PGT Innovations

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Michael Rehaut: Good afternoon. Thanks for joining us, our last session of day one. My name is Michael Rehaut. I'm the senior analyst covering the homebuilding and building products sectors for J.P Morgan. This is again, the end of day one of our two-day 15th Annual J.P. Morgan Homebuilding and Building Products Conference.

We're excited to close out the day today with us John Kunz from PGT Innovation, CFO. John will be doing a fireside chat. It's a 35-minute session. We'll close out the day right around 4:20, if not a little earlier.

I have several questions to ask John. Also, if you would like, there is an Ask a Question or Submit Question button that investors can use on the digital conference website. If you'd like to submit a question, I'll be happy to relay that to John during the latter part of today's session.

Again, John, want to thank you and PGT for your time today, really appreciate participating in the conference. Let me kick it off with the '22 guidance, particularly in terms of the sales breakdown, I was hoping to get a sense. You recently reiterated your guidance for sales growth at 16 to 25 percent.

If you could try and give us a breakdown of that growth by acquisition, price, and, volume, how does that compare to last year's growth of 18 percent?

John Kunz: Great question, Michael. Overall we are continuing to grow both through acquisition and organically as well. One of the things that has impacted us this year has been the effect of the price increases that we announced last year. We had two price increases that we announced year that influence demand.

Overall, what you're going to see, you're going to see volume growth in that mid-single-digit range, probably similar, maybe a little bit stronger than what we had in Q1. Then you're going to see price escalate on top of that. You're going to have some price escalation on top of that.

When you compare 2022 to 2021, you're also going to have the impact of Anlin. Anlin overall is going to be about 5 percent of sales for a year-over-year comparison. You have a few of those things mixing in to get that 25 percent growth.

You're going to see quite a meaningful jump, from our 116 number in 2021 to call it that 14 range, overall for revenue growth in 2022.

Michael: If I'm to take the midpoint of your guidance of roughly 20 percent growth, you're talking about half from price, a quarter from volume, a quarter from Anlin. Is that...

John: That's reasonable.

Michael: Maybe shifting out a little bit further over the medium term, over the next two or three years. One of the things that Jeff highlighted throughout the call last week was your different growth drivers, strategic growth initiatives, the expansion of Western, even core Florida growth. You have New South.

How should we think about volume growth over the next two or three years? How might price mix also play a role over that time frame?

John: Our anticipation is that you're going to continue to see volume growth. When you look at the Florida market, which is 75 percent of our sales, it's a penetration story. You're going to continue to see penetration for our products, both the impact and non-impact type products.

Our anticipation is that you'll continue to see that type growth. We're not even close to a maturity point with respect to impact-resistant windows in Florida. We still think there's probably a lot of room to grow.

Our estimate is less than 50 percent of the homes in the Florida market have it. It's probably in the 30 to 40 percent range of impact, so there's still a lot of opportunity to continue to grow in the overall market.

Windows was a whole, we still see volume growth there, the non-impact side of the business. That's evidenced by Western. Western has been putting up great numbers. Our Western business and our Anlin business have been putting up great growth numbers.

We don't have a yearly comp for Anlin yet because they haven't been in the fold for a full year. Just based on our estimates versus our initial models that we used to value the company, they're exceeding our expectations.

Both markets, that California market, Western market continued to grow very well for us. Our anticipation is that will continue to grow. When you look at the macro-environment, the macro-environment for windows is influenced by a lot of different things.

People get concerned with new homes, higher interest rates, gas prices, etc. It's not reflected in our numbers. When we're looking at our numbers and our growth rates, we don't see that slow-down or haven't seen that slowed down yet in orders or in backlog. It's still at elevated levels.

We're anticipating that to continue to grow because there's such a lack of inventory of new homes. People are investing in their current ones or continue to wait for the new homes that are being brought on. I'm in the process of moving from Dallas to the Sarasota area and looking at new homes and under-constructions.

I was talking to builders out there. It's 18 to 24 months, absent supply chain issues, for me to get into a house. We don't really have two years to wait to get into a house. There is a significant backlog of demand that is waiting for the supply side to catch up.

Michael: Without a doubt. Moving along here in terms of some of your strategic objectives, one of the elements of your slides from last week also referred to different selling initiatives and marketing enhancements.

I was wondering if you could walk through some of those and how they support your growth objectives over the next two or three years.

Can you still lever your SG&A potentially while putting additional investments into selling and marketing?

[pause]

John: Sorry about that. One of the things that we have seen a company transition to is from a direct-to-distributors to a direct-to-consumer approach. We are getting more into the direct-to-consumer approach. We have initiatives along those lines. We're opening up new stores and growing our direct-to-consumer business overall.

We have 17 stores in total, four new stores. In the coming year, they'll be in Dallas, Fort Worth, Atlanta, Carolinas. We're going to see that growth continue on that side of the business.

On the traditional dealer side, we don't have anyone that's exclusive, but we're going to continue to see growth with our selling initiatives from that perspective.

There's a lot of opportunity there. The one that just came into law last week or the week before was the home hardening initiative in Florida that was just signed into law by DeSantis, House Bill 7071. Consumers will not have to pay a sales tax going forward.

We think that is a great opportunity for us to continue to leverage impact-resistant windows and to drive more market penetration than what we've had in the past in Florida. We think that'll be a great two-year runway.

What Jeff it said on the call as well is that we don't expect a spike in demand. Since we have two years to do this, this will be a more even approach to the home hardening initiative overall. That will be a great benefit for us.

With regard to SG&A, we were a little bit high on SG&A this quarter. We were a little bit over 26 percent, I think like 26.7 percent. I would expect to leverage that in the coming quarter. Now, we did have some costs with respect to our sales initiatives on the direct-to-consumer side that drove it up.

We have some distribution costs in there that drive that number as well, but there's an opportunity to leverage the SG&A costs going forward. I still think that we'll be in that 25, 26 percent range for the full year. It's not a significant drop, but we think there's an opportunity.

We think there will be an opportunity going forward beyond this year to address some of those costs. We do have some transition costs as far as, as we grow and realign the business, we've got to capitalize on some of that. We are working to make our processes more efficient, where we can get some of that SG&A cost down.

Historically, we've been a relatively small-cap company and haven't had the opportunity to invest in all those process improvements. Those process improvements are now coming.

We're getting one common system. We're going to have one common system throughout the organization and be able to leverage that technology and improved processes to reduce our costs.

Michael: Maybe also talking about SG&A a little bit, but thinking about margins and profitability, holistically, since 2016, operating margins have mostly remained in a 12 to 14 percent range. Both gross margins and SG&A have drifted higher, obviously, in part, due to business mix with New South, etc., some of your different strategies.

How should we think about both components going forward? What are the drivers of those trajectories?

John: When you look at our business overall, our target is to be in that upper-teens range. When you look at 2021, we were handicapped a little bit by supply chain issues, raw material costs, the delay between when we announce something and when we ultimately get the price for. Then we had some production issues in our largest plant in North Venice.

We had a lot of things that impacted us in that 2021 timeframe. If you go back and look at 2020, current-year performance, our guidance, we feel comfortable with a 17 percent margin. North of 17 percent margin is a sustainable number for us. We think that we can get back to those levels and can sustain those levels.

Now, some of it's going to come through SG&A. I just talked about what we're doing on the SG&A side. We have we're going to have common ERP systems across our acquisitions. We're not going to have multiple ERPs. We're going to transition to that.

We're going to leverage off of that to improve our processes. When you look at our back-office operations, they're a little bit disparate. Each organization that we acquired did their own thing and wasn't fully integrated. There's an opportunity to fully integrate or more fully integrate those organizations than what they are today. We'll be able to leverage that going into the future.

When you look at that gross margin line and that gross margin profitability, we internally look at material margins to make sure that, when we start, we're not losing it in price. We certainly saw that in 2021. We were losing margin in pricing because raw material costs were rising faster than what our selling price was. We saw compression there.

We also saw compression from our overall performance, especially in our North Venice operations. As we started in Q4 and carry through into Q1 and what we expect in Q2 is that material margin number has improved.

We're seeing now that number is coming back in more historic norms. You're seeing the labor, the efficiency cost, the throughput from the conversion costs, so to speak, come in a bit.

That's what leads us to believe that we can be that high-teens type EBITDA margin type company going forward. We believe that's a sustainable approach.

Michael: Just to be clear, that's high teens EBITDA margins or operating margins?

John: No, EBITDA. That's right.

Michael: Maybe shifting also to M&A, it was helpful and I was hoping you could just review some of Jeff's comments from the call in terms of where you've taken Western and New South since the acquisition to today. Let's start there with the track record of Western and New South as a couple of case studies, which I think have been very successful for you guys.

John: They have.

Michael: Then wanted to ask about the strategy and pipeline going forward.

John: I would throw Eco into that too. When you look at the Western, Eco, Anlin, all have been very successful. Our diligence requires that when we go in, we're looking at the business, the business model, to make sure the business model is sustainable, that were not buying on peak earnings or unsustainable type of business.

We know the business well. We know the business, the players in the business, capabilities. Our diligence requires us to go in and understand how the business operates and why we believe it's sustainable or that we can grow the business from where it is, at current or improve margins.

The thing that we like about that Western business is, with our leadership team and with our incorporation of them under the PGT umbrella, they've exceeded many of our estimates that we had. We think there's more opportunity as well.

When we transition these businesses, we just transitioned our Western business. We're moving to be D365 as our common platform for ERP. We're going to be moving Anlin and we're going to be moving Eco there currently. As we get these businesses on the same platform, it allows us to manage it more uniformly across the business, and you'll see benefits from that.

We've been fortunate. We've been very successful with the acquisitions we've had. They've been very beneficial, exceeding our model estimates as far as expected sales and margin growth. That's very, very encouraging from that perspective.

On the going-forward basis, there's certainly opportunities out there. We do get the question, "What's our capital allocation policy? What are your thoughts with respect to share purchase and the like?" We believe that we can continue to invest in the business and grow shareholder value through acquisitions.

First, we're going to invest in the business to make sure that we can continue to grow our existing brands and our existing products. That's important, and that's why you'll see a little bit of a step-up in CapEx from where we've been historically. That 3.5 percent range is probably where we'll end up.

From there, once we invest in that, we also believe there's opportunities for us to continue to grow through acquisitions and maintaining a disciplined process with it. We can't go in and overpay. We can't go in and pay on EBITDA, peak earnings, or however you want to frame it. It has to be a disciplined approach.

What Jeff said on the phone too is these are all built from relationships, and these relationships take time. It takes time for them to evolve. It takes time for the owners to get comfortable. None of these are public companies that we are having conversations with.

It will come over time, and that's how most of these play out, is knowing the players, knowing the markets, knowing our customers, the sustainability of that revenue base, making sure you maintain the margins. That's what we're looking at. There seems to be opportunity for us to continue down that path in the back half of the year.

Michael: Maybe a little bit more on the M&A pipeline and how you think about it. Maybe you could talk a little bit about the total addressable market in terms of where you play and, as part of that, how you evaluate M&A in different product categories, if there's specific either products or geographies that you're currently focused on, and also in terms of perhaps the size of deals that we should be thinking about.

John: From a market perspective, we're probably pretty much tapped out in the Florida market. I don't know that there's an opportunity for us to grow much beyond where we are through acquisitions in the Florida market. We have a pretty good market share. Our impact-resistant windows are the premium brand out there.

We think that we can continue to grow with the market in Florida and even capture some share. We may have lost some share in Florida as a result of our production issues last year 2021, but we captured that.

What we have been focusing on is the vinyl and aluminum windows space. We think that the markets in the southern half of the country will grow faster than the economy as a whole. That's where we've been focusing. That's what we know. That's where we've been targeting. It will be extensions of those products.

Where we're continuing to look is in the Texas market. The Texas market, we're opening up two new stores with our New South, one in Dallas and one in Fort Worth.

Those two cities we're certainly targeting, opening up new stores. What we believe, with the migration into Texas, there is a lot of opportunity for us to expand in that area.

Then it's along the south into the East Coast as well because it's while Florida has the reputation for the impact-resistant windows and the hurricanes, we also believe that there's a market along the coast for them, along with non-impact windows overall. We still think that there's opportunities for that as well.

The only other side is do we broaden our approach and go beyond vinyl and aluminum? Something we certainly look at. I'm not sure that there's anything right now, but something that we'd certainly contemplate.

Michael: I have a few more questions, but I'll again remind people from the audience that, if they'd like to ask a question of John, to submit through the Ask a Question or Submit Question button on their digital conference book. I'd be happy to relay that.

Just a couple more here for me. Going back to some of the slides or comments from the earnings call late last week Jeff referred to to break down your end-market exposure, R&R, that 55 to 60 percent range. 58 percent hits a bell for me, new resident at 42. Where could that mix be over the next two to three years based on the growth rates of your different businesses?

John: It depends a lot on the homebuilders too, how quickly they do. I know there's some conversation on the call with respect to lead times for homebuilders, etc. Windows have been the sore thumb out there with respect to our ability to fulfill orders.

We have improved that. Out West, we've done better than what we've had in Florida markets, but the western markets for new home building, we're probably in that five-week range. Out east, it's probably a little bit longer than that for new homes.

The transition and product mix, I still think R&R is going to be the strength for us, especially if you have an event. If there's an event where another hurricane comes through this season, we always seem to have a spike right after that, a spike in orders for that. There's a lot of opportunity for that.

People are continuing to remodel and look at their windows and have them replaced, one, because of the age of the window and, secondly, for the safety or security protection that the impact-resistant windows provide as well. I think that mix will continue to weigh more toward the R&R market than the new homes.

Maybe if new home builds and the supply chain pick up, that number will come back down, maybe to a 50-50 range. You're asking me my expectations. I expect the R&R will continue to be a little bit more heavily weighted than the new ones.

Michael: Just to round out the questions here because we've walked through a bunch of them -- again, appreciate all your comments, John -- is on capacity and supply chain. There have been different challenges. You alluded to one or two of them over the last couple of years in terms of managing and expanding your manufacturing capacity as well as some labor at points.

Where are you within that journey in terms of supply chain and manufacturing footprint? How are you planning for the next two or three years?

John: We're certainly on that Journey, as you see. What we're doing, there's a few ways to address the capacity issue. One is to improve your overall performance. If you eliminate some of the bottlenecks, you can improve your performance and throughput.

That's what we've seen to some degree in 2022, just taking control of our operations, specifically our North Venice operation, improving our approach to the manufacturing, and addressing some of the supply chain issues. When we talk about supply chain, we've seen that moderate in 2022.

We weren't as constrained in 2022 as we were in 2021. It seemed like it was hitting us from all angles. Glass, aluminum, vinyl, labor all were impacting us in 2021. That has seemed to moderate. We increased our labor costs by 14 percent. Aluminum's up dramatically. Vinyl is flat now here overall. The good news is we're continuing to get product.

When you look at capacity and beyond, we just opened up a Fort Myers location to help some with that. It's hard to give you an exact number as far as what our exact capacity addition was when we did that, but that certainly is helping our throughput.

We are looking at another facility, looking at other facilities to help address our desire to grow. We think that we can grow, as I said, through acquisition and through investment. We're looking at some investments that we can make to expand that capacity in the Southern states as well.

Michael: Those are the questions that I had prepared. I don't know, John, if you have any closing remarks that you'd like to offer in terms of the company, working off the slides from late last week. I'm happy to turn over to you before we close out the session.

John: I don't know that I have any. Many investors ask me, "What is everyone else asking you about? How do you see it?" I think that you did, Mike, in the beginning as well. We don't have that crystal ball as far as what '23 or '24 looks like. All we can tell you is what we see right now and what we see in the coming months.

The order intake that we have is still strong. We're still seeing that. Our backlog is still relatively strong. We're pretty optimistic with respect to the remainder of the year. That's why we tightened our guidance or increased it somewhat. We also said we are optimistic that we can achieve the higher end of the range. Absent some disruption from the supply chain, we are optimistic that we can do that.

Ultimately, what goes beyond 2022 is anyone's guess. You have a lot of macroeconomic factors influencing that, specifically interest rates, inflation, gas prices. All of those things are impacting it. What we see is what I also mentioned.

The new home build is out there for a while. It seems demand on the home side is going to continue to be there. While interest rates go up, it doesn't seem to be constraining that demand. Supply needs to catch up there. We're optimistic that, '23 and '24, we can continue to see growth just from the conversations we've had with our Customers.

That's about it. We've learned from our mistakes in '21. We want to demonstrate that. We want to speak with our actions as far as our performance, make sure we get back to that high-teens EBITDA margin number. We think that is a sustainable number for us. That's where we were historically. That's where we think we should be. Hopefully, we can carry that on into '23, '24, '25, and beyond great.

Michael: Thank you so much, John, appreciate the time. I think that's a great way to close it off. That will conclude day one of our two-day conference, J.P. Morgan's 15th Annual. We will resume tomorrow morning at 8:15 with the AEK Company, followed by Masonite, MDC later on in the morning, Meritage, and KB Home to homebuilders.

The afternoon, we have Stanley Black & Decker, TopBuild, Century Communities, Forestar. With that, John, I want to thank you and PGT's time and participation in the conference. Have a great rest of the afternoon. For those coming back tomorrow, we'll see you then.

John: All right, Mike, very good. Take care.

Michael: Thank you. Take care.

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