and we're moving products from one plant to a different plant so we can service our customers better. And with that, comes a temporary shift to a short-term shift in expenses.

Well, we think it's the right thing to do long-term for our customers to make sure that we're maximizing that relationship with them. They recognize that in good times and bad times we're there to service them, but that does come with a little bit of cost right now inside of Q3. Again, we think that we'll get through those if some of the stability comes around with the supply chain and the markets themselves. But right now, we think that's the best way to operate is to make sure we service our customers.

Matthew Bouley
Analyst, Barclays Capital, Inc.

Q

Wonderful. Well, thank you for that color, Jeff. And Jim, congrats, again, and best of luck.

James S. Metcalf
Chairman & Chief Executive Officer, Cornerstone Building Brands, Inc.

A

Thank you.

Operator: Thank you. [Operator Instructions] And your next question is from Kurt Yinger of D.A. Davidson.

Kurt Yinger
Analyst, D.A. Davidson & Co.

Q

Great. Thank you. And good morning. I just wanted to start off on the windows side. It looked like price was maybe kind of a 10-point benefit to sales growth this quarter. As we look ahead and think about the various pricing actions you've taken, is that benefit something we should expect will continue to expand until you start lapping some of these benefits in 2022, or is that kind of the run rate we should be looking at in the back half of the year?

James S. Metcalf
Chairman & Chief Executive Officer, Cornerstone Building Brands, Inc.

A

That's a great question and we have, as we said, a really strong backlog on our windows business and we are putting – when we put a price into the market, for example we just recently had a price increase over the last couple of weeks, we will not feel that until the back half of the year. So, some of the pricing in windows will still be coming through that we've announced in the first and second quarter because of the lead times and the backlog we have. So it'll be priced when it shipped. So we're expecting to continue to see strong price performance in our windows business and in the back half as well.

One thing that, as Jeff just said, we have really focused on taking care of our customers and we have incurred extra costs. So we're trying to offset as many of those costs as we can. But most importantly, we want to make sure that our lead times are consistent and that's really important in this market. We can have a long lead time, but that consistency of that lead time is really something that we're really focused on. It's very important to all of our customers. So we're going to continue to be aggressive on price because of these costs that we're talking about and some of the second half price improvement will be coming through as we work down and attack our backlog.

Kurt Yinger
Analyst, D.A. Davidson & Co.

Q

Got it. Okay. That makes sense. And on the pro forma net leverage targets for the end of the year, a lot of moving pieces there with the acquisitions and divestitures and pro forma. But could you help us I guess frame what that 3.5% to 3.9% kind of range means in terms of your expectations around free cash flow generation?

Jeffrey S. Lee
Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Cornerstone Building Brands, Inc.

A

Yeah, Kurt. Let me talk a little bit about some of the things and how we're thinking through the pro formas. We try to be transparent with the pro formas and providing as much detail as is readily available. And I think we're going to still provide some additional details as time moves forward around the moving parts, right? Two acquisitions, two divestitures. And so, when you go back to the appendix, we tried to be very thoughtful around providing guidance for Q3, expecting these transactions like we mentioned to close inside the quarter.

A couple of things I think are important. If you look at the pro forma statements and you look at the reported EBITDA margins and then you look at the post pro forma EBITDA margins that take into consideration the acquisitions and divestitures, there's about a 50 basis point decline inside of the grow – or excuse me the EBITDA margins. But I also want to remind everybody that what's not built into the pro formas historically are the synergy savings and the benefits that we anticipate that we're going to pick up from the acquisitions as well.

So it's -and we kind of put them all together and you look at the decline in about 50 basis points, and then you look at the synergized savings that come back with that as well, we get back to a pretty neutral position as a company. But more importantly, we transitioned our way from markets in particular that aren't as large and as deep and aren't growing as fast and into markets like Jim talked about where we have margin expansion or ability to grow margin and that they have faster growth rates. So we're really excited about how we reposition the company around those and how it really transforms into our EBITDA margins, not only in the short-term but in long-term as we go forward.

Specifically, talking about your comment around free cash flow. We've tried to provide as you look at the third quarter guide. Now, you've got three quarters basically of how we're thinking through that on EBITDA perspective as approximate guide for our cash flow. Our capital spending, we've taken to $100 million to $120 million. We brought that down slightly. And just a couple of comments around that.

It's not because we're not excited about the opportunities. We have as many or more opportunities than we've seen in the past. We're having some supply constraints as well on getting some of the capital equipment. And so, that's going to – that's going to push you out into the future years. Not significant timing, we're not talking about years, but we are talking about months. So, some of the projects that were expected to be inside of the fourth quarter are moving into the first and second quarter. And with that, we've taken some of the things that are less capital intensive on cost savings and we've shifted those from the first and second quarter into the fourth quarter.

So we don't anticipate it's going to have an impact on our EBITDA for the year. But it does have a benefit, if you will, from a capital spending perspective. But all of that, as we kind of think about the cash flows. The other thing that's interesting inside of 2021 versus 2020 is a more normalized working capital use and source of cash. When we think about our typical seasonality as a company, we have a use of cash in the first two quarters and then we have a source of cash in the third and fourth quarter. 2020 was the opposite of that, just because of the pandemic. But we expect 2021 to come back in line with that normal type of seasonality that we've seen. So, use of cash in the first half and a source of cash in the back half.

Kurt Yinger
Analyst, D.A. Davidson & Co.

Q

Okay. All right. That's really helpful. Thank you. And just one on M&A. I mean, you've made good progress deleveraging. But even at the end of the year, you'll still be kind of a ways away from the net leverage targets. With the deals you've done, I mean, is there a digestion phase where you maybe want to take a step back from acquisitions, or is that still kind of a key priority in terms of the growth trajectory over the next 18 to 24 months?

Jeffrey S. Lee
Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Cornerstone Building Brands, Inc.

A

So, Kurt, I guess we see it, maybe just a little bit different. We're accelerating our net debt leverage ratio as a company inside of 2021. So we've been very consistent around talking about a three-quarters to 1 turn reduction every year. And we did that. If you go back and look at our historical performance, we've been able to accomplish that. We did slow down a little bit inside 2020 with a half turn reduction and we guided that we'd have a slight change there.

And then as it came back into 2021, we started with that three-quarters to 1 turn reduction but quickly accelerated that by basically a year. So we feel like we're one year ahead of where we were targeting as a company. And ending this year as we kind of go back to the guide for this year at 3.5 times to 3.9 times by the end of the year puts us in a really nice position as a company.

And then you fast forward a year from then, right, and you get that three-quarters to 1 turn reduction and we're right within where we'd like to be as a company. So we feel good about our position as a company, our liquidity strong as a company. And specifically around your comment on acquisitions, we're just going to be very strategic. We've been very disciplined. We've seen some opportunities that we've passed on. And we want to make sure that we're looking at the right things that will drive the right strategic value. Tuck-in acquisitions could be something that could be very appealing to us for the right geographies and the right capabilities as a company. So, we'll be very disciplined like we have been.

And going back to the first couple of slides that Jim presented, that's how we're thinking about acquisitions as well, right? Do they fit in our large markets? Do we have a right to win within our channels and our customers? Do we have the sourcing and some of the manufacturing benefits that come with them that could drive some of those synergies? So being very disciplined around our approach to make sure that if we do acquisitions not only do we want to make sure that they help our leverage ratio or they can get there through synergies, but also that we – that they're strategic for us.

Kurt Yinger
Analyst, D.A. Davidson & Co.

Q

Okay. All right. That makes sense. And just last one for me. Any thoughts or color around the potential to actually pay down a material portion of debt and the interest expense implications as we look into 2022?

Jeffrey S. Lee
Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Cornerstone Building Brands, Inc.

A

Yeah. I think if you do the math and you look at the proceeds that are coming in from DBCI and also from IMP and you look at the Cascade acquisition, there's still a big delta that's there. And we're – there's a lot going on right now inside the marketplace. And we're just making sure that we have fully thought through all of our strategies with the potential opportunities combined with the pay down of debt. And it's a very active discussion amongst the team and also with the board of directors.

Kurt Yinger
Analyst, D.A. Davidson & Co.

Q

Got it. Okay. Well, appreciate all the color and good luck here in the back half.

Jeffrey S. Lee
Executive Vice President, Chief Financial Officer & Chief Accounting Officer, Cornerstone Building Brands, Inc.

A

Thank you.

Operator: Thank you. We have no further questions at this time. I will turn the call back over to Tina Beskid for closing remarks.

James S. Metcalf
Chairman & Chief Executive Officer, Cornerstone Building Brands, Inc.

Yes, before I turn it over to Tina, just as we looked at the quarter, a lot of moving parts, all extremely positive. We're very pleased with what we've accomplished in the quarter. But if I could just kind of frame it up on how we see the headlines for the second quarter and going forward, we see continued strength in the residential market into 2022, probably at least the first half of 2022. So, the demand there is going to be – continue to be very strong and attacking that backlog is going to – is first and foremost, our number one objective and really taking care of our customers.

The second area, which I think is very positive, the commercial market is improving. We're seeing positive backlog. Our order intake is very, very strong. And with the lag on pricing, I think we're positioned extremely well for – into 2022 for our commercial business. So really, it's going to be the key, and really the industrial logic of putting these companies together is really to have each one of our segments, Siding, Windows and Commercial all heating up at the same time. And I think we're positioned extremely well as we enter into 2022.

The third area, and Jeff just talked about it, is accelerating our leverage and our debt pay down. That's really critical. We've been very consistent about that on every call. I think with the divestitures we just talked about, it gives us additional financial flexibility to accelerate that by one year, but also gives us some ammunitions for some potential tuck-ins for the businesses that have deep market. And we think we deserve, as Jeff just said, the right to win.

And then the last headline is really as we reposition the portfolio to really focus on growth and participate in those deep markets where we can be the leader and will be the leader, and we're really excited about the future. So really, I just wanted to wrap up the call with kind of the headlines of the quarter and how we see the back half of the year, and how we are really well-positioned for 2022, and really excited about Rose Lee joining us, about the talent that we've acquired as a company, but also developed the talent internally.

So, as we wrap up the call, I really appreciate all of your interest in Cornerstone. Hopefully, we have delivered on the commitments that we've made over the last few years. That's something that Jeff, and Tina, and I have been very focused on is do what we say we're going to do and commit and sometimes even over deliver. So, I appreciate your interest. And now, I'll turn it over to Tina.

Tina M. Beskid
Vice President-Finance and Investor Relations, Cornerstone Building Brands, Inc.

Thanks, Jim. Thank you again for your interest in Cornerstone Building Brands. As Jim mentioned, we are very excited about our value proposition and the favorable long-term outlook for the company. This formally concludes the call.

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