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ROCK - Q3 2013 Gibraltar Earnings Conference Call

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## CORPORATE PARTICIPANTS

**Brian Lipke** *Gibraltar Industries, Inc. - Chairman and CEO*

**Henning Kornbrekke** *Gibraltar Industries, Inc. - President and COO*

**Ken Smith** *Gibraltar Industries, Inc. - SVP and CFO*

## CONFERENCE CALL PARTICIPANTS

**David Calusdian** *Sharon Merrill - IR*

**Josh Chan** *Robert W. Baird - Analyst*

**Robert Kelly** *Sidoti & Company - Analyst*

**Matthew Dodson** *JWest, LLC - Analyst*

## PRESENTATION

**Operator**

Good day, ladies and gentlemen, and welcome to the Gibraltar Industries third-quarter 2013 earnings conference call. (Operator Instructions)

I would now like to turn the conference over to David Calusdian from the investor relations firm, Sharon Merrill. Please proceed.

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**David Calusdian** - *Sharon Merrill - IR*

Good morning, everyone, and thank you for joining us. If you have not received a copy of the earnings press release that was issued this morning, you can find it in the investor info section of the Gibraltar website, Gibraltar1.com. During the prepared remarks today, management will be referring to the presentation slides that summarize the Company's third-quarter performance. These slides also are posted to the website. Please turn to slide number 2 in the presentation.

Gibraltar's earnings release and this morning's slide presentation both contain non-GAAP financial measures. Reconciliations of GAAP to adjusted measures have been appended to the earnings release. Additionally, the Company's remarks contain forward-looking statements about future financial results. The Company's actual results may differ materially from the anticipated events, performance, or results expressed or implied by these forward-looking statements. Gibraltar advises you to read the risk factors detailed in its SEC filings, which can also be accessed through the Company's website.

On our call this morning are Gibraltar Chairman and CEO, Brian Lipke; recently retired President and Chief Operating Officer, Henning Kornbrekke; and CFO, Ken Smith. At this point, I will turn the call over to Brian.

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**Brian Lipke** - *Gibraltar Industries, Inc. - Chairman and CEO*

Thanks, David. Good morning, everyone, and thanks for joining us on our call today. I'm going to start off with some highlights on our business this quarter and then turn the call over to Henning and Ken for more detailed comments on our results. Then I'll close my prepared remarks with some thoughts on the outlook for Q4 and 2014. And then at that point, we will open the call to any questions that any of you may have.

Before I move into that part of our discussion this morning, I would like to make a special note. As most of you know, Henning Kornbrekke retired from Gibraltar at the close of our third-quarter and has agreed to continue on as a consultant for an interim period. And since we are reviewing the third-quarter results, which he was part of, he is also participating in today's earnings call. I want to publicly extend a note of thanks to Henning for his many contributions to Gibraltar during his more than a decade with the Company, which included some very challenging times for our industry and for Gibraltar over the last five years or so. Henning, your support and efforts have helped to position Gibraltar for a significantly improving performance as our end markets continue to rebound. Thanks for your many contributions over the years.

With that, I'll ask you to turn to slide number 3 in our presentation titled Q3 Overview. Gibraltar over-performed this quarter on both the top and bottom lines compared to last year. Net sales were up 6%. Adjusted EPS increased nearly 30% from Q3 last year and also exceeded our EPS guidance for the quarter. The revenue growth came from our recent acquisitions, which continue to perform as expected, with sales improvements by some of our operating units, which were offset by lower sales from our industrial business.

On the bottom line, our adjusted EPS of $0.31 came in higher than last year's $0.24, mainly driven by lower-than-expected operating costs, the earnings from recent acquisitions, and improvements from some of our operating units which, again, were partially offset by reduced profitability in our industrial business. Weakness in the industrial and infrastructure markets continues to weigh on our organic sales, which were nearly flat with Q3 last year. Residential repair and remodeling activity remains well below historic levels but appears to be firming. We did, however, see continued improvement in the residential new construction market.

Our strong balance sheet, positive cash position, and strong operational cash flow provide Gibraltar the financial wherewithal to seek opportunities to grow our sales, earnings, and improve our operating performance characteristics to participation in the acquisition arena.

During the quarter, we announced the purchase of a small but innovative and growing solar powered ventilation product line. The acquired product line complements and expands our roof ventilation product offerings sold into the residential housing market. We expect these products to strengthen our position within the growing residential market for energy conservation products, and we plan to apply the technology of some of these existing products to help their sales.

As we begin to look into 2014, overall the macroeconomic trends that we see suggest a strengthening of some of our end markets along with growing signs that other of our end markets could begin to improve during 2014. In addition, the many internal operating initiatives currently underway will drive continued operating performance improvements as we move into 2014. As a result, we have a growing confidence that 2014 will be a stronger year for Gibraltar.

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

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**Henning Kornbrekke** - *Gibraltar Industries, Inc. - President and COO*

Thank you, Brian. Good morning, everyone.

Let's turn now to slide number 4, titled Revenue Exposures, which illustrates our 2013 revenue exposure by end markets served. As the center pie chart shows, the residential and low-rise commercial building market represents about 50% of our current sales. Of that 50%, one-fifth comes from the low-rise commercial building market which consists of structures such as professional buildings, hotels, and retail centers. The other four-fifths of this half of the overall business is residential, and most of that is driven by repair and remodeling activity. The other half of our consolidated sales is split roughly 40% and 10%, coming from the industrial and transportation infrastructure markets respectively. And repair and remodel activity is a meaningful driver of demand from these two market categories.

So with this context, let's move to slide number 5, titled Revenue Dynamics. As Brian cited, we had solid sales growth this quarter, led by recent acquisitions. And for businesses owned in both periods, we had strong growth from residential new construction. Our third-quarter sales to the home-building sector were up 10% year-over-year, driven by continued demand for our storage and security products.

Regarding residential repair and remodeling demand, on our call last quarter, we dialed down our previous guidance for consolidated revenues in 2013, in part due to lower second-quarter volume and moderate market activity, but we expect an improvement in quarter three versus quarter three of 2012. Quarter three's actual sales were nearly consistent with this expectation. Overall, residential repair and remodeling sales, including roofing, were flat with quarter three of 2012, which included a negative comparison for our ventilation products.

Although we don't sell roofing shingles, we do sell roof and attic ventilation products along with trims, flashings, metal roofing, and rain dispersion products. Our products generally correlate with the shingles as part of a reroofing project, and they comprise about 25% of our consolidated sales. Our reroofing projects for the first nine months of 2013 were down 3% year-over-year, a function of the 20% decline in the market, driven by unfavorable weather in some parts of the country and, we believe, the lingering effect of the recession on consumer confidence and consumers' willingness to commit to big-ticket home remodeling projects.

Let's turn now to our transportation infrastructure business, which contributes 10% of our consolidated revenues. Our quarter three sales in this business were weaker, declining 5% organically this quarter versus quarter three of last year. The two-year federal transportation bill that was enacted a year ago is driving the demand for our infrastructure products that we expected, and quarter three sales related to smaller projects were in line with our forecast. The shortfall this quarter was associated with larger size projects. Many states remain cautious with investments in large projects due to the uncertainty of federal funding after the expiration of the current federal transportation appropriation.

The industrial markets are still facing challenges. 40% of our consolidated revenues are generated from sales of industrial products. This market remains soft, with slow improvement expected in the year ahead as an improvement in the economy or a pickup in capital projects begins to accelerate. Overall, our industrial sales, including sales by the industrial businesses we acquired in Q4 of 2012, increased 2% this quarter versus quarter three of last year, unifying this equivalent in the majority of industrial markets. However, relatively weak demand continues to foster a competitive and price-sensitive market environment in which we experienced reduced pricing compared to last year's third quarter. Excluding the acquisition, total industrial sales decreased from Q3 last year, including European industrial sales, which were down 14%.

The economic weakness in Europe is continuing to depress the demand for our security products as well as our precision expanded metals sold in European OEMs for filtration applications in automobiles and off-road heavy equipment.

Let's turn now to slide number 6, titled Q3 Margin Increase. Overall, Gibraltar's operational performance improved, compared to expectations for the quarter. Adjusted gross margin was up 20 basis points year-over-year to 19.9%. The increase was driven by residential and low-rise building construction, which approximated a 10% growth rate. Plus the contributions from our recently acquired businesses; these contributions were partly offset by lower pricing in volume in our industrial business. With the improvement in SG&A as a percent of sales noted on slide 6, which was the result of lower operating expense, the adjusted operating margin also increased, rising 60 basis points versus Q3 of 2012.

To sum up, our business fundamentals continue to be solid, and we're poised to deliver better performance when the macroeconomic conditions improve in the periods ahead.

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

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**Ken Smith** - *Gibraltar Industries, Inc. - SVP and CFO*

Thanks, Henning. And good morning.

Before I comment on slide 7, I want to provide some color to the non-cash asset impairment charge we recorded in our GAAP results this quarter. The charge primarily relates to our sole European business that sells fabricated expanded metal products into a variety of industrial markets across Europe. The European recession, accelerated by sovereign debt issues and governmental austerity measures, has contracted economies there and has diminished the sales and cash flows generated by our European business. After updating the fair value of our European industrial business based on expected future cash flows, we wrote down that business' intangibles this quarter.

Now let's turn to slide number 7, titled Year-over-Year Performance. First I'll detail the third-quarter results and comparisons. For the third quarter, revenues increased on acquisition-related growth, while businesses we owned in both quarters experienced a 1% decrease in revenues. Companywide, the 1% organic decrease was comprised of a 3% decrease in pricing, partially offset by a 2% increase in volume. The pricing pressure primarily related to sales of our industrial products, as Henning noted. Sales of residential products increased 6% organically compared to Q3 last year, net of volume gains from residential new construction and residential repair and remodeling volume that was equivalent to last year.

Regarding the factors affecting margins and earnings as cited by Brian and Henning, the following reconciles our nearly 30% EPS improvement from last year's adjusted EPS of $0.24 to the $0.31 this quarter with the key differences being a $0.04 increase from lower operating costs, plus a $0.02 increase from the recent acquisitions, plus a $0.01 increase from residential new construction volume, plus $0.02 improvement on lower interest expenses resulting from our successful refinancing of notes in January 2013, and a $0.01 increase in the lower income tax rate. And these five increases were partially offset by one factor, that being a $0.03 decline from industrial products pricing and corresponding margin.

Compared to our August 1 guidance for Q3, the unexpected earnings improvement that resulted in the higher $0.31 of adjusted EPS came from lower operating expenses for health claims and compensation costs and from the lower income tax rate due to a discrete tax event this quarter.

Now I'll describe the first nine months' results and comparisons on slide 7. Revenues for the first nine months were up 3% with, again, acquisition-related growth providing 7 percentage points. Businesses we owned in both periods experienced a 4% decrease, which was comprised primarily of decreased pricing in sales of our industrial products. However, sales of residential products increased slightly -- the net effect of growth in residential new construction, more than offsetting the small decline in residential repair and remodeling.

Regarding the factors affecting adjusted earnings for the first nine months, the following reconciles last year -- $0.61 per share to the $.61 this year, with the key differences being an $0.11 increase by our more efficient West Coast residential business, plus a $0.06 increase from the recent acquisitions, plus a $0.02 net increase from residential and low-rise buildings and new construction, and a $0.05 increase on lower interest expense resulting from the refinancing of notes earlier this year. And these four improvements were offset primarily by the following three factors -- a $0.17 decline from industrial pricing and corresponding margin, a $0.06-per-share decrease on higher equity-based compensation tied to our average higher stock price this year, and a $0.01 decrease from the small change in the new year-to-date income tax rate.

I will now turn to slide number 8, titled Free Cash Flow. We generated cash in the first nine months of 2013 and delivered an improvement over last year, which came from higher cash earnings plus less pay-down in liabilities. Our free cash flow for the first nine months of 2013 was nearly 5% of net sales, in my opinion a strong performance that we anticipate will continue to the fourth quarter as we enter our slowest period of seasonality and reduce our working capital investment accordingly.

In addition to the strong free cash flow generated so far this year, we also receive this quarter an additional $12 million of cash from the sale of one of our larger manufacturing plants located in California. This transaction was a result of the restructuring efforts put in place but our team on the West Coast over the past [two] years and will allow us to further reduce our costs going forward.

Days of net working capital for the third quarter of 2013 continue to be low at 64 days, and this compares favorably to 65 days of net working capital in the third quarter last year. And we believe this shortened cash conversion time is sustainable in periods of higher economic growth which lies ahead.

Now slide number 9, titled Guidance. The fourth quarter is historically the slowest sales volume during the year as colder weather reduces construction activity. Regarding the fourth quarter of 2013, we expect revenue to rise approximately 8% compared to last year, with the majority of that increase coming from recent acquisitions, while organic revenues are expected to increase on higher residential construction activity compared to last year.

Concerning the fourth quarter adjusted EPS from Continuing Operations, we expect it will be equivalent to last year's $0.05 per share as continued improvement in residential and new construction and lower interest expense are expected to be counterbalanced by continued weakness in demand along with competitive pressures in our industrial businesses.

Concerning our guidance for the full-year 2013 listed on slide 9, we now expect that Gibraltar will deliver modest sales growth in 2013 with equivalent margins and earnings compared to last year, bringing us to the full-year 2013 revenue growth approximating 4.5%. We expect adjusted gross margin for the full year to approximate 19%, unchanged from our prior guidance. Regarding our SG&A expense for the full year, we expect it to approximate 13.3% of revenues. And while not shown on slide 10, we continue to expect adjusted net interest expense to approximate $15.5 million for this year and the adjusted effective income tax rate to approximate 37%.

With that detail, we expect adjusted earnings per share from Continuing Ops this year to be in the range of $0.63 to $0.66, which is equivalent to the $0.65 generated during the full year of 2012.

Now on slide 10, entitled EPS guidance, our now-expected adjusted EPS for 2013 brackets the upper end of the range we provided you on our last earnings call on August 1. The most significant change in our improved expectations relates to our third-quarter over-performance, which raised our year-to-date results. Regarding end markets, we expect residential repair and remodeling demand to have modest growth in the fourth quarter, complementing continuing strength in residential new construction. Longer-term, when we see a more broad-based end market rebound, as we believe it will, Gibraltar is well positioned to deliver more significant improvement on both the top and bottom lines.

Click that, I'll turn the call back to Brian for his concluding remarks.

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**Brian Lipke** - *Gibraltar Industries, Inc. - Chairman and CEO*

Thank you, Ken.

Before we open the call your questions, I wanted to talk about the outlook for Q4 and the quarters ahead. We continue to focus on organic growth opportunities which will consume some of our approximate $200 million to $300 million of available manufacturing capacity as a key to our growth. We're continuing to be aggressive in driving organic growth, and we feel good about our prospects in this area. In the residential repair and remodeling sector, we're not expecting significant improvement in Q4, but 2014 is shaping up to be a stronger year than 2013. Although the recovery in big-ticket remodeling has taken longer to materialize than we had anticipated, the latest published reports suggest that conditions may finally be improving.

Harvard's Joint Center for Housing Studies index, "Leading Indicator of Remodeling Activity," is dramatically up from where it was a year ago. The Joint Center's economists said in September that remodeling contractors have been reporting improving market conditions and are seeing strength in the future market indicators.

Pent-up demand is one factor. It's been six years since the housing collapse, and home maintenance projects can only be deferred for so long. In addition, recent homebuyers are traditionally the most active home remodelers, and this year's strength in existing home sales is beginning to translate into stronger sales of home improvement products. Given these dynamics, the LIRA index is projecting continued strengthening of the repair and remodeling market through the end of 2013 and into the first half of 2014.

We remain optimistic about the outlook for new residential construction. Housing appears to be in the midst of a long-term recovery. The current reports on permits, seasonally adjusted starts, and new home sales suggest that residential new build has lost some momentum recently. We believe this is in large part due to the rise in home prices and mortgage interest rates this past summer. The industry and its observers see this as a temporary slowdown, however, and our order flow for residential products suggests that they are right. After a slow start to the year, we are now seeing more new homebuilding projects annually actually being started, and our distributors also are gaining confidence in the recovery. We expect this trend to continue into the fourth quarter and into next year.

The outlook in commercial new construction also appears to be favorable. The American Institute of Architectural Building Index, or ABI, for the month of September was 54.3, up from 53.8 in August. Accordingly, this means that business conditions at architectural firms have been steadily improving for the past year. This improvement signals an impending turnaround in nonresidential construction activity. In light of these dynamics, for 2014, we anticipate 10% to 15% year-over-year growth in the residential and low-rise commercial new construction sector.

We're leveraging the momentum in both the new construction and repair and remodeling markets, residential as well as commercial, by aggressively launching new and modified products for the building industry, products that we've developed organically as well as by acquisition. Last quarter, I talked about the growth of package deliveries as consumers continue to order more and more over the Internet. Gibraltar is focused on providing solutions to this growing need. One example of our efforts in this area include a new secure delivery solution we've introduced for apartments and condominiums that eliminates the need to have someone at the front desk to handle parcel deliveries. This is one of a long line of new product initiatives being undertaken. Parallel with that, we are developing a suite of new products that align with the U.S. Postal Service's strategy to take cost out of their business, which creates numerous growth opportunities for Gibraltar.

In the residential and low-rise commercial sector, we introduced one of the most innovative products in years during the third quarter, a product that's gaining traction for us. It's a new type of roof jack. A roof jack is the metal device that prevents rain water from leaking around the plumbing and heating vent pipes that protrude up through a shingled roof. The difference between this new roof jack and conventional products is that ours is articulating, meaning that a single design can be installed regardless of what the pitch of the roof is. This makes it easier for builders and contractors to manage their inventories, and it's been extremely well received in both of these communities as a result.

In our construction products business, despite the slowdown in Q3, we're continuing to anticipate solid performance going forward, and the infrastructure business we acquired in Q4 last year is making a solid contribution. Most importantly, the underlying need to repair and upgrade the nation's aging bridges and highways is as compelling as ever. This is a crucial responsibility for the states as well as Washington, DC.

State governments are recognizing the transportation infrastructure problems that they are facing are becoming more acute. As a result, we're seeing a growing number of them beginning to focus on ways to generate new tax revenue at the state level specifically for infrastructure projects over and above funds coming from the federal government, which bodes well for this part of our business.

In our industrial markets, we are anticipating a continuation of near-term challenges. While volume is flat compared to 2012, we expect our industrial sales to be down 6% organically for the full year 2013 versus 2012, which takes into account the 7% organic sales contraction in the first nine months of 2013, compared with the first nine months of 2012. Including acquisitions, we now continue to expect our company-wide industrial sales for 2013 to increase 2% year-over-year.

Longer-term, we are well positioned for an eventual recovery in industrial demand, and prospects for that recovery appear to be improving. The Institute for Supply Management Purchasing Managers Index, or PMI, for September marks its highest reading for the year, with 11 of 18 manufacturing industries reporting growth. Comments from the supply executives surveyed were generally positive and optimistic about increasing demand and improving business conditions. We're seeing similar optimism, anecdotally, in discussions with our major customers, which is another positive indicator for 2014.

Our sales growth for the first nine months of 2013 have been driven to a large extent by our recent acquisitions, so I want to comment on our position relative to acquisitions. Acquisitions will continue to be a factor in our growth initiatives. With our strong balance sheet, positive cash position, improved liquidity, and positive cash flow generation, we are in a good position to participate in the acquisition arena. We're continuing to look for acquisitions that meet the disciplined criteria that we've developed. Key to these criteria are to improve our return on invested capital, improving our margins while providing new organic growth opportunities. Our focus is to acquire companies that build on our existing product leadership positions where possible, or companies that allow us to establish new product leadership positions in new product areas. In the case of the four most recent acquisitions, each, while smaller in size, have all met our key acquisition criteria. We feel good about our ability to identify, assess, and integrate new businesses to drive return improvement, margin expansion, and provide organic growth opportunities.

Summing up, looking across all of our markets, we believe the prospects today are better than they were a year ago. With the operational improvement we made this past year, we have stronger capabilities to capitalize on the improvement in end-market activity that we expect we will see unfolding. We look forward to finishing 2013 as strong as possible and improving on this record in 2014.

At this point, we will open the call to any questions that any of you may have.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Peter Lisnic, Robert W. Baird.





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**Josh Chan** - *Robert W. Baird - Analyst*

This is Josh Chan filling in for Pete. I have a question on the industrial pricing pressure that you noted. If we just focus on the industrial side, could you tell us how much pricing was down in that particular vertical? And then also, did it get worse compared to just the second quarter?

**Ken Smith** - *Gibraltar Industries, Inc. - SVP and CFO*

It was down approximately 4% in the third quarter. And it was largely east from the second quarter.

**Josh Chan** - *Robert W. Baird - Analyst*

I'm sorry, did you say it was down a little bit from the second quarter as well?

**Ken Smith** - *Gibraltar Industries, Inc. - SVP and CFO*

Yes.

**Josh Chan** - *Robert W. Baird - Analyst*

Okay. And then -- so how are you thinking about industrial pricing heading into the fourth quarter and next year? Steel prices have bounced off the bottom a little bit, so is that going to be a benefit in terms of firming up the price? Or how are you thinking about industrial pricing going forward?

**Brian Lipke** - *Gibraltar Industries, Inc. - Chairman and CEO*

As I noted in my prepared remarks, we believe that for the near term that we will continue to face pricing pressure. However, more importantly, the decline in sales and operating margins in that part of our business is simply not acceptable, and we have worked very hard with the managers of that business to come up with a significant series of internal operating initiatives that we hope and believe will counter the downward margin pressure that we've experienced this year to a very large extent. So, in short, let me say that, in a positive sense, we're expecting that even with continued pricing pressure in the industrial market that our internal activities are going to offset a significant part of that as we move into 2014.

**Josh Chan** - *Robert W. Baird - Analyst*

Okay. That's encouraging to hear. On the repair-remodel market being flat for you, how are you thinking about that comparison versus the market? I guess, many building products manufacturers have been seeing somewhat accelerated growth in recent quarters. And obviously your products aren't comparable to the broader market in general, but could you help us understand that gap between this accelerating growth that some are seeing and the relatively flat comparison still here?

**Brian Lipke** - *Gibraltar Industries, Inc. - Chairman and CEO*

Sure can. When we talk about repair and remodeling, we include in that our roofing products because a substantial amount of those are used in reroofing activity, which we consider to be a repair and remodeling activity. If you follow the roofing industry stats this year, you'll note, as Henning mentioned, that they -- that part of the remodeling industry has experienced a downturn compared to where it was in 2012. Far more significant, though, than the downturn that we are experiencing in those products. So that has been an offset to some of the other business areas that we're







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involved in, which have actually seen improvements in their sales, products that go to the residential repair and remodeling marketplace other than roofing related.

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**Josh Chan** - *Robert W. Baird - Analyst*

Okay. I guess if you take out the ventilation business, is there a way that you can ballpark for us maybe how fast the rest of the repair-remodel business is growing?

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**Henning Kornbrekke** - *Gibraltar Industries, Inc. - President and COO*

We think repair and remodel is going to grow probably at high single-digit rates as we go into 2014, and we think that will accelerate as we move through 2014. As Brian indicated, agrees with the data we're getting from LIRA. I think LIRA is looking at double-digit growth, and certainly we would correlate to high single-digit into low double-digit growth.

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**Josh Chan** - *Robert W. Baird - Analyst*

Okay, great. Thank you.

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**Operator**

Robert Kelly, Sidoti & Company.

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**Robert Kelly** - *Sidoti & Company - Analyst*

Just a point of clarification on the previous caller's question. I think you answered his question that pricing for industrial was down sequentially from 2Q? Is that correct?

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**Ken Smith** - *Gibraltar Industries, Inc. - SVP and CFO*

Yes I did.

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**Robert Kelly** - *Sidoti & Company - Analyst*

So selling prices were down sequentially? All right, so --

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**Ken Smith** - *Gibraltar Industries, Inc. - SVP and CFO*

No, the effect of pricing being down lessened in the third-quarter comparison.

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**Unidentified Company Representative**

(multiple speakers) prices (inaudible) stabilized.

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**Robert Kelly** - *Sidoti & Company - Analyst*

(multiple speakers) Yeah, so -- yes, that's what I wanted to reconcile because in your 2Q transcript you said that that there was in $0.08 year-over-year drag from industrial pricing and margins, and this quarter it's a $0.03 drag. So is it the comp's just easier, or are you just seeing some stability in the demand trend and the pricing trend?

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**Henning Kornbrekke** - *Gibraltar Industries, Inc. - President and COO*

There is some stability going forward. And, in fact -- and I think we indicated -- I think all us did, that there is some upward momentum as we move through the fourth quarter into the first quarter. So we're starting to see signs that are encouraging.

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**Robert Kelly** - *Sidoti & Company - Analyst*

Upward momentum with respect to volume or pricing for industrial?

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**Henning Kornbrekke** - *Gibraltar Industries, Inc. - President and COO*

Both.

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**Robert Kelly** - *Sidoti & Company - Analyst*

Okay. As far as the steps that you taking internally to offset --

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**Brian Lipke** - *Gibraltar Industries, Inc. - Chairman and CEO*

One last comment on top of that. I'm a believer that -- because the demand is so low that we're seeing more price competition. As demand increases, I think we'll see that abate -- diminish as demand increases. And I think also tied to that is, as demand increases, that should provide greater stability and upward mobility for steel prices, which also help us raise our selling prices.

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**Robert Kelly** - *Sidoti & Company - Analyst*

Sure, sure. So, a self-reinforcing scenario?

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**Brian Lipke** - *Gibraltar Industries, Inc. - Chairman and CEO*

Exactly.

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**Robert Kelly** - *Sidoti & Company - Analyst*

As far as the steps that you are taking to address what could be -- assuming that pricing and demand remain until we get to 2014, you talked about internal steps that you take, what are those exactly? Have they been taken, or do you plan on taking them in 4Q?

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**Henning Kornbrekke** - *Gibraltar Industries, Inc. - President and COO*

It's an ongoing project. We are looking very closely at the business. We're structuring the business so that it can be competitive in the environment that exists today. And as we complete that restructuring of the business, it will improve its output as we go into 2014. So we expect the operating characteristics to get stronger. That's the way we're positioning the Company going forward.

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**Brian Lipke** - *Gibraltar Industries, Inc. - Chairman and CEO*

A little more color on that is that we have been involved in consolidation activities in that part of our business. And a couple of the steps that we've taken actually resulted in disruptions in the yields that we were getting from raw material. We are aggressively working on that, we think we have the majority of that behind us, and that should contribute in a meaningful way to better returns in that business.

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**Robert Kelly** - *Sidoti & Company - Analyst*

Okay. All right. So in the slide that you've given us for 3Q, you talk about industrial being a 40-basis-point drag on operating margins in 3Q, right?

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**Henning Kornbrekke** - *Gibraltar Industries, Inc. - President and COO*

Right.

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**Robert Kelly** - *Sidoti & Company - Analyst*

So as we hit 4Q, given the steps you've taken and given the stability in pricing, should that number decline, should it be less than 40 basis points in 4Q? And at what point does it become a neutral drag, just given the steps you're taking internally?

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**Henning Kornbrekke** - *Gibraltar Industries, Inc. - President and COO*

I think it's going to be neutral in the fourth quarter, and I think it will improve as we go into the front part of 2014. Don't forget, we are moving into a slower period. It's a seasonally slower period, and as we move out of that and we get the natural pickup through the first two quarters of the year with the improvements that Brian just described, we'll continue to have more of an impact -- a meaningful impact -- which will eventually correlate to improvements you see on the P&L.

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**Robert Kelly** - *Sidoti & Company - Analyst*

Okay. So just tying that back to the fact that you see residential remodel and new construction fundamentals improving, the mix of acquisitions getting better, and industrial being neutral to EBIT in 4Q, why do you see flat earnings year-over-year in 4Q?

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**Brian Lipke** - *Gibraltar Industries, Inc. - Chairman and CEO*

The fourth quarter is always a wild card. Different companies make year-end determinations on inventory levels. And, as a result, it's always difficult for us to project what is going on there.

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**Ken Smith** - *Gibraltar Industries, Inc. - SVP and CFO*

You would also have, in our transportation infrastructure business, some of the large projects that got shipped in the second half of 2012 are not in our backlog currently to the degree they were last year. So we'll have a bit lower earnings coming out of our infrastructure business in the fourth quarter compared to the prior year's quarter, is one example.

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**Henning Kornbrekke** - *Gibraltar Industries, Inc. - President and COO*

Yes. Timing becomes the big issue, particularly in some of our businesses. If things go the right way, they might all close in the fourth quarter; in which case, we'll overproduce and it's not going to get shifted into the first quarter. As Brian said, it's harder to predict at this point.

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**Robert Kelly** - *Sidoti & Company - Analyst*

No, understood. There's a lot of moving pieces, but it seems like the trend for 90% of your businesses is moving out, just given the commentary. So having said all that, running out into 2014 in a similar scenario. Would 2014 be the year we start to see the incremental operating leverage? You've talked about, in the past, 30% being your bogey for incremental operating margins. Should we start to see that show up in 2014, based on what you're saying here in 3Q into 4Q?

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**Henning Kornbrekke** - *Gibraltar Industries, Inc. - President and COO*

Yes, we believe we'll see improved -- based on everything we've told you so far, our expectation is improved gross margins as we going to 2014. We think that will correlate with the improvements we just discussed in the industrial business. We continue to see the improvements that we had said that we hope to see in the West Coast business; that has continued to perform just about as expected, and we think that will continue into 2014. So I think when you put all the pieces together, you start to see the expected improved operating characteristics that we've been describing for the last probably two years.

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**Ken Smith** - *Gibraltar Industries, Inc. - SVP and CFO*

Most of the revenue growth being from the increased volume with the cost structure we have. Just (inaudible) I am in agreement with what Henning just said.

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**Robert Kelly** - *Sidoti & Company - Analyst*

Okay, fair enough. And then just as far as the industrial market -- I'm sorry, the infrastructure market, it seemed like the reauthorization of the highway bill, the changes to the federal credit program, that seems to be a pretty big catalyst for state-level spending, at least, in the next two years. I know it's not showing up in your backlog just yet, but are you hearing that commentary and sentiment from the infrastructure customers that you are dealing with?

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**Henning Kornbrekke** - *Gibraltar Industries, Inc. - President and COO*

It is, and it varies by state. I think when will we look at additional analysis, we have a different mix of products this year than we had the previous year. As Ken had described, we have more smaller projects and fewer bigger projects, so I think that -- based on, I think, what we're looking at, right, I think we'd expect a more leveling of the project activity. We'll have a greater portion of larger projects and continue to do well in the smaller bearing projects that we've been involved in.

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**Brian Lipke** - *Gibraltar Industries, Inc. - Chairman and CEO*

I'd back up one step from what Henning just said and mention that the need for bridge and highway repairs and maintenance is more acute than ever. I would also mention that the states now are recognizing that they have to come up with ways to raise revenue to augment what they are getting from the federal government to catch up with the needed repairs to bridges in various and different states. I'm personally seeing a number of bridges, older bridges, where -- in more rural areas where they've actually reduced the traffic flow to one lane at a time because of the structural deficiencies on some of those bridges. So the states are recognizing that the need is getting increasingly more acute, and we've read several articles recently about states looking at different ways to raise additional revenue to find bridge and road repairs. So the need is clearly there; and I think the recognition, particularly at the state level, that money needs to be spent is registering, and they're looking for ways to come up with increased tax revenues.

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**Henning Kornbrekke** - *Gibraltar Industries, Inc. - President and COO*

A lot of them have set up agencies to pay for those -- if you look at the Verrazano Bridge. That's really funded by the Port Authority, and the Port Authority also funds the Whitestone Bridge and the Throgs Neck, and they all need to have repairs. The Tappan Zee Bridge is funded by the New York State Freeway Authority, which is also self-funded. And we're seeing more of those types of situations across the nation.

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**Brian Lipke** - *Gibraltar Industries, Inc. - Chairman and CEO*

And we are very positive on that business on a long-term perspective.

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**Robert Kelly** - *Sidoti & Company - Analyst*

Great color. Thanks very much.

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**Operator**

Matthew Dodson, JWest, LLC.

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**Matthew Dodson** - *JWest, LLC - Analyst*

Kind of hit on your infrastructure again -- can you talk about if you're seeing an increase in biddings? And then if the TIFIA really comes through, when would you see that orders come to you in 2014?

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**Brian Lipke** - *Gibraltar Industries, Inc. - Chairman and CEO*

It's a good question. Generally from the start of the bidding process to the time that we begin shipping orders for major projects can be well in excess of a year or more. In fact -- I'm trying to think which major bridge project -- we actually -- we ship products over a three-year period of time. Golden Gate Bridge. So there is a delay from when funding becomes available and when actual products get shipped. So it's all moving in a positive direction, but there is a timing delay in all of that. Actually, it was the Oakland Bay Bridge that we shipped products over three years. Sorry.

As far as bidding activity goes, we've seen a steady rate --

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**Henning Kornbrekke** - *Gibraltar Industries, Inc. - President and COO*

It's actually only a few select suppliers for the types of products that we make, and so the bidding activity has been fairly normal, and we wouldn't expect that to change. It's a small segment of the market that we participate in, and we are well represented in that segment of the market.

**Brian Lipke** - *Gibraltar Industries, Inc. - Chairman and CEO*

I'd like to add, too, we didn't mention this in our prepared remarks, but we had a joint venture that we established with a Chinese manufacturer to produce some of our products in their facility, and we recently shipped a first project through that joint venture to Mexico just about a month ago. This -- having a facility in China is going to put us closer to the Chinese markets. And the fact that we are in a joint venture with a Chinese company, we expect will help us penetrate to a greater extent not only the Chinese market but also the market overall in that part of the world.

**Henning Kornbrekke** - *Gibraltar Industries, Inc. - President and COO*

The Asian market is growing, and now that we've got presence there, we really expect to grow with that market.

**Brian Lipke** - *Gibraltar Industries, Inc. - Chairman and CEO*

And actually, just a little bit more color on that. In 2012 -- I don't have the numbers for 2013 yet -- we shipped infrastructure products to 16 different countries around the world. So, clearly, our technology, our designs, and our competitive position allow us to go far afield from the United States.

**Matthew Dodson** - *JWest, LLC - Analyst*

To frame that up, would you expect you to start delivering on these projects in 2014, or do you expect to bid on more projects in the United States in 2014? Or is it a combination of both?

**Henning Kornbrekke** - *Gibraltar Industries, Inc. - President and COO*

Both.

**Operator**

Thank you. At this time, we have no further questions. I would like to turn the call back over to Brian Lipke for closing comments.

**Brian Lipke** - *Gibraltar Industries, Inc. - Chairman and CEO*

Thank you, operator. And thanks to everyone for listening in on our call today. We're going to be out on the road attending conferences and doing non-deal road shows over the course of the year, so we look forward to seeing many of you during those trips. And we'll be speaking with you about our fourth-quarter earnings results on February 20 of 2014. We look forward to speaking with you then. Thank you.

**Operator**

Ladies and gentlemen, thank you very much for your participation in today's conference call. You may disconnect. Have a wonderful day.