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Core & Main, Inc. (CNM)

Q1 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, everyone and welcome to the Core & Main Q1 2024 Earnings Call. My name is Angela, and I'll be coordinating your call today. [Operator Instructions]

I will now hand you over to your host, Robyn Bradbury, Senior Vice President of Finance and Investor Relations to begin. Please go ahead.

Robyn Bradbury

Senior Vice President-Finance & Investor Relations, Core & Main, Inc.

Thank you. Good morning, everyone. This is Robyn Bradbury, Senior Vice President of Finance and Investor Relations for Core & Main. We're excited to have you join us this morning for our fiscal 2024 first quarter earnings call.

I'm joined today by Steve LeClair, our Chair and Chief Executive Officer; and Mark Witkowski, our Chief Financial Officer. Steve will lead today's call with an overview of our first quarter execution highlights. Mark will then discuss our financial results and updated fiscal 2024 outlook followed by a Q&A session. We will conclude the call with Steve's closing remarks.

We issued our earnings press release this morning and posted a presentation to the Investor Relations section of our website. As a reminder, our press release, presentation, and the statements made during this call include forward-looking statements. These statements are subject to risks and uncertainties that could cause actual results to differ materially from our expectations and projections. Such risks and uncertainties include the factors set forth in our earnings press release and in our filings with the Securities and Exchange Commission.

We will also discuss certain non-GAAP financial measures, which we believe are useful in assessing the operating results of our business. A reconciliation of these measures can be found in our earnings press release and in the appendix of our investor presentation.

Thank you for your interest in Core & Main. I will now turn the call over to Chair and Chief Executive Officer, Steve LeClair.

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

Thanks, Robyn. Good morning, everyone. Thank you for joining us today. If you're following along with our investor presentation, I'll begin on page 5 with an overview of our market position. Core & Main is a leading specialty distributor of water, wastewater, storm drainage, and fire protection products serving municipalities, private water companies, and professional contractors across municipal, non-residential and residential end markets nationwide. Our specialty products and services are used in the maintenance, repair, replacement, and construction of water and fire protection infrastructure.

Customers partner with Core & Main for our breadth of products and services, extensive industry knowledge, familiarity with local municipal specifications, convenient branch locations, and project management capabilities. We serve both smaller local customers and larger regional or national customers with relevant expertise, and our sales associates take a consultative approach to provide customer-specific solutions for projects of all sizes. We are often involved in our customer's planning processes all the way from project design to project completion.

Our footprint consists of more than 350 branches across 49 states, which serves as a critical link between approximately 5,000 suppliers and a diverse base of over 60,000 customers. We are an industry leader, yet we estimate we have only 17% share of a fragmented \$39 billion addressable market. Accordingly, our long-term growth opportunity is significant.

Turning to page 6, we are pleased with our start to fiscal 2024. Net sales grew 11% to a first quarter record of \$1.74 billion. This performance was indicative of supportive end market volumes and an earlier start to the selling season in some northern geographies. Residential lot development improved sequentially from the fourth quarter. This was the first quarter in more than a year that residential volumes improved on a year-over-year basis. We are encouraged by our backlog and bidding activity across this market.

We're seeing solid activity across the non-residential construction landscape. While some verticals in this market remain soft, like office space and retail, others continue to be strong, such as highway and street projects, data centers, battery plants, and other large industrial manufacturing projects. We are seeing good momentum in municipal projects being bid and coming online during an important part of the construction season. Though still relatively small in scope, we are also seeing projects funded by the Infrastructure Investment and Jobs Act make their way into our backlog and bidding activity in certain parts of the country. These projects are primarily related to new water treatment plant facilities and service line replacements. While we're pleased to see projects utilizing the federal funding, we've seen limited progress on major municipal repair and upgrade activity, and it does not appear we are seeing any incremental benefit so far this year.

Market volume growth in the quarter was supplemented by the execution of our product, customer, and geographic expansion initiatives to deliver above market growth. We achieved 31% growth in metering products this quarter, highlighting our ability to drive the adoption of new products and technologies throughout the industry. While this growth reflects some improvement in the supply chain for meters, we are pleased with the magnitude of new projects being bid and awarded.

Beyond our product initiatives, our recent greenfields are also performing well. Every time we add a new branch, we add sales resources and reduce the average time it takes for us to reach our customers. This enhances our value proposition, giving us the opportunity to earn market share. Each of our greenfields continues to mature and offer additional growth opportunities. We are actively evaluating a pipeline of new locations to expand into. Acquisitions are an important part of our long-term growth strategy, and our team continues to execute on an active pipeline of opportunities.

During and after the quarter, we added five complementary businesses to the Core & Main team, one of which was our largest acquisition to-date. These acquisitions offer expansion to new geographies, access to new product lines, and the addition of key talent. Gross margin came in at 26.9% versus 27.9% in the prior year. While underlying product margins were impacted as expected, gross margins continue to be strong, supported by the robust performance of our private label and sourcing initiatives and benefits from M&A. Mark will walk you through the various components impacting margins later in his financial commentary.

Turning to our cash flow and capital allocation priorities, we were pleased with the \$78 million of operating cash flow achieved in the first quarter. Given the seasonal pattern of working capital needs for our business, we typically generate most of our cash in the second half of the year. Our cash generation this quarter reflects a lower than normal seasonal inventory build, resulting from our continued inventory optimization efforts. We continue to balance capital allocation between organic and inorganic growth opportunities, as well as returning capital to shareholders.

During and after the first quarter, we deployed over \$600 million to acquire five complementary businesses. We are also prioritizing organic investments in greenfields, in addition to upgrading our fleet, facilities, and technology tools that will benefit us in 2024 and beyond. Our ability to invest in organic growth and value-creating acquisitions is underpinned by our strong operating cash flow, balance sheet capacity, and liquidity.

On page 7, we highlight the exceptional businesses recently added to the Core & Main family. Eastern Supply is a distributor and fabricator of a wide variety of storm drainage products operating out of locations of Virginia and Pennsylvania. For close to 30 years, the team at Eastern Supply has provided drainage products and related services to contractors, engineers, and municipalities across the Northeast.

Dana Kepner is a multi-region distributor of water, wastewater, and storm drainage products operating out of 21 locations across Arizona, Colorado, Nevada, Texas, Wyoming, and New England. They are a highly credible partner in the waterworks industry, and their core values align with our own at Core & Main. Dana Kepner offers opportunities to generate synergies through our combined purchasing capabilities, facility optimization, and fixed cost leverage as we drive new revenue-generating opportunities by providing our customers with broader access to products and services.

ACF West is a distributor of geosynthetics and erosion control products with six locations across Oregon, Washington, Idaho, and Utah. For over three decades, the team at ACF West has offered their municipal and contractor customer solutions for geosynthetics, erosion control, stormwater management, and terrain stabilization. ACF West is a trusted distributor with a longstanding and loyal customer base, and their product and service offerings are an excellent complement to our business.

EGW Utilities is a distributor of products and services to underground utility contractors and municipalities in Texas. The team at EGW Utilities has been providing underground infrastructure products and services since 2001. Their commitment to delivering value-added solutions and maintaining strong customer relationships has

enabled them to provide customers with the resources and support needed to complete projects successfully. We are happy to have the EGW team a part of the Core & Main family, and we look forward to the additional private label capabilities and capacity this acquisition brings us.

Our most recent acquisition, Geothermal Supply Company, is a distributor and fabricator of high-density polyethylene pipe and other related products. They primarily serve the geothermal, water, and sewer industries from a single location in Kentucky. Adding GSC to the Core & Main family will create exciting new opportunities for us in an important and expanding area of HDPE. Their expertise in the industry fits well with our existing fusible product offering, and we are confident this will be a positive partnership for both new and existing customers.

The integration of these businesses is progressing according to plan, and our acquisition strategy continues to create tremendous value for Core & Main. We have a very active M&A pipeline and expect to continue adding value-creating businesses to the Core & Main family throughout 2024 and beyond.

To wrap up my prepared remarks, we are pleased with our performance in the first quarter. We have generated significant momentum for the business in recent months, and we are well-positioned to achieve our objectives by continuing to execute our growth strategies as we enter an important part of the construction season. Thank you to our associates for advancing the reliable infrastructure in the communities in which we live, work, and play, is becoming more and more apparent that our communities need a partner to help repair and upgrade our nation's fragile water infrastructure. And I am proud that we are there and ready to answer the call.

With that, I will now turn it over to Mark to discuss our first quarter financial results and fiscal 2024 outlook. Go ahead, Mark.

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Thanks, Steve, and good morning, everyone. I'll begin on page 9 with highlights of our first quarter results. We achieved nearly 11% net sales growth in the first quarter, with organic sales growth of roughly 3% and approximately 8% added through acquisitions. Organic sales volume grew mid-single digits as our teams continued to drive market share gains to supplement modest end market growth. Pricing was a minor headwind for the quarter as we continue to experience deflation on certain products and our end markets have remained competitive.

Our gross margin in the first quarter came in at 26.9%, compared to a record 27.9% in the prior year. As expected, underlying product margins were impacted by a higher average cost of inventory in 2024, compared to 2023. This unfavorable impact was partially offset by strong private label performance, our sourcing optimization efforts, and benefits from M&A. Selling, general, and administrative expenses increased approximately 15% in the first quarter to \$257 million. Excluding acquisitions, SG&A increased mid-single digits with most of that increase attributable to inflation and investments in personnel to support current volumes and future growth.

Interest expense in the first quarter was \$34 million, compared with \$17 million in the prior year period. The increase was primarily due to the addition of the incremental \$750 million term loan that's due in 2031, higher borrowings under our senior ABL credit facility, and an increase in interest rates on our variable rate debt. The provision for income taxes in the first quarter was \$33 million, compared with \$31 million in the prior year period. Our effective tax rates in the first quarter of this year and last year were 24.6% and 18.9%, respectively. The increase in the effective tax rate was primarily due to the exchanges of partnership interests in conjunction with the secondary offerings and repurchase transactions we completed last year.

We recorded \$101 million in net income for the first quarter, compared with \$133 million in the prior year period. The decrease in net income was primarily due to lower operating income and an increase in interest expense. Diluted earnings per share in the first quarter decreased 2% to \$0.49, compared with \$0.50 in the prior year period. Diluted earnings per share decreased primarily due to a decline in net income, partially offset by lower share counts following our repurchase of 45 million shares during fiscal 2023.

Adjusted EBITDA in the first quarter decreased approximately 1% to \$217 million, and adjusted EBITDA margin decreased 150 basis points to 12.5%. The decrease in adjusted EBITDA margin was primarily due to lower gross profit as a percentage of net sales and higher SG&A due to the impact of cost inflation and investments to drive growth.

Now, I'd like to provide an update on our cash flow and balance sheet on page 10. Net cash provided by operating activities in the first quarter was \$78 million. We were pleased with this level of cash flow in what has historically been a lower cash generation quarter. We experienced an inventory build this year, though less than typical, as we continue to optimize inventory levels. We supplemented our operating cash flow with additional borrowings to make significant investments in the growth of the business with over \$600 million of cash spent on M&A during and after the quarter. We remain committed to the capital allocation priorities we previously laid out.

In the near term, we expect to generate additional cash flow from operations to fund our organic initiatives and M&A while working to enhance our liquidity and reduce our net debt leverage. As we progress throughout the year, we expect to provide additional details on our plans for returning capital to shareholders, which may include additional share repurchases and the potential for a future dividend program. As a reminder, we deployed \$1.3 billion on share repurchases during fiscal 2023.

We entered into a new \$750 million term loan during the quarter to expand our capital structure. The new term loan matures in February 2031 and carries interest that term SOFR plus a margin of 225 basis points. Concurrent with the issuance of the term loan, we extended the maturity of our existing ABL facility to 2029, and we also entered into an interest rate swap with an all-in fixed rate of approximately 6.2%. The interest rate swap has a starting notional amount of \$750 million that increases to \$1.5 billion on July 27, 2026, through the instruments maturity in 2028.

Excluding the pro forma effects of acquisitions, net debt leverage at the end of the quarter was 2.7 times, and our current available liquidity is more than \$1 billion. The year-over-year increase in net debt leverage was primarily due to higher borrowings to fund investments in organic growth, acquisitions, and share repurchases. On May 21, we closed on the refinancing of our senior term loan due 2028 and reduced our applicable margin rate from 260 basis points to 200 basis points, resulting in interest expense savings of approximately \$9 million annually. There were no other changes to terms or maturities.

Before we head over to Q&A, I'll wrap up our updated outlook for fiscal 2024 on page 11. With one quarter of the year behind us, our outlook for a low-single digit end market volume growth remains unchanged, and we expect to continue gaining market share through the execution of our product, customer, and geographic expansion initiatives. We continue to expect new residential construction to grow modestly in 2024. Our residential bidding activity and orders continue to show strength despite higher interest rates and the expectation that they will remain higher for the foreseeable future. We are pleased to hear optimism from the public homebuilders and continue to believe shortage of available homes, which supports multi-year tailwinds for our products.

Non-residential construction has been solid thus far, and our bidding activity and order pace in this market continues to be positive. We expect to see continued strength in highway and street projects, data centers, battery plants, and other large manufacturing projects with some continued softness in office space and retail construction. Overall, we expect the non-residential market to be flat to slightly up for the year. Municipal repair and replacement activity, which represents over 40% of our net sales, is resilient due to healthy municipal budgets and the critical need to upgrade aged water infrastructure. We continue to believe this end market will grow low-single digits in 2024.

Based on our visibility and the long-term length of projects funded by the Infrastructure Investment and Jobs Act, we are continuing to evaluate when we may see incremental value from these investments. We expect sales volume to more than offset a slight headwind from pricing in fiscal 2024, yielding a low-single digit average daily sales growth, excluding acquisitions. We expect the M&A we completed through today will contribute 7% to 8% of total sales growth in fiscal 2024. We maintain a strong pipeline of opportunities, and we expect to continue adding more high-quality businesses to the Core & Main family as we move through the year.

Gross margins performed well in the first quarter with the negative effect of normalizing inventory costs mostly behind us on a sequential basis. We've seen fairly stable market costs in recent quarters, which can increase the level of competitiveness on the projects we bid. We expect that these competitive pressures could impact gross margins for the balance of the year, as we look to maintain and grow our market share, but not by more than what we guided to previously of 30 basis points to 50 basis points. We'll continue to work to offset any potential compression through the execution of our gross margin initiatives.

Taking all together, we are narrowing and raising our annual outlook based on results to-date and recent acquisitions. We now expect net sales to be in the range of \$7.5 billion to \$7.6 billion, reflecting year-over-year growth of 12% to 13%. We are also narrowing and raising our outlook for adjusted EBITDA to range from \$935 million to \$975 million, reflecting year-over-year growth of 3% to 7%. We are confident in our ability to continue delivering strong performance in 2024. Our unique business model, commitment to driving shareholder value, and ability to successfully navigate changes in the macro environment position us extremely well for the long term.

At this time, I'd like to open it up for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you, Mark. [Operator Instructions] We have our first question from Matthew Bouley with Barclays. Your line is open.

Matthew Bouley

Analyst, Barclays Capital, Inc.

Q

Hey, good morning, everyone. Thanks for taking the questions. Wanted to pick up on that gross margin commentary. It sounds like you said the sort of effect of normalizing inventory costs is now behind you, but now you're speaking to some kind of potential competitive pressures. I just kind of wanted to clarify all of that. The 30 basis points to 50 basis points, is that kind of the guide for the full year? I guess, that's number one.

And number two, just can you kind of put a little additional color on what you're seeing with these kind of competitive pressures and how that should affect your gross margin cadence through the year? Thank you.

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Yeah. Thanks, Matt. It's Mark. Appreciate the question. First, just on the cadence of gross margins, I would say that 30 basis points to 50 basis points that we talked about last quarter, I would think about that sequential kind of coming off of Q1. So, we might see that coming up in Q2, Q3, maybe a little bit in Q4. So, as you think about where we are, we've been I'd say pretty consistent indicating that we'd have some gross margin normalization and it's come in kind of largely as expected. Last year was a really – was our record quarter from a gross margin perspective. So, we had indicated that we'd see some pressure this quarter, we did. We got most of that behind us.

I'd say the new piece that we're looking at is the fact that market costs really in the industry have been pretty stable, which is a really good thing for us. What does happen and what tends to happen is on projects, when costs are stable at the distributor level, they can get kind of competitive. We've seen a little bit of that. It's not something that's new to us. Feel like that'll be more than overcome with volume as we go after those projects. But that competitiveness can squeeze margins a bit when market costs are stable. We tend to be able to expand margins pretty good when prices are kind of moving a little bit. They've been stable, which has been very good for us, but could see a little bit of that gross margin pressure in the next couple of quarters.

Matthew Bouley

Analyst, Barclays Capital, Inc.

Q

Got it. Okay. That's helpful. And then, secondly, I mean, I guess following up on the deflation commentary, I mean, you just said in a lot of areas it sounds like market pricing is stable. But I think in the guide, you spoke to sort of slight price deflation for the year and maybe that's a slight change from the last quarter. So, I guess, where are you seeing some deflationary headwinds? It looked like in the quarter there was a little bit in fire protection, but not to put words into your mouth, where are you seeing a little bit of deflationary pressure, and if there's any offsets on the inflationary side, would be curious to hear that as well. Thank you.

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

A

Yeah. Thanks, Matt. As we've talked about, it's really those more commodity-based products, and steel piping is certainly one of those that's been under pressure and you can see that in the fire protection results. Not really a surprise there, we knew that was coming. Municipal PVCs off of I'd say the record highs we saw in 2022. But, overall, it's been pretty stable here the last several months. So, again, nothing really new there. But that slight tweak that we made to the language just really coming off more of the basket of goods that we sell to win projects to those customers that are a little bit more price sensitive, it's a subset of the customers.

But given that stability of pricing, it's a little bit more of just something you got to do to make sure you're holding on to share, and we definitely are going to maintain and grow share and not put any of those types of projects at risk. So, slight tweak to the language I wouldn't view it as any kind of significant item at all, but something that we wanted to point out that does impact the top line just very slightly and could put a little slight pressure on the gross margins.

Now, I think, we've been pretty effective at offsetting all of those things. One on the volume side, we're driving our strategic growth initiatives that we have. And then, on the gross margin side, I think you've seen us do a pretty decent job of offsetting those impacts of the gross margin normalization that we expected by driving some really good private label growth. Our sourcing optimization has come in really strong for the quarter. So, we're going to continue to fight to hold on to those margins, but just want to indicate where we are seeing some of that pressure.

Matthew Bouley

Analyst, Barclays Capital, Inc.

Got it. Well, thanks, Mark. Thanks, Steve. Good luck, guys.

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Yeah. Thanks, Matt.

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

Thanks, Matt.

Operator: Thank you. The next question is from Nigel Coe with Wolfe Research. Your line is open.

Nigel Coe

Analyst, Wolfe Research LLC

Oh, great, thanks. Thanks very much for the question. So, just wanted to maybe pick up off that last question on price deflation. It seems that if you sort of plug in the numbers, it looks like price down maybe 1% or so this quarter. I'm just wondering what kind of visibility you have as we get into the kind of the more meaningful quarters and how would you gauge the risk of broader price deflationary pressures and perhaps that's deflation becoming a bit more kind of severe?

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Yeah. Thanks, Nigel. We've got pretty good visibility. Obviously, a lot of discussions that take place with our field teams, with the supplier base, and feel really good about kind of where the market costs have stabilized in the market. So, really anything beyond that some minor tweaks just to remain competitive again on a small subset of

customers that are a little bit more price sensitive. So, don't view there as being any significant trend from that perspective. And if anything, what we've seen is when you get that little bit of squeeze there, it really forces the field teams to really drive some of these margin initiatives even harder. And we saw some really good pull through in the quarter, in particular with private label to really find some benefit on the cost side.

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

A

Yeah, just to add into that. What we've seen is now as these supply chains have mostly stabilized and the prices have stabilized, that's typically, as expected, start seeing more competitive nature on some of the larger projects that may involve a lot more of standardized pipe of standard sizes. And that's kind of what we're seeing, not unexpected. And as Mark mentioned, our level of pull through that we've seen with private label has been accelerated. And we're really confident about what we're seeing with the ability to drive even more volume through there, and I think to offset a good portion of that.

Nigel Coe

Analyst, Wolfe Research LLC

Q

That's great color. Thank you. And then, on the margins, typically we see 2Q, 3Q EBITDA margins picking up sequentially on the strong volume kind of leverage on SG&A. But given the sort of the inflationary pressures you're seeing on SG&A, mainly on investment spending, just wondering how we should think about SG&A growth over the remainder of the year? And do we still expect to get good SG&A leverage in 2Q, 3Q?

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Yeah. Thanks, Nigel. On the SG&A side, I'd keep in mind that really what you're seeing there and I highlighted this in the prepared remarks is, a good portion of the increase in rate in the quarter was related to some of the M&A. You could see about I'd say about two-thirds of the dollars that we have was really acquired SG&A from M&A. So, there'll be some opportunities as we go forward. It takes a little longer to get the synergies out of SG&A with the M&A that we do. We get some immediate benefits at that gross margin level, and you've seen those benefits come through on our gross margin line.

So, I'd say from a go forward 30 basis points to 50 basis points of SG&A rate pressure over the next couple of quarters as we work through some of that M&A and get some synergies there, still making investments in the business. We've made some good investments into some key talent and some of the initiative areas that we've got to drive growth. We've been investing in technology, position the company well going forward for growth and productivity. So, I wouldn't expect any significant leverage there until we get kind of later end of this year.

Nigel Coe

Analyst, Wolfe Research LLC

Q

Okay. Thanks, Mark.

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Yeah.

Operator: Thank you. The next question is from Mike Dahl with RBC Capital Markets. Your line is open.

Mike Dahl

Analyst, RBC Capital Markets LLC

Q

Good morning. Thanks for taking my questions. Sorry to harp on the gross margin here, but I guess, I'm still not fully clear, Mark. Back to Matt's question, the 30 basis points to 50 basis points, is that a full-year 2024 versus full-year 2023 or is that you'll see 30 basis points to 50 basis points down sequentially in 2Q and then hold stable from there? That's the first part of the question.

And the second part is, is that a net number? Because obviously, as you articulated, you've done a very good job of finding offset through your internal initiatives so far. So, is that the net headwind you expect for margins or is that kind of the gross headwind and the net maybe somewhat less than that?

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Yeah. Thanks, Mike. Good news to the gross margin questions, but we'll – just to clarify that the 30 basis points to 50 basis points think of that as sequentially starting in Q2. As it relates to the initiatives, we're going to continue to drive those. We had a really good, I'd say, initiative quarter in Q1, some of that can be a little choppy, but we think we're going to be able to build off of that and try to offset as much of that 30 basis points to 50 basis points as we can. So, I think about it as the lower end of that range if we continue to drive those gross margin initiatives and get that continued benefit. And if we have any other effects, you can get some choppiness on various projects and certain things, it could be at the higher end of that. But think about that as sequential coming off of Q1.

Mike Dahl

Analyst, RBC Capital Markets LLC

Q

Okay, got it. And all else equal, potentially stable or better from there. The...

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Customers are going to...

[indiscernible] (00:33:31)

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

...not worse than neutral.

Mike Dahl

Analyst, RBC Capital Markets LLC

Q

Second question just around kind of the M&A, capital deployment, leverage, obviously you frontloaded a lot of the buyback last year and now you've spent this amount on M&A. So, the first part on M&A, it seems like just back of the envelope, I know the Dana Kepner deal was private equity and competitive, so makes sense that that would be higher margin. But it seems like combined you might be speaking to a multiple on these recent deals that's more like in the 11% to 12% range, which would be kind of higher than what you've been doing on some of the smaller tuck-ins. So, maybe just speak to that and what you're seeing in the market for multiples, what you can drive on kind of a post-synergy basis as well.

And then, with your leverage now in the high 2s, it sounds like you're pivoting in the near term to kind of deemphasize the buyback and focus your capital mainly on M&A and ultimately deleveraging. But maybe just speak a little more towards how you're thinking about priorities for this year.

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

A

Yeah. Mike, I'll talk first about the M&A pipeline. And while we don't disclose the multiples, I'll share with you that certainly with Dana Kepner being the size and magnitude that it was and the fact is [indiscernible] (00:35:03) was at the high end of what we have traditionally paid in terms of a multiple from a pre-synergy standpoint. All the other acquisitions have all come in at the low to medium range that we have typically done pre-synergy. So, I'm really not seeing any change there in terms of the overall multiples. But certainly, we felt really compelled with Dana Kepner given its locations and the long-term viability of a lot of those markets and the position that they had that that was worth looking at that level.

So, we'll continue to do that. Our M&A pipeline continues to look strong, and you'll see that there is a balance of deals that are in the small-to mid-size in the range and in our pipeline and everything else. So, we feel really confident that we've got a good active pipeline. These things tend to be a little lumpy and that's what you saw a little bit in this quarter. It looks outsized. And in terms of that, in terms of the M&A growth that we have traditionally done and that's not a bad thing. It's just the size and magnitude of Dana Kepner and the timing of the other deals falling in in line with that.

And Mark, you want to talk a little bit more about capital allocation?

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Yeah. Mike, I think in terms of the capital allocation priorities, no real changes there. I mean, organic growth, the M&A are going to continue to be our top priorities. And we'll continue to look at share repurchases and consider dividends at some point. We think we can execute all of that with the level of cash that we generate and expect to have that excess capital return back to shareholders. I think that was just a highlighting that we did complete a lot of share repurchases in 2023. So, I wouldn't expect that at that level. You'd expect that allocation to be a little bit more balanced as we move forward.

Mike Dahl

Analyst, RBC Capital Markets LLC

Q

Okay. That makes sense. Very helpful. Thanks, Steve. Thanks, Mark.

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Yeah. Thanks, Mike.

Operator: Thank you. The next question is from Anthony Pettinari with Citigroup. Your line is open.

Asher Sohnen

Analyst, Citigroup Global Markets, Inc.

Q

Hi. This is Asher Sohnen on for Anthony. Thanks for taking my question. It sounded like there was some maybe price pressure from a kind of mixed down to more price sensitive customers if I understood your comments

correctly. And so, can you just talk about maybe what's driving that trend? Is it sort of just the increased number of large projects that you called out? And then, do you expect maybe competitive intensity to worsen over time as more large projects come online with IIJA?

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

A

I'd share that what we're seeing here was really kind of as expected in terms of the competitive nature and the normalizing of the supply chain and the pricing structure. We've been indicating this really for about the last year, and it's taken about that time to really formulate and just remind everybody we go back to first quarter of last year where we had some pretty significant comps in terms of margins that we were going up against. So, this is pretty standard for what we're seeing right now in the industry. We're certainly seeing the competitive nature of the businesses now as we traditionally have seen. Our ability to offset a lot of this with private label and some of our other pricing initiatives continues to be strong, and we'll continue to see a lot of upside there to offset some of that.

But there are definitely a lot of projects out there. We're seeing some really good bid activity, you mentioned IIJA. So, one of the things that we are encouraged about is we're starting to see more bidding volume coming in over this last quarter from IIJA funded projects. Many of these projects are what I would call longer-term treatment plant projects. So, in many cases, what we're evaluating there is likely material flow on these things will be to back half of this year into certainly 2025 in terms of timing, and we're evaluating how much of that will be incremental as we go forward. But we're starting to be encouraged by at least seeing the bidding activity accelerate in the first quarter of this year.

Asher Sohnen

Analyst, Citigroup Global Markets, Inc.

Q

Got it. And then, switching gears, you've called out that an earlier start to the season in some of your northern geographies may have been a sales tailwind. So, just looking at the balance of the year, can you walk through any notable weather comps you may be facing maybe regionally?

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

A

Yeah. I'd share as we got into the first quarter of this year, particularly areas in the upper Midwest that are really softer winter and we're able to accelerate some of that early season to the kick in. We're definitely dealing with some choppy weather as we saw in May with a lot of wet weather. And for our business, wet weather is not really conducive to digging and putting in pipe and valves and fittings. So, we're watching that one closely. We figure that there's probably going to be depending how the season pans out over the next month or two, you get a better feel for how weather may impact it. But it's always choppy. In winter, it can be very dicey. And in spring, the start of the season can be delayed with rain and wet conditions. So, we'll continue to monitor that and usually that levels out over the quarter.

Asher Sohnen

Analyst, Citigroup Global Markets, Inc.

Q

All right. Great. That's very helpful. I'll turn it over.

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

A

Thanks.

Operator: Thank you. The next question is from Kathryn Thompson with Thompson Research Group. Your line is open.

Kathryn I. Thompson

Analyst, Thompson Research Group LLC

Hi. Thanks. Just a few clarifications based on your prepared commentary and in the Q&A. Just for guidance, on the municipal side, you had said to expect some steady low-single-digit growth in that end market implied in guidance. But could you just clarify again on the non-res and the residential end market? Previously, you said non-res was going to be flattish and resi had said low-single digit to mid-single digit growth. But any updates on those two end markets for guidance?

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Yeah. Thanks, Kathryn. You got that right. In terms of the prepared commentary, I would say muni continues to be very steady kind of low-single digit. Non-resi, we're watching early kind of start of the year, definitely some different pockets going on there. But we've seen some really good strength in some of the highway work, a lot of storm drainage product. As you can see in our breakout of storm drainage, we had a really good quarter there. That gave us a little bit more confidence that we'd see maybe a tick up on the non-resi side.

And then, from a residential perspective, we were kind of thinking in the mid-single digit range, the first quarter was really strong. We're kind of thinking that for the rest of the year maybe slightly under that, but kind of low-single to mid-single digit for resi, primarily due to the fact that we still are seeing these interest rates stay up a little higher. So, just being a little bit more cautious on the resi side, but overall still feel good about the overall kind of low-single digit volume growth for the end markets.

Kathryn I. Thompson

Analyst, Thompson Research Group LLC

Okay. And then, on annualized revenue contribution from acquisitions, you gave the percentage range, but could you frame the acquisition contributions more from a revenue standpoint and clarify just a little bit more? You said descriptively it's better margins, but help us think about a finer point on what to expect from margins more on an annualized basis from these acquisitions.

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Yeah. Thanks, Kathryn. From a contribution standpoint, as we talked about in the remarks, it's about a 7 points to 8 points of growth for the year that's in the, I'd say \$450 million range for the top line. So, good revenue growth coming from the acquisitions and very pleased with how those are being integrated. At this point, we're seeing a lot of good progress from the acquisitions that we've been working through.

In terms of the EBITDA contribution, I would think about those kind of at the company average kind of neutral from that perspective. We've seen a little better contribution at the gross margin level and a little higher SG&A rate with some of those acquisitions. So, it's coming out just about neutral from an EBITDA standpoint.

Kathryn I. Thompson

Analyst, Thompson Research Group LLC

Okay, great. And then, just another clarification on your fire protection that saw a decline due to lower selling prices offset somewhat by acquisitions. What are you seeing in terms of just volumes? Is really the decline in that segment more due to pricing or are you seeing any changes in volumes?

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Yeah. On the fire protection product line, a couple of different moving pieces there. Obviously, the steel pipe deflation that we've talked about has been a big driver of the top line there. We've offset some of that with some good M&A on the fire protection side. So, from a, I'd say organic volume side, it's been down a little bit and it really represents more of that completion work on some of the, I'd say traditional facilities that are out there in that non-resi space.

At the total company level, non-resi has been stronger due to more of the, like I said, the street highway work that gets a lot of storm drainage and then some other work going around, around the megaprojects and some other areas. So, I'd say it's been a little soft there. But again, nothing that was kind of coming in as expected and that's going to be a good growth category for us going forward. There's still a lot of good opportunity for expansion in that fire protection space, and we're going to continue to try to drive that above the market.

Kathryn I. Thompson

Analyst, Thompson Research Group LLC

Q

Okay. Any update on just private label as a percentage of mix? The goal is to grow to 10%, 15%, had previously been around 2%. Any update there?

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Yeah. We had a good quarter from a private label pull through perspective. We were kind of hovering around kind of low 2% of COGS and that ticked up in the quarter. We got into more of a normalized, I'd say, buying pattern from an inventory perspective. That was something that was hampering our private label growth a little bit in 2023. Since we've been able to clear out a lot of that inventories, allowed us to replenish a lot of that with our private label product, and we were very pleased with the results we had in the first quarter and expect we'll be able to continue driving some more growth there throughout the rest of this year.

Kathryn I. Thompson

Analyst, Thompson Research Group LLC

Q

Okay. Great. Thanks so much.

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Yeah. Thanks.

Operator: Thank you. The next question is from Joe Ritchie with Goldman Sachs. Your line is open.

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

Q

Hi, thanks. Good morning, everyone.

[indiscernible] (00:46:46)

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

...so I won't ask the gross margin question. Yeah, good morning.

Q

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

Hi.

A

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

Maybe just going back to the deflation for a second. So, I'm just curious there's been some talk of on large municipal pipe expansion from companies like Westlake. I'm just wondering, is that having any kind of impact on the deflationary comments that you guys are making or do you expect it to have an impact going forward?

Q

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

Yeah, Joe. This is Steve, but really no impact right now. And I think it'll be a while before any type of capacity comes online for that. And there's been a lot of talk about other expansion into plastic pipe that can sometimes be confused with what's happening really in our end markets and the municipal piece. So, a number of the expansions that have been kind of noted out there are areas like in polyethylene pipe and corrugated thermoplastic pipe and some of these areas in plumbing, et cetera, that really aren't related necessarily to our end markets. So, we're not seeing any real impact at all from any new capacity coming on board and don't anticipate that to be an issue in the near or medium term.

A

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

Okay, great. That's good to hear. And then, I just want to circle back on the M&A commentary and also in how it relates to the guidance increase. I guess, we were roughly thinking that the new acquisitions were roughly about \$100 million or so in revenue. So, even if it's kind of below company-wide margins, probably higher EBITDA contribution than the \$5 million increase that you have at the midpoint, just want to understand like how M&A like contributed to the guidance and then whether my numbers are close to correct?

Q

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Yeah. Joe, thanks for that. Yeah, you're pretty spot on with what the figures. I would say really no significant changes to how we were thinking about guidance. We did look at the low end and given the M&A contribution, we felt very confident to take the low end of the range up that was consistent kind of with the acquisition contribution and that was really the rationale there. Still watch and still early in the year. We were very pleased, I'd say, with how the quarter came in, very pleased with the bidding activity and the backlogs that are building. So, lot of good momentum in the quarter. As Steve mentioned, there was a little weather and severe storms in May. So, we really wanted to see that kind of play out before we consider taking the guidance up anymore. But that was really the rationale was felt very confident taking the low end and very pleased with the quarter and how biddings coming on.

A

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

Okay. Got it. Thank you.



Operator: Thank you. We currently have no further questions. So, I'll hand back over to Mr. Steve LeClair for closing remarks.

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

All right. Thank you, all, again for joining us today. It was a pleasure to have you on the call. Our consistent execution quarter-after-quarter as a result of the hard work of our branches and functional support teams, our focus on operational excellence, and the diversity of our products and end markets. We are confident in our ability to drive ongoing value creation as we continue to execute our growth strategy and deliver on our capital allocation priorities. We have many levers for driving growth and profitability, the cash flow generation to capitalize it, and the team to execute it. So, thank you for your interest in Core & Main.

Operator, that concludes our call.

Operator: Thank you, Steve. This concludes today's call. Thank you for joining. You may now disconnect your lines.

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