Apogee Enterprises, Inc.
FY2024 First Quarter Earnings Call Prepared Remarks
June 23, 2023

Jeff Huebschen, Vice President, Investor Relations

Good morning and welcome to Apogee Enterprises' fiscal 2024 first quarter earnings call. With me today are Ty Silberhorn, Apogee's Chief Executive Officer, and Matt Osberg, Chief Financial Officer.

I'd like to remind everyone that there are slides to accompany today's remarks. These are available in the investor relations section of Apogee's website.

During this call, we will reference certain non-GAAP financial measures. Definitions of these measures, and a reconciliation to the nearest GAAP measures, are provided in the earnings release and slide deck we issued this morning.

I'd also like to remind everyone that our call will contain forward-looking statements. These reflect management's expectations, based on currently available information. Actual results may differ materially. More information about factors that could affect Apogee's business and financial results can be found in today's press release and in our SEC filings.

With that, I'll turn the call over to you, Ty.

Ty Silberhorn, Chief Executive Officer

Thank you, Jeff, and good morning, everyone.

Apogee's team delivered yet another strong quarter. Our strategy and strengthening operational execution continue to drive results.

This morning, I'll cover highlights from the quarter, how our strategy is driving sustainable improvements in our business, and our progress on this year's priorities. Then, I'll turn it over to Matt for more details on the quarter and our outlook.

The first quarter was a solid start to our fiscal year, continuing the positive trends we've established over the past several quarters. We delivered top and bottom-line growth, sustained operating margins at 9.3%, and had a strong cash flow quarter, with cash from operations significantly higher than last year's first quarter.

These improved financial results are underpinned by the strengthening operational execution across our businesses. We are successfully managing the things that we can control. We're driving sustainable productivity improvements through the Apogee Management System. We're maintaining a strong focus on cost management. We're improving key processes and systems across the company. And we're bringing more rigor and focus to how we are managing the business.

Looking at the segments, our results this quarter were led by outstanding growth and profitability in Architectural Glass. Our Glass team continued their impressive momentum, with their seventh consecutive quarter of sequential margin expansion. I'll have more to say about the transformation of our Glass business in a moment.

Framing Systems and Large-Scale Optical also had solid quarters, with strong execution, pricing that offset inflation, and improved sales mix as we continue to emphasize differentiated product offerings.

Results in Architectural Services came in below our expectations this quarter, as they continue to work through a transition to better position the business for long-term growth and manage lower than expected profitability on a handful of projects. We remain confident in our Services team and the long-term potential of the business. Our Hamon brand is a recognized leader in its industry, with a strong market position and broad set of capabilities. In recent years, Services has outperformed its market, and we're confident we will see improved performance as we move through this fiscal year.

Even with the softer than expected results in Services, the first quarter was a strong start to our fiscal year, with our Glass business outperforming the market due to their shift to premium and their continued operational execution. We are well positioned to build on our success from this quarter and are increasing our full year earnings outlook.

Our improved performance continues to be driven by our three-pillar strategy, which is referenced on slide 5 in our presentation. The performance of Architectural Glass over the past two years is a great case study of our strategy at work. Page 6 highlights the Glass segment's transformation. Operating under the Viracon brand, our glass business has long been an industry leader. We have a reputation for quality and service, deep relationships with customers and influencers, and a wide range of capabilities, including proprietary products.

Even with those strengths, the Glass segment had underperformed its potential. Through our strategy work, we identified two imperatives for change. We needed to build a more competitive cost structure, sustaining it with productivity. And we needed to shift our focus to the premium segment of the market, that recognizes the value we provide. The team has achieved tremendous success in both areas. We've driven sustainable productivity improvements through the deployment of the Apogee Management System, our approach to Lean and Continuous Improvement. Additionally, our facility rationalization reduced our overall cost structure, without impacting our ability to serve customers in our target markets.

We repositioned the business as a leader in premium solutions, and we aligned the entire organization to better serve this target market. This included changes to our sales organization, leveraging innovation and partnerships to deepen our product offering, and driving improvements in quality, service, and delivery to outperform customer expectations. This shift in market focus has led to a more favorable sales mix, improved pricing for the value we offer our customers, and new growth opportunities.

The progress with our strategy is evident in our financial results. The team has delivered impressive margin gains and positioned the business as an economic leader. Based on this progress, we are increasing our target margin range for Glass, as shown on page 7. Our new target margin range is 10 to 15% on a full year basis, compared to our previous range of 7 to 10%. It is very encouraging that this quarter, three of our four business segments delivered margin above the target ranges we set at our investor day, especially given that we are still early in our AMS journey.

As we move through fiscal 2024, our strategic framework positions us for further progress toward our financial targets, and positions us to outperform throughout the market cycle.   While overall non-residential construction activity remains healthy today, there are reasons for a somewhat cautious view of the market as we move forward. Higher interest rates, along with overall economic uncertainty may impact construction activity, for at least some period. However, through our team's efforts, we are transforming Apogee into a higher performing, more resilient company. I'm confident that we will drive further performance gains as the year progresses.

Page 8 outlines our priorities for the fiscal year, that we introduced last quarter, and where we will continue to focus for the remainder of the year. Our entire team is aligned on driving further progress to advance our strategy, and to deliver continued performance gains.

Now, I'd like to introduce Matt Osberg. Matt joined us in late April, and I'm very excited to have him as a part of the team. He brings terrific experiences and perspectives, and he's established a strong record of creating value throughout his career. Let me turn it over to Matt, to provide more details on the quarter and our outlook.

Matt Osberg, Chief Financial Officer

Thanks, Ty, and good morning everyone. I'm very excited to be part of the Apogee team, and the opportunities we have as a company to continue to drive shareholder value. I look forward to speaking with many of you in the coming quarters.

Before I review the results for the first quarter and our updated fiscal 24 outlook, I want to take the chance to recognize Mark Augdahl for the work he did in the interim-CFO role. Mark did a fantastic job leading the company through a time of transition, and he has been extremely valuable to me as I have on-boarded with the Company. Great job Mark, and thank you.

Now turning to our results for the quarter. The first quarter was a strong start to our fiscal year, building on the momentum established last year. Consolidated net sales grew 1.4%, to $361.7 million. The increased sales were primarily driven by strong growth in Glass, which was up 27.5% compared to the prior year. As expected, this was partially offset by a net sales decline of 13.5% in Services, which grew 14% in the first quarter of fiscal 23. Consolidated operating income increased 1.7%, primarily driven by strong sales and margin improvement in Glass. The Glass segment's operating margin was 17%, over a 10-percentage point improvement compared to the first quarter of last year, and reflects the impact not only of higher volume, but also benefits from pricing and mix, as we execute our strategic shift to emphasize premium, high-performance products. This result also demonstrates the significant operational progress that has been made with our initial deployment of AMS.

At a consolidated level, the Glass margin improvement was offset primarily by segment margin declines in Framing and Services. As a reminder, in the first quarter of last year, Framing had an approximately $4 million benefit related to the timing of pricing actions and inventory flows. Last spring, as aluminum prices spiked, we were able to realize the benefit of higher selling prices, as we worked through lower-cost aluminum inventory. Setting aside this benefit, the Framing operating margin this quarter was roughly in-line with the prior year. Services had an operating loss of $0.6 million, primarily due to lower estimated profitability levels on a select number of projects that are nearing completion, the impact of lower project volume, and approximately $1 million of severance costs as we continue to execute our strategic transition in the Services business. As Ty mentioned, we remain confident in Services' long-term potential and expect the operating performance trend to improve as the year goes on.

Diluted EPS grew 5%, to $1.05, primarily driven by higher operating income, a lower effective tax rate, and a lower diluted share count, which reflects the benefit of our share repurchase activity. This was partially offset by higher interest expense, primarily due to higher interest rates. Our tax rate in the quarter was 25.0%, roughly in-line with our long-term rate assumption of 24.5%.

Turning to our cash flow and the balance sheet, we generated $21.3 million of operating cash flow in the quarter, an improvement of $52 million over the first quarter of last year. This was primarily driven by improved working capital, as the first quarter of last year had unfavorable working capital impacts related to sales growth and inflation. As a reminder, the first quarter is typically our lowest quarter for cash flow, due to the timing of certain annual payments.

We had capital expenditures of $7.4 million in the first quarter, primarily relating to investments to expand capacity in our higher-margin businesses, enhance productivity through automation, and deploy improved systems to better support our business. We also returned over $10 million in cash to shareholders through dividends and share repurchases.

Our balance sheet remains very strong, with net leverage below one-time trailing twelve-month EBITDA, and no significant debt maturities until 2027.

Looking at Backlog trends for the quarter; backlog for Framing was $221 million, compared to $243 million in the fourth quarter of last year. Several factors are impacting Framing backlog. First, we've improved service levels for our short lead-time products, so we are converting backlog into sales more quickly. Second, as a part of our strategic shift, we continue to move away from lower margin sales that we would have pursued in the past. Finally, we continue to see choppiness in bidding and award activity.

Services finished the quarter with $709 million in backlog. This was a slight sequential decline compared to the fourth quarter of last year, but 4% higher than the first quarter of prior year.

Turning to our updated fiscal year outlook, which is on page 12. We are pleased to be able to increase our full-year diluted EPS outlook to a range of $4.15 to $4.45, primarily reflecting our strong first quarter results and an improved outlook for our second quarter. This updated outlook implies EPS growth at the bottom of the range of approximately 4%, and EPS growth at the top of the range of approximately 12%, compared to last year's adjusted EPS of $3.98.

Our outlook includes our continued expectation of net sales for the year to be flat to slightly down, reflecting lower volumes in Services and Framing, partially offset by growth in Glass. Also, our outlook range contemplates the latest market forecasts, which point to a potential slowdown in non-residential construction in the second half of our fiscal year.

Despite our sales outlook, we expect to drive EPS growth through expanded operating margins. Although the 17% operating margin in Glass this quarter is likely not sustainable for the full year, we are increasing our margin expectations for Glass to be in the 10-15% range for the year, which is well above last year's level. Services' margins should improve as we move through the year, but are expected to fall short of their 7 to 9% target range. Although Framing margins are projected to decline compared to prior year, we expect margins near the top of its 9 to 12% range. Finally, we expect LSO margins to be slightly down compared to last year.

We continue to expect an average tax rate of approximately 24.5% and full-year capital expenditures of $50 to $60 million. We also expect both operating and free cash flow growth for the year.

As a reminder, fiscal 24 is a 53-week year, with an extra week of operations in the fourth quarter. For the full year, the extra week will add approximately 2 percentage points of growth to revenue.

In closing, I am pleased with our first quarter performance and ability to raise our outlook for the year. Advancing our strategic objectives is driving improved profitability, even in a year with sales growth headwinds. This improved profitability will position us better to outperform throughout the market cycle. Additionally, our strong cash flow and low leverage position are enabling us to deploy capital to invest in our business and return cash to shareholders through dividends and share repurchases. We also continue to look for accretive acquisition opportunities that would accelerate our growth and profitability.

I am glad to be part of the Apogee organization, and excited to contribute to the work the team is doing to drive value for all our stakeholders. With that, I'll turn it back over to Ty for some concluding remarks.

Ty Silberhorn, Chief Executive Officer:

Thanks, Matt.

To wrap up, I want to reiterate how proud I am of the team for delivering another strong quarter and a great start to our fiscal year. We continue to make progress advancing our strategy and improving operational execution. I'm particularly happy with the performance of our Glass segment, and our increased long-term outlook for that business. Through our team's efforts across all of Apogee, we are well positioned to continue our progress in the coming quarters.

With that, we are ready to take your questions.

Reconciliation of Non-GAAP Financial Measures

The Company defines Net Leverage as Net Debt divided by earnings before interest, tax, depreciation and amortization (EBITDA). Net debt is defined as total long-term debt (GAAP measure) reported within the Company's consolidated balance sheets, less unrestricted cash and cash equivalents held by the Company. EBITDA is defined as the trailing twelve months of net income (GAAP measure) plus interest, income taxes, depreciation and amortization. The following are reconciliations of total debt to Net Debt and net income to EBITDA as well as a calculation of Net Debt to EBITDA as of May 27, 2023.

Net Debt

		5/27/2023
Total debt	$	170,669
Less: Cash and cash equivalents		24,642
Net Debt	$	146,027

EBITDA

		Trailing Twelve Months Ending 5/27/2023
Net earnings	$	104,952
Income tax expense		12,412
Interest expense, net		8,490
Depreciation and amortization		41,836
EBITDA	$	167,690

Net Leverage

	5/27/2023
Net Debt	146,027
EBITDA	167,690
Net Leverage	0.87x