

# **Carlisle Companies Incorporated, Q1 2020 Earnings Call, Apr 21, 2020**

Carlisle Companies Incorporated (NYSE:CSL)

CALL PARTICIPANTS: 3

PRESENTATION: 5

QUESTION AND ANSWER: 62

# Call Participants

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## EXECUTIVES

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Chairman, President & CEO

**James Giannakouros**

VP of Investor Relations and FP&A

**Robert M. Roche**

VP & CFO

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VP & Equity Research Analyst

**Saree Emily Boroditsky**

Equity Analyst

**Timothy Ronald Wojs**

Senior Research Analyst

# Presentation

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## Operator

Good afternoon. My name is Shontelle, and I will be your conference operator today. At this time, I would like to welcome everyone to the Carlisle Companies First Quarter 2020 Earnings conference call. [Operator Instructions]

I would now like to turn the call over to Mr. Jim Giannakouros, Carlisle's Vice President and Investor Relations and Financial Planning and Analysis. Jim, please go ahead.

## James Giannakouros

VP of Investor Relations and FP&A

Thank you, Shontelle. Good afternoon, everyone. And welcome to Carlisle's First Quarter 2020 Earnings Conference Call. We released our first quarter financial results after the market closed today. And you can find both our press release and earnings call slide presentation on our website at [www.carlisle.com](http://www.carlisle.com) in the Investor Relations section.

Leading the call today are Chris Koch, President and Chief Executive Officer; and Bob Roche, our Chief Financial Officer. We will begin with Chris discussing COVID-19 impacts, the related economic reality for Carlisle and the trends we're experiencing in our businesses as a result. Bob will discuss Carlisle's first quarter performance and current financial position. Following Chris and Bob's remarks, we will open up the line for questions.

Before we begin, please refer to Slide 2 of our presentation, where we note that certain statements made during this call may be forward-looking and actual results may differ materially from our expectations due to a number of factors, including impacts from COVID-19. A discussion of some of the risks and uncertainties that may affect our results are provided in our press release, and in our SEC filings on Forms 10-K and 10-Q. Those considering an investment in Carlisle should read these statements carefully, along with reviewing the reports we filed with the SEC before making an investment decision.

With that, I will turn over the call to Chris.

## D. Christian Koch

Chairman, President & CEO

Thanks, Jim. Good afternoon. Everyone, please refer to Slides 3 through 5 for these opening comments. I'd like to start the call acknowledging the obvious. The impact that COVID-19 pandemic has had on all our lives. Our thoughts go out to all those affected. It's not often in the human experience that we

collectively face the same global adversary that will certainly change our notions of security, community, safety and a mere day-to-day functioning for years to come. Even more rarely do we collectively come together to unite and exhibit our humanity, understanding and compassion as human beings. One area in which Carlisle has directed its philanthropic efforts has been the cause of civility. In this crisis, we should all be mindful to observe the many examples of civility, which give us hope that when this is all over, we'll be a more understanding civil and compassionate society.

All of us should take the time to express special gratitude for those on the front lines combating the coronavirus for our collective well-being as well.

We know many of you on the call today reside in New York and the Tri-state area as well as many major metro areas hit hard by COVID-19. I'd like to thank you for joining us and your continued interest in Carlisle Companies and wish you and your families good health and safety during these challenging times.

At Carlisle, our pledge has always been to provide a safe working environment for our employees. Our safety-first culture has reduced our incident rate well below industry standards for all our businesses. We're following best practices and guidance from recognized authorities on employee health and safety measures, including safe, hygiene and social distancing, enhanced facility cleaning and disinfecting, travel and facility access restrictions and telecommuting where practical.

As of April 20, we've had 29 confirmed cases of coronavirus out of nearly 16,000 employees since we were first impacted in our Chinese facilities well over 3 months ago. In these instances, we immediately followed or exceeded the procedures, protocols and expectations of local governing authorities. After appropriate shutdown periods, we have and intend to reopen the affected facilities.

We're pleased that our businesses remain operating and are considered essential in many country, states and local jurisdictions. This is evidence of the importance our products and the employees who design and produce them are. We're very pleased to be able to provide uninterrupted service to our customers who need our products to maintain critical infrastructure, support vital transportation needs and supply critical medical products at this time.

Most of our North American customers, particularly in construction, have also been considered essential and remain open for business as well. Today, nearly all of our over 100 sites globally are fully operational with the following exceptions. Nogales, Mexico; Orzinouvi, Italy; Chino, California; and 2 U.K. facilities in the cities of Pontypool and Belper.

The crisis management protocols we follow today emerged as the coronavirus threat began to impact our facilities in China. As the virus spread across the

globe, we were able to adapt and prepare for what has transformed from a regional health outbreak into a global crisis. And what has turned out to be a devastating impact on our health systems and on the global economy. As the crisis continues, we'll review and update our policies and responses accordingly.

We're prudently adjusting our business operating norms in response to intensified and necessary health and safety guidelines and dramatic decline in demand as well. We intend to stay on a course of responsible business activity to maintain a stable foundation for the post-COVID-19 recovery we know will arrive. However, in the near term, all companies, including Carlisle, must brace for adjustments to business structures, employment and pay policies as the timing remains unclear of a return to acceptable levels of safety to allow increased personnel and economic activity.

While Carlisle is in a strong position to weather a prolonged economic downturn, we are making necessary adjustments to our cost structure where appropriate to maintain that strength. We remain committed to emerging in a very strong financial position and in a position to leverage anticipated future growth.

Bob will provide more granularity, but I want to touch on some important areas of our financial position. Due to our strong balance sheet, in the first quarter, we were able to avoid layoffs and disruptions in our operations outside of health and safety or government-mandated shutdowns. We paid our dividend of \$28 million, deployed \$23 million into capital expenditures and invested close to \$15 million into R&D.

As of the end of the quarter, we have a strong cash position of \$1.2 billion, with an additional \$500 million undrawn on our credit facility. We fully expect to pay our dividend in June and anticipate increasing our dividend in September for the 44th consecutive year.

We remain committed to and focused on Vision 2025, our strategic guide to achieving \$15 in earnings per share. This goal remains very much intact. Some of the specifics about our businesses that reinforced our conviction include: CCM is well positioned to exhibit resilience during this global market downturn. We still foresee a significant need for maintaining an aging U.S. infrastructure. We see a strong and growing backlog as we believe the vast majority of reroofing demand is merely being delayed, not canceled. And we will benefit from lower input costs and a highly variable cost structure. Due to our size and scale, we believe we have the lowest cost structure in the industry.

CCM status is the best-in-class building products supplier continues to be evidenced through price and market leadership, superior products and service, industry leading innovation, a strong and increasing reroofing backdrop and a high-teens operating income profile. Over 60% of CCM's product are shipped directly to the job site, reinforcing the Carlisle experience daily to our contractor base. Through February, the mid-single-digit growth rate CCM experienced were

in line with our expectations for 2020. However, government-mandated shutdowns and quarantining efforts intensified in March, volumes in our core U.S. commercial roofing business began to drop nearly 10% in the last 2 weeks of the quarter, with Europe seeing double declines -- double those declines. We anticipate second quarter sales in North America will be impacted somewhere between 20% and 30%.

There have been some bright spots. We're very pleased with recent results of our newer platforms within CCM. Spray foam was able to grow in the quarter and notably through March, which we view as momentum that should continue after the current malaise in the U.S. construction market dissipates.

Architectural metals maintained its momentum and was up mid-single digits organically in the first quarter with profitability improvements, both in leverage and integration efforts gaining traction.

For our interconnect business, we entered 2020 already significantly burdened with declines driven by the issues surrounding Boeing 737 MAX. The emergence of COVID-19 and its impact on airline travel had an almost immediate and substantial effect on aircraft production, expectations and aerospace manufacturing. We've all been exposed to daily information on the significant commercial aerospace downturn in its details as what has transpired in the airline industry has been front-page news for weeks. Accordingly, we are actively seeking to accelerate and complete restructuring actions, many of which were contemplated in Vision 2025.

Our commercial aerospace business declined approximately 20% in the quarter, accelerating into March, which saw sales levels down roughly 35%. We're anticipating declines of up to 50% in the second quarter, and we will be rightsizing our commercial aerospace business to meet the reality of what we believe will be a longer recovery by eliminating variable cost and optimizing our footprint.

CIT aerospace customers are not sharing forecasts at this time, and both Boeing and Airbus are operating at extremely limited production levels. These declines were already underway in Q1, with the fully disclosed impact from the 737 MAX certification delays, which we previously estimated at \$50 million in sales impact in 2020.

Essential to any aerospace recovery will be a return to flying by the general population. In April, all airlines were impacted to levels previously unseen with one airline indicating a 95% drop in air travel demand. With most of the major U.S. airlines recently agreed to terms with the federal government on a bailout, we feel some clarity and stability has returned. However, it's unclear when business and personal travel will completely recover.

To offset expected commercial aero declines, we are seeking new opportunities

with space and defense customers, positioning to take advantage of opportunities created by undercapitalized competitors and driving product innovation. Despite the current situation, we are encouraged by the fact that aircraft manufacturers, including Boeing and Airbus, went into this downturn with a multiyear backlog of over 13,000 planes. We're hopeful that air travel will return to normal levels by mid-2021, and that airlines will continue to defer not cancel orders, allowing the multiyear backlog to be realized.

CIT's Medical Technologies platform, a key focus area for both organic investment and bolt-on acquisitions, is currently benefiting from increased demand for critical medical equipment to combat COVID-19. As a result of actions, we are taking both in aerospace and the positive sales in medical, we believe CIT's end-market mix will improve dramatically, potentially to a more balanced and more profitable mix than outlined in Vision 2025.

Turning to CFT. As I mentioned on our quarterly calls throughout 2019, CFT entered 2020 already experiencing the impact of uncertainty surrounding Brexit and the unresolved U.S.-China trade negotiations. Added to these issues was a meaningful downturn in global automotive production that has continued to linger. These pressures were exacerbated by the pandemic spread and will likely result in a second quarter revenue decline of over 20%. We are pleased that all CFT locations are currently operational and delivering important products to our customers.

A few silver linings for CFT include the multiple acquisitions to create a Sealants and Adhesives platform we made in 2019 that are integrating and performing above expectations. For the most part, customers are postponing orders not canceling. We are seeing the emergence of post-COVID demand in China, and new product launches are in line with expectations despite market headwinds.

Turning to CBF. CBF was the most affected by the coronavirus. In January, our factories in Hangzhou and Suzhou, China were impacted by the government mandates. Quickly following was a complete shutdown of our Orzinouvi, Italy facility, which as a reminder, is located in the heart of the Lombardy region, the hardest-hit area of Europe. Our team in Orzinouvi continues to be on a government shutdown, with a minor exception for critical spare parts for agriculture. We're encouraged by the fact that outside of Italy and our facility in Pontypool, Wales, our employees are safe and now back to work.

Long periods of plant idling had an obvious negative effect on CBF's first quarter performance, and we expect similar declines in the second quarter. As contemplated in our 2020 operating plan, CBF was undertaking restructuring actions to rightsize the business in line with anticipated global mining, ag and construction growth rates through 2025. These actions will position CBF to be able to meet our profitability expectations in the future.

Moving away from our business segments. M&A remains a key pillar for Vision

2025, and we continue to evaluate opportunities to deploy capital into strategic and synergistic acquisitions across CCM, CIT and CFT. Our financial strength and cash flow generating capabilities afford us flexibility, and we intend to remain opportunistic.

Another pillar of Vision 2025 is COS, the Carlisle Operating System, which has delivered significant savings over the last decade and will continue to be an essential tool for our businesses to rely on as they seek new opportunities to make our operations and business processes more efficient.

COS continues to generate savings and efficiency gains, equaling 1.4% of sales in the first quarter that will position Carlisle well when we emerge from this downturn.

Now I'd like to point out a few key highlights of the first quarter of 2020. First, CCM exhibited its resilience, both in profitability and in maintaining positive volume growth year-over-year, despite the immense pressures felt in March due to COVID-19.

Even though volumes were only up 0.8% in the quarter, operating income grew almost 16% year-over-year, and operating margin expanded more than 200 basis points to 15.9% in the quarter. These gains were driven by our continued commitment to deliver a premium Carlisle experience to our customers, given strong underlying reroofing demand, solid price discipline, favorable raw material trends and strong COS execution.

Second, I'm pleased that the integration of Providien within CIT, which we acquired in the fourth quarter of 2019, is going extremely well. Specifically, the rapid deployment of COS, including quickly training the team and conducting Kaizen events at all 4 of our Providien facilities. These events are aimed at improving safety, capacity and material flow. We've begun integrating finance, HR and IT with all initiatives tracking really well, and we've begun a customer integration process to drive cross-selling.

Providien brings significant scale and adds thermoforming, injection molding and precision metal machining capabilities to our expanding component and vertically integrated medical device solutions. It opens up market adjacencies, such as robotics, drug delivery in oncology, and establishes focused new product development for CIT's growing medical platform.

Third, we're very excited to have published our first-ever ESG report in the first quarter of 2020, and I welcome all of you to visit our website and download a copy. While Carlisle has been a responsible corporate steward for over a century, we are at the beginning of our ESG reporting journey. We're eager to share our progress to date and plans for the future with investors, customers and the communities in which we operate.



Lastly, we're extremely pleased with the progress we have made on our center-led initiatives. None more so than our supply chain work, which has dramatically improved our communications among the divisions and has helped facilitate a real-time pulse on all of our suppliers, very few of which have had any delivery issues in the first quarter or thus far into the second.

Bob will now provide operational and financial detail about the first quarter and review our balance sheet and cash flow. Bob?

**Robert M. Roche**

VP & CFO

Thank you, Chris. Please turn to the revenue bridge on Slide 7 of the presentation. Revenue decreased 3.9% to \$1 billion in the first quarter. Organic revenue declined 7%. Acquisitions contributed 3.4% of sales growth for the quarter, and FX was a 30 basis point headwind.

Turning to our margin bridge on Slide 8. Q1 operating margin declined 70 basis points. Pricing and volume combined for 200 basis points, and acquisitions were a 50 basis point headwind. Offsetting these, COS added 140 basis points. Freight, labor and raw material costs netted to a 20 basis point improvement, and restructuring and rationalization costs were an additional 20 basis point tailwind.

On Slide 9, we have provided an EPS bridge. As Chris mentioned earlier, we reported first quarter diluted EPS from continuing operations of \$1.09, which compares to \$1.33 last year. Volume, price and mix combined were a \$0.37 year-over-year decrease. Raw material, freight and labor costs netted to a \$0.21 benefit. COS contributed \$0.20. Debt extinguishment, loss and net interest expense were a negative \$0.18, while taxes were an \$0.08 benefit.

Now let's turn to Slide 10 to review the first quarter performance by segment in more detail. As CCM revenues increased 0.8%, acquisitions contributed 0.3% of the growth. Organic growth was 0.7%, partially offset by a 20 basis point foreign currency translation headwind. Stable U.S. commercial reroofing and our Architectural Metals platform drove this performance.

Operating margin at CCM was 15.9% in the quarter, a 210 basis point improvement over last year, driven by raw material and COS savings, partially offset by wage inflation. CCM executed extremely well in delivering approximately \$20 million of net price cost realization in the first quarter.

Turning to Slide 11 to review CIT's results. CIT revenue declined 8.9% in the first quarter. This decline was driven by the crisis in commercial aerospace markets, partially offset by positive trends in our Medical Technologies platform.

CIT's operating margin declined 510 basis points year-over-year to 7.3%, driven

largely by the 737 MAX volume declines, raw material and wage inflation. These were partially offset by favorable mix, the impact of FX and savings from COS.

Turning now to Slide 12. CFT's sales declined 7.6% year-over-year. Organic revenue declined 18.8%, acquisitions added 12% in the quarter. CFT is still experiencing the lingering effects of Brexit, U.S.-China trade negotiations and automotive market declines. These declines were exacerbated by COVID-19-related volume experienced in all regions.

Operating margin at CFT declined 530 basis points year-over-year to 4.8% as significant volume declines and related deleverage were partially offset by past restructuring facility rationalization efforts, lower SG&A and efficiencies from COS.

Turning to Slide 13. CBF's first quarter organic revenue decline of 20.8% was due to an accelerated COVID-19-related decline in all regions, made more acute by temporary plant closures in China, Italy and the U.K. CBF is also experiencing a continued multiyear decline in mining, ag and construction. FX also had a negative 1.4% impact. Operating loss was \$3.8 million or a negative 5.4% operating margin, driven primarily by volume declines, unfavorable mix and higher restructuring costs.

On Slides 14 and 15, we show selected balance sheet metrics. Our balance sheet remains strong, as we ended the quarter with \$1.2 billion of cash on hand and \$500 million of availability under our revolving credit line. In the quarter, we paid off the remaining \$250 million balance on our 5.8% senior notes due in 2020 and releveraged into \$750 million of 2.75% senior notes due in 2030. We deployed \$121 million in the first quarter, repurchasing 950,000 shares. We paid our first quarter dividend totaling \$28.3 million on March 2, fully expect to pay our dividend in June and anticipate increasing our dividend in September for the 44th consecutive year.

We continue to approach capital deployment in a balanced and disciplined manner. Investing in organic growth through capital expenditures and opportunistically repurchasing shares, while also actively seeking strategic and synergistic acquisitions.

Free cash flow in the quarter was \$30.4 million. We expect to generate free cash flow conversion in excess of 125% for the full year.

Finally, we expect to maintain our strong investment credit ratings of BBB/Baa2 during this crisis.

And with that, I'll turn the call back over to Chris.

**D. Christian Koch**

Chairman, President & CEO

Thanks, Bob. Please turn to Slide 16. In light of current economic uncertainty caused by COVID-19, we've decided to withdraw our full year 2020 revenue guidance until a clear picture emerges for our businesses.

Turning to our corporate items. Corporate expense has been lowered from \$100 million to \$105 million to approximately \$80 million for the year. Depreciation and amortization expense is expected to be approximately \$230 million.

For the full year, we continue to invest in our businesses and expect to maintain our previously stated level of capital expenditures of \$100 million to \$120 million. We also expect free cash flow conversion of approximately 125%. Net interest expense is expected to be approximately \$75 million for the year.

Finally, we expect our tax rate to be approximately 24%. At Carlisle, we remain committed to our Vision 2025 objectives, ultimately driving \$15 in earnings per share. The foundations of Vision 2025 success rest on driving organic growth with leverage, utilizing COS consistently to drive efficiencies, building scale with synergistic acquisitions and deploying over \$3 billion in capital.

When coupled with our long-standing and defining management approach of combining continuous improvement, entrepreneurial spirit and decentralization with an increasingly center-led approach, we created a unique culture, which assures that the day-to-day energy, focus and efforts of our employees are directed towards actions that drive results and support the key initiatives within the context of our strategic plan.

At CCM, where approximately 70% of our business is in reroofing, we are in the midst of the strongest reroofing cycle ever. Coupling this with our continued expansion into the building envelope, namely spray foam and architectural metal and greater focus on international markets than in years past, we believe this sets up CCM well to contribute to Carlisle's goal of 5% organic growth through the Vision 2025 period.

Given the value of the Carlisle experience and the focus on delivering the most comprehensive roofing support and solutions to contractors, building owners and architects, coupled with a best-in-class cost structure and a commitment to pricing resolve, we expect profitability to hold up well relative to more cyclical end market exposures, providing a solid anchor to Carlisle's stable overall operating earnings, cash flow and returns.

With CIT, we remain committed to being a premier and reliable supplier of interconnect products to the commercial aircraft, space and defense industries. With backlog still high and with airlines, in general, delaying not canceling orders, we expect the industry to return to growth once passengers are comfortable flying again. While we were disappointed with the current demand situation, we believe the fundamentals that supported the growth in airline travel will return when the situation is safe. We also believe that the actions taken during this

downturn will result in a more efficient and a higher-performing CIT when volumes return. We're excited about our progress on building out CIT's global Medical Technologies business, which is well-positioned to leverage favorable industry dynamics such as aging populations and trends towards minimally invasive procedures. We maintain an appropriate and opportunistic approach to augmenting this platform with tuck-in acquisitions.

At CFT, while end market exposures have challenged our ability to grow the business in recent quarters, our original CFT acquisition deal thesis remains intact as we continue to establish a solid platform on which to build going forward.

While we are taking some actions on cost near terms, we will not sacrifice future growth potential for what should be a meaningful contributor to achieving Vision 2025.

As we enter the second quarter in a period of increasing uncertainty, we once again express our thanks to our dedicated employees, their families, our business partners and all those associated with Carlisle's success. Given our 100-year history and the resilience this company has shown in times of diversity and uncertainty, we remain confident in Carlisle's outlook, our strong financial foundation, cash-generating capabilities, unwavering commitment to our Vision 2025 strategic plan and to providing products and services essential to the world's needs.

This concludes our formal comments. Shontelle, we're ready for questions.

# Question and Answer

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## Operator

[Operator Instructions] Your first question comes from Tim Wojs with Baird.

### **Timothy Ronald Wojs**

Senior Research Analyst

#### **Question:**

I know it's pretty dynamic. I guess on CCM, and you gave us a little bit of an outlook here for Q2 on the sales side. But how confident and any kind of color you can give us on just how quickly some of the reroofing demand could snap back in your eyes?

I mean, is it something where you think we have more of a moderating kind of decline as you go into the back half of the year? Or do you think it can snap back quicker than that?

### **D. Christian Koch**

Chairman, President & CEO

#### **Answer:**

Well, I think there's a lot of opinions out there, Tim. I spoke with our top contractors and distributors over the last couple of weeks. And I think it's been interesting. The backlog was definitely there. We -- a lot of people were off to record starts in the first quarter. And I think there will be work to do where they're able to get on job sites in that through June. I think as we get into the second half, it gets more murky. And really, it all depends on how quickly we can free up the quotation is processed, how quickly we can get people back into the buildings for reroofing because a lot of those buildings people are out commuting from home. And so they don't want workers in there and any proximity either. They're, in a lot of cases, not enough people there. So my thoughts are that if we can get something in terms of a relief on some of the policies that are in place right now within the May, June time frame, it could be a good second half to the year. I think if it gets prolonged into August and September, then we start to push up against the fall. And also, I think then the ability to quote and get jobs approved and that will prove difficult. So I didn't really give you much more there, but 1 of those 2 is probably the outcome.

### **Timothy Ronald Wojs**

Senior Research Analyst

**Question:**

Yes. I guess from what you're saying, I mean, would you say more of the second quarter decline, you would say, is due to things like permitting issues and not getting access to buildings as opposed to actual demand?

**D. Christian Koch**

Chairman, President & CEO

**Answer:**

Yes, I think the demand was there. I think definitely, the incoming booking rates for people, the jobs that were lined up, I think, like I said, it was a good start to the year. And I think we've had a enforced slowdown, let's say, as opposed to one that had anything to do with the underlying demand.

**Timothy Ronald Wojs**

Senior Research Analyst

**Question:**

Okay. That's helpful. And then maybe just -- if you could give us maybe an updated outlook on what you're thinking about the cost basket in CCM? And I think previously, it was \$25 million to \$35 million. I think a majority of that was cost deflation. Where oil is today and just given how much you buy in terms of like poly oils and MDI, what does that kind of cost bucket look like today?

**D. Christian Koch**

Chairman, President & CEO

**Answer:**

So we're -- we've moved that up to around \$40 million, \$45 million is our current outlook. Obviously, that can change. There could be some upside to that. But right now, we're thinking, I'd say the price cost combo is \$40 million to \$45 million. And I just want to add that, that does include our pricing thoughts in that \$40 million to \$45 million.

**Timothy Ronald Wojs**

Senior Research Analyst

**Question:**

Okay. And just, I guess, the assumption is just given the raw material basket is widening in terms of the deflation, there's going to be some pressure on price?

**D. Christian Koch**

Chairman, President & CEO

**Answer:**

I think that's an accurate statement.

**Timothy Ronald Wojs**

Senior Research Analyst

**Question:**

Okay, great. And then the last one, just on aerospace. I guess is there a way to think about what you're restructuring and kind of the -- what's available to restructure, I guess, if aerospace does kind of go through a more prolonged slump here?

**Robert M. Roche**

VP & CFO

**Answer:**

Yes. Tim, as you know, this is Bob, we definitely took out a lot of, I'll call it, factories over the last couple of years, as you well know. So I don't think there's a lot of sizable footprint reduction to be done, but the team is reducing costs with what they see volumes doing. And some of that can be done through overtime reductions and temporary workforce and others, but there will be some reductions in that business due to the fact that volumes in aero are expecting to be down so sizable this year.

**Operator**

Your next question comes from Bryan Blair with Oppenheimer.

**Bryan Francis Blair**

Director & Senior Analyst

**Question:**

I wanted to follow up on CCM's volume cadence year-to-date. I know it was solid January, February. Declines as of the back half of March, and I assume that you're seeing peak or what you expect to be almost peak declines in April. Is that the 20% to 30% range that you've cited for the second quarter or is April different than that rate?

**D. Christian Koch**

Chairman, President & CEO

**Answer:**

So I think you're seeing -- yes, it's indicative of that, that 20% to 30%. I mean, it may accelerate a little bit start entering in April and the 20% and move up a little bit as we get further on, but that's our thought right now.

**Bryan Francis Blair**

Director & Senior Analyst

**Question:**

Got it. Okay. And then sorry if I missed this, did you cite the organic growth rate for CIT Medical in the quarter?

**D. Christian Koch**

Chairman, President & CEO

**Answer:**

We did not cite the organic growth rate for CIT Medical on the call. Let me get back to you on that, all right?

**Bryan Francis Blair**

Director & Senior Analyst

**Question:**

Okay. Just in terms of that outlook, second quarter and full year to the extent that you can offer directional guide, should that remain resilient, perhaps grow in this environment? Or are there offsets to the underlying demand expansion?

**D. Christian Koch**

Chairman, President & CEO

**Answer:**

Bryan, can you rephrase that question for me?

**Bryan Francis Blair**

Director & Senior Analyst

**Question:**

Sure. I'm speaking specifically to CIT Medical again. Should that remain in positive territory in terms of core growth rate in the second quarter and the full year or are there offsets then?

**D. Christian Koch**

Chairman, President & CEO

**Answer:**

Yes. No. I think it should remain positive. And we continue to -- actually we expand our capabilities without digressing too much. There's been a lot of work by Bill and the team in Providien and Lars, the leader of our RedGroup organization and then our existing wire and cable medical people to facilitate greater coordination. And I would say we're getting greater access, and we're



seeing greater demand for projects at existing customers and some new customers. The only impact would be some of the telecommuting or the, I say, travel restraints, if you're heard some of the new contacts where we'd like to be out there with the engineers working with them in the field. But other than that, our growth rates are good. And in terms of organic growth in the first quarter for CIT Medical, it was in the 12%, 13% range.

**Bryan Francis Blair**

Director & Senior Analyst

**Question:**

Okay. Good to hear. And last one on the stepped-up restructuring in CIT, how should we think about the payback period there?

**Robert M. Roche**

VP & CFO

**Answer:**

Yes. The payback is probably close to a year or less, Bryan.

**Operator**

Your next question comes from Saree Boroditsky with Jefferies.

**Saree Emily Boroditsky**

Equity Analyst

**Question:**

So I wanted to see what is driving your assumption for higher free cash flow conversion for the full year. And then for my second question, just given that your balance sheet is in really good shape. How are you thinking about capital allocation between share repurchases and acquisitions, just given the uncertainty in the current environment?

**Robert M. Roche**

VP & CFO

**Answer:**

Yes. On your -- I'll start with the second one. On -- our priorities aren't changing. They're continuing with -- we're looking for acquisitions. In these times, obviously, acquisitions have slowed down with everybody's business being where it is. We're hopeful that will pick back up in the second half, and we want to continue to be acquisitive with our strength. And then we will continue to be opportunistic in repurchasing shares as we see -- as we move through the rest of the year.

**D. Christian Koch**

Chairman, President & CEO

**Answer:**

And then the question, Bob, on the 125% free cash flow.

**Robert M. Roche**

VP & CFO

**Answer:**

Yes, 125% free cash flow. In times when revenue is shrinking in this business, we will obviously reduce inventory. Most of it is working capital-driven because it will reduce inventory and receivables will come down.

**D. Christian Koch**

Chairman, President & CEO

**Answer:**

Yes, just one -- I'll just add one more thing on the M&A because I'm sure it will come up. The pipeline you see has been, I would say, it slowed down dramatically when this started. I think there's, obviously, a lot of people that are not looking to monetize their assets at this time. So I think things will start to free up as we see how long this goes on and people get some more stability, and we'll be there on those assets we've identified within CCM, CIT and CFT to act if there's opportunities that present themselves.

**Operator**

Your next question comes from Garik Shmois with Loop Capital.

**Garik Simha Shmois**

Managing Director

**Question:**

Just wanted to start off just on CCM. Just as far as the weakness that you're seeing right now. Are these mostly project delays, the best that you can tell? Or are you seeing outright cancellations in which your customers are saying, you know what, we just don't have the visibility and we'll get back to you at some point in the future whether or not we want to reroof?

**D. Christian Koch**

Chairman, President & CEO

**Answer:**

Well, I think in terms of our impact, I think really at the contractor level, they're mostly, I would say, delayed. I don't have the exact ratio, but I would

say that the ratio of cancellations to delays favors delays by far. For us, we also sell a considerable amount of our product through distribution. And one of the effects that's exacerbated our volume declines has been -- this is typically the season when our distributors start to load up on product to get ready for the summer months and the 2 quarters in the summer, second and third that are typically our big quarters.

So they've been looking, I think, for the most part, and you know the big ones, they've been looking to serve cash. And so we've seen a big drop-off on that. With that said, we've still been producing, we've still been inventorying. And we, as I said in the call, intend to be to make sure our contractors are supplied with products. So been a little bit of a drop-off there that's exacerbated that volume decline. But I think for the most part, to answer your question again, mostly delays.

**Garik Simha Shmois**

Managing Director

**Question:**

Okay. And just one more on CCM. You called out in the slide, health care and education is, I guess, relative bright spots. Are you seeing some activity getting pulled forward into the second quarter, just given some -- maybe some capacity availability in some of those verticals? And maybe if you do whip around on some of the different verticals in CCM?

**D. Christian Koch**

Chairman, President & CEO

**Answer:**

Well, I think, obviously, the education one's an easy one to touch on. I don't have numbers I'm going to give you, but what I'd say is with the children and students out of school, it's given some people, I think, some thoughts that maybe they should get the work done now. Because what happens if we need to bring people back to school earlier in the summer, we won't have that same window.

And then health care, obviously, there's a big focus on health care right now and just no sense that anybody wants a delay there. And certainly, we can't have any leaking or dysfunctionality in a roof that's over a nursing home or a medical facility. Obviously, these people have enough to deal with, they don't need to deal with that. So I know our contractors are taking care of that immediately, and that's a primary focus for them. So Bob, I don't know, do you want to add anything on any verticals there?

**Robert M. Roche**

VP & CFO

**Answer:**

No. I think, yes, you covered it, Chris, that the education and health care is what we're seeing right now.

**Garik Simha Shmois**

Managing Director

**Question:**

Okay. Just lastly, just on the CapEx guidance. You maintained that. So I'm just kind of curious as to how you're thinking about CapEx this year. You've taken some restructuring actions that you put forward in accelerating, but at what point will that potential need to be adjusted, if at all?

**D. Christian Koch**

Chairman, President & CEO

**Answer:**

Yes, I think that's -- I'll start, and then Bob can continue. But I think that's why we emphasize the Vision 2025. Typically, when we make capital investments, they are done for the longevity of the business and not being in a position where that's going to impact our performance from a cash perspective or put us into a situation where we can't deliver on our other commitments. We don't see any point in hesitating. Specifically in CCM, I mean, we don't view this to be a -- I mean there's still a lot of product going through CCM. CCM still maintains a great position in the industry. It's viewed as the premium product. We want to make sure that all of our facilities are, first of all, safe. So if there's any safety CapEx that goes through. And then anything that's going to drive efficiency, product quality improvements, expansions into new markets, specifically in some of our acquisitions like spray foam, or an architectural metal, we're going to continue to do those. Because, as I said, we think we have the lowest cost operating structure, and we want to continue to maintain that. Bob, anything?

**Robert M. Roche**

VP & CFO

**Answer:**

Yes. No. And Garik, as Chris said, most of this CapEx in the year is skewed towards CCM. We had already brought CIT down with the known MAX issues we talked about in February. So we're -- and we intend to be offensive. And a lot of our projects are cost-related, where we're taking costs out, automating and like Chris said, safety. So we don't see the need or, say, opportunity to cut that because it will hurt the business longer term.

## **Operator**

Your next question comes from Kevin Hocevar with Northcoast Research.

### **Kevin William Hocevar**

VP & Equity Research Analyst

#### **Question:**

Chris, hoping to dissect the down 20% to 30% comments for -- in the CCM business one other way. Curious, there are certain parts of the country that are more prohibitive in terms of construction activity, like Boston, New York, Michigan, et cetera, versus others that have deemed are less prohibitive in terms of construction activity. So curious, are what -- curious what type of declines you're seeing in those more prohibitive places versus the rest of the country?

### **D. Christian Koch**

Chairman, President & CEO

#### **Answer:**

Well, I think the declines are pretty substantial. I know when I was talking to one of our contractors in Pennsylvania, who also had branches in Ohio, Pennsylvania basically shut down and Ohio still operating and still fulfilling the backlog that they were working on. So I think it's pretty dramatic. I think in a place like Boston as well or Washington state, I think New York, Pennsylvania, Washington State, Michigan. I mean, they're serious about it, and it's a big difference.

### **Kevin William Hocevar**

VP & Equity Research Analyst

#### **Question:**

Got you. And then in terms of -- what can building owners do to -- it sounds like the projects that are in the backlog right now are getting delayed. But what about new bidding activity? And what are -- are building owners -- instead of just delaying, are they taking other actions to -- as opposed to waiting a couple of months or a year to replace the roof, are they taking other actions to defer that spending in terms of patch and repair, putting a coating on top, whatever? Just curious, your thoughts in terms of what other actions building owners can do? And are they taking those actions now to really defer the bigger spend of the full replacement of the roof?

### **D. Christian Koch**

Chairman, President & CEO

**Answer:**

My knowledge is now, let's say, a week old. And in this time, that seems to be a lot. But I think I'd say most building owners probably don't have this at the top of their list. To be perfectly frank, I think with the rental -- with the rents and people not paying rents or delaying rents or the economic situation of their tenants and things like this, my guess is that if they have a project underway and it's gotten inspection approval and they're in the midst of it, they complete it, my guess is if you have an emergency situation on a leak and you're able to fix it, you're fixing it. Nobody wants to operate a building where whether it's a warehouse or anything else that has those issues, you're just destroying the product or creating an unsafe situation for your workers. But my guess is, after that, with few exceptions right now, they're focused on that income-generating side of it. And also, really, the lives of their people that they rent from them, and in many cases, have been renting for many years and are suffering financial disaster.

I think they'll turn to the roots a little bit later, but my guess is we haven't seen -- I mean, I just haven't seen enough to address your question with any more granularity than that.

**Kevin William Hovevar**

VP & Equity Research Analyst

**Question:**

Sure. And it might be -- my last question, in terms of -- it might be tough to say at this point, but 2019 was then seemingly the peak this cycle for demand. 2020 will be down something. Is this -- does it take -- how long does it take do you think to recover to get back to that 2019-type peak level? Is that something that, given the resiliency and the primarily retrofit side of thing, is that something within a year or 2, could get back to 2019 levels? Or does that take a couple of years before we fully recover?

**D. Christian Koch**

Chairman, President & CEO

**Answer:**

I'll put it for you this way. We had constraints on labor that had built up some of the highest backlogs we've had in this industry, specifically with our team, it's been 70% reroof, which we know is -- we have to do it. I think it's one of the first things you need to do to create a safe and obviously, feasible working space for the people to work in the building. So my guess is when things get released, it is going to be a rapid return. I know the contractors are ready. We've got -- they're trained, they have product, they're professionals. I mean, they're ready to go as soon as it happens. And as I

said, I don't really believe any demand is being destroyed. I believe that it's sitting there and it's even building because remember, reroofing is an ongoing process. So anything that's not being reroof now is sitting there, it's working its way towards being reroofed. If it's in year '17 and we wait a year, now it's in year '18. So it's generally 20 years when we need to have them reroof. So yes, I think a rapid recovery once these restrictions get lifted.

## **Operator**

[Operator Instructions] Your next question comes from Joel Tiss with BMO.

## **Joel Gifford Tiss**

MD & Senior Research Analyst

### **Question:**

I have kind of a weird question. How do you think, like, you've probably been talking to people who've been doing this for a long time. And how do you think about demand for buildings for square footage as we go into 2021 and '22? Like, I understand the backlog that's there is going to want to -- people are going to want to knock it out quick. But longer term, like if restaurants go bankrupt or businesses stop, whatever, aren't around anymore or more people work from home. Like, can you -- have you talked to anybody about kind of structural issues that might change this business over the next decade?

## **D. Christian Koch**

Chairman, President & CEO

### **Answer:**

Joel, it's interesting. We have spent some time looking into that and talking. Obviously, there's a wide variety of opinions, and I think it's appropriate. I think we see things like education, and we knew there were already trends to online learning, and we wonder what that impact will be on the physical plants. Yes, we also look back over events that have occurred over the last few years, the Great Recession, 9/11, things like that, and we know that small colleges and universities continued in a lot of ways to behave like they used to. So will it be a rapid transformation? I don't know. Medical is one that people have said, that the digital transformation that was already occurring on medical records on maybe FaceTiming with your physician will be accelerated, and maybe we won't go back from that. But I still think in terms of hospitals and that, what we're seeing out of this is that the infrastructure may not have been what we want it to be in certain cases. And so we may see an enhanced construction around new facilities with better capabilities to address surges and things like that. Certainly, the use of the Internet for shopping, I know in my family and me personally, we're doing a

lot of that. That's a trend that had been building anyway. It looks like it's going to continue to build. Amazon seems to be showcasing what they can do in this situation. So yes, it will be interesting. I think there's going to be -- I don't really have an answer for you other than in some places, it will be affected. In others, I think we'll go right back to probably doing things the way we were already doing. But I think in terms of the net-net, we're still going to be in a really good place, at least through the reroofing backlog and probably into 2030, 2032, somewhere in there.

**Joel Gifford Tiss**

MD & Senior Research Analyst

**Question:**

Okay. That's good. And then just on acquisitions, I know, whatever, it's probably not appropriate timing to think about it. But have you rethought about where you would take like maybe something that you really, really would love to have all of a sudden becomes available in 6 months? Is there sort of a limit that you would take the debt-to-EBITDA to? Or has that -- have you thought about like changing that? Or like just what's your thought process there?

**D. Christian Koch**

Chairman, President & CEO

**Answer:**

No, no. Yes. I think -- no, I think on acquisitions, there's a pause. Obviously, one of the reasons is the integration and the due diligence issues not being able to get there and all that, you understand that, and we haven't thought about it. I think our strategy, we've come back and said, at least from a target perspective, we want to do the same things we're doing in CCM, CIT and CFT. And then I think, Bob, you want to just touch on the debt. I don't think it changes...

**Robert M. Roche**

VP & CFO

**Answer:**

Yes. We're at 1.6% net debt-to-EBITDA right now, Joel. We have -- our covenants don't allow us to go above 3.5%. Like we said, with the size of things we see out there, it's hard getting above 2.5%, but we -- if something, the prime target came up, we'd go to 3% probably.

**Operator**

Your next question comes from David MacGregor with Longbow Research.



**David Sutherland MacGregor**

CEO, Director of Research & Senior Analyst

**Question:**

I guess as the economy goes through its reopening, whatever that might ultimately end up looking like, how do you position the business tactically to achieve maximum possible recovery?

**D. Christian Koch**

Chairman, President & CEO

**Answer:**

Well, I think we just -- we're in a very, I guess, advantageous position. We have really been able -- like I said, all of our factories have stayed open. We always invest in safety. We invest in efficiency. We've got a great leader, Doug Taylor with COS, he's been here for 5 years. He and his team, they work every day. Whether the economy is doing well or not, they're working on ways to earn more money for us, operate more efficiently. So in terms of positioning, I think you do all that work before you get to this point. And you have an organization like we do with a lot of great people who are just -- they're ready to go, they've got the capabilities. They've got everything we need. We've got great suppliers. Like I said, we haven't had really any issues with the supply chain. They're ready to go. So I think we're positioned to do it. I mean it's -- go ahead, Bob.

**Robert M. Roche**

VP & CFO

**Answer:**

And just to add CCM specifically, I mean, normally, during the first quarter, we're building inventory for the season anyway. And this just allowed us to build more with the slowdown we have in taking products. So like Chris said, we expect demand to come back at CCM. We have -- I'm going to say, excess inventory. We have a lot of inventory because we will build that anyway. So we're ready to serve our customers as soon as it comes back.

**David Sutherland MacGregor**

CEO, Director of Research & Senior Analyst

**Question:**

Good. I guess if I could get you to maybe go back and talk a little bit more about what you're seeing right now in terms of bidding activity, and I'm guessing it's slowed. But to what extent are you seeing bidding activity? What are the patterns you may be seeing there right now that maybe surprised you a little bit given the slowdown? And to what extent are you

seeing more aggressive pricing in these bids?

**D. Christian Koch**

Chairman, President & CEO

**Answer:**

I can't comment on really any -- I haven't seen any pricing action in the bids. I think, as I said, people are focused on maybe completing the jobs they've got. And I think there is substantial trouble in getting these quotes and bids out. I look at the retail or the consumer -- general housing, and we saw the results that traffic is down and inventories are down on residential. But one of the problems with selling a house is you can't get -- nobody wants to open their house to have you come by and take a look. I think the same is true in commercial. We've got that issue. We've got someplace to shelter in place. You can't leave your home anyway in San Francisco or whatever. So yes, it's impactful. I don't think the pricing is and the bids is probably impacted right now or the first thing they're thinking about. Yes, I can't give you a lot of clarity other than that.

**David Sutherland MacGregor**

CEO, Director of Research & Senior Analyst

**Question:**

Okay. If I could maybe just squeeze one more in quickly. The second quarter outlook, you've provided some clarity around your expectations there. Can you talk about what you're expecting in terms of distributors out the door sales trends in the second quarter?

**D. Christian Koch**

Chairman, President & CEO

**Answer:**

I can't. I think that we have -- like I said, we have good access to the contractors in that. I think distribution is probably saying the same things we are. And yes, I can't because each distributor, at least the big ones, they're all different, they all operate in a different way, in different regions. So I would just -- I guess, my general comment would be they're probably seeing the same things as we are.

**Robert M. Roche**

VP & CFO

**Answer:**

Yes. And 60%, 65% of our product is shipped from our facility straight to the job site due to the size. So it's not normal for distribution to hold that much

anyway. Like Chris said, in these months, they build up a little bit, getting ready for the summer. But most of the jobs shipped directly from our warehouses, which is why we're building it indoor to get ready for the...

**Operator**

There are no further questions at this time. I'll now turn the call back over to the presenters.

**D. Christian Koch**

Chairman, President & CEO

**Answer:**

Thanks, Shontelle. This concludes our first quarter 2020 earnings call. Thanks, everybody, for your participation. We look forward to speaking with you on the next earnings call and having a, hopefully, more clarity on where we are in the situation. Be safe. Thanks.

**Operator**

This concludes today's conference call. You may now disconnect.

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