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ESE - Q1 2016 ESCO Technologies Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 09, 2016 / 10:00PM GMT

THOMSON REUTERS

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PRESENTATION

Operator

Good day and welcome to the ESCO first quarter 2016 conference call. Today's call is being recorded. With us today are Vic Richey, Chairman and Chief Executive Officer, Gary Muenster, Vice President and Chief Financial Officer.

And now, to present the forward-looking statements, I would like to turn the call over to Kate Lowrey, Director of Investor Relations. Please go ahead.

Kate Lowrey *- ESCO Technologies Inc. - Director of IR*

Thank you. Statements made during this call regarding 2016 and beyond EPS, EPS as adjusted EBIT tax rates, future growth, profitability and revenue, operating margins, sales, acquisitions, implementation of the company's capital allocation strategy, the cost, benefits and timing of restructuring and cost production activities, the result of recent acquisitions, corporate costs and other statements, if they're not strictly historical, are forward-looking statements within the meaning of the Safe Harbor provisions of the Federal Securities Laws.

These statements are based on current expectations and assumptions and actual results may differ materially from those projected in the forward-looking statements. Due to risks and uncertainties that exist in the operations and business environment including, but not limited to, the risk factors referenced in the company's press release issued today, which will be included as an exhibit to the company's form 8-K to be filed.

We undertake no duty to update or advise any forward-looking statements whether as a result of new information, future events or otherwise. In addition during the call, the company may discuss some non-GAAP financial measures in describing the company's operating results. A reconciliation of these measures to the most comparable GAAP measures can be found in the press release issued today and found on the company's website at www.ESCOtechnologies.com, under the link Investor Relations.

Now Ill turn the call over to Vic.

Vic Richey *- ESCO Technologies Inc. - Chairman, CEO*

Thanks, Kate and good afternoon. Before I give my perspective on the quarter, I'm going to turn it over to Gary for a few financial highlights.

Gary Muenster *- ESCO Technologies Inc. - EVP, CFO*

Thanks, Vic. As a reminder, we previously announced certain restructuring actions that are being taken related to our lower margin international operations, primarily in the Test business. We described and quantified the specific actions in the resulting annual cost savings expected from these actions.

The detailed restructuring costs were excluded from the FY 2016 guidance provided in November and we noted we would be presenting our quarterly and annual operating results for 2016 on an EPS as adjusted basis. Our restructuring actions are ahead of schedule and are expected to come in below the original budgeted amount.

Our current view indicates the total cost will be slightly under the $9 million we originally projected and we still expect the restructuring to be substantially complete by March 31st. We're looking forward to the completion of these actions as it eliminates a significant management distraction at the operating unit level and allows us to begin realizing the identified cost savings and operating benefits sooner.

Turning to our results, I'm pleased with our Q1 performance from several perspectives including earnings, cash flow, and entered orders, which each, significantly, exceeded expectations in the quarter. Starting with earnings, we reported EPS as adjusted of $0.47 a share, which is 24% higher than Q1 of last year and 21% higher or $0.08 above the top end of our November guidance of $0.34 to $0.39.

While all three operating segments came in better than planned, the primary driver of our increased earnings resulted from filtration and Tests outperforming our previous expectations by a considerable margin. The favorable tax rate contributed almost equally to the EPS results in both Q1 periods.

Our Q1 cash flow was several million dollars ahead of projections and our entered orders, led by the continued strength of our commercial aerospace business and, in particular, the A350 program, came in better than expected, which resulted in a $10 million increase in total company backlog.

I think it's worth repeating here that our strategy and our operating theme, that we've communicated over the past few years, is well-defined and remains clearly in focus throughout the organization. Through these goals, we will strive to execute on our financial plan, deliver solid earnings results that meet or exceed expectations, position the company for sustainable long-term earnings growth, enhance our focus on returns, and follow our capital allocation plan.

Here are a few highlights from the release to allow you to better understand the underlying results.

Q1 sales increased 10% or $12 million compared to the prior year primarily driven by an $8 million or 17% increase in filtration sales. Test sales increased by 9% year over year and Doble sales, while increasing only $1 million, we view as a positive given that the 2015 Q1 sales mix created a challenging comp due to an unusually large quantity of our highest margin protection sweep products being delivered this that period.

Regarding EBIT, consistent with the increased sales, both filtration and Tests exceeded our internal earnings targets by a meaningful level and Doble essentially came in on plan for the quarter. Corporate costs were higher than last year primarily due to the timing and volume of spending on professional fees incurred supporting our M&A activities.

On the balance sheet front, we continue to maintain a very favorable debt level with $30 million of net debt outstanding as of December 31st. While we remain firmly committed to our capital allocation strategy, which includes share repurchases and dividends, we did not repurchase any shares in Q1. This was primarily the result of the timing of the M&A activities, which were in process, coupled with management's knowledge of the pending Q1 earnings results prior to this release.

We remain fully committed to our capital allocation strategy and expect to continue to opportunistically repurchase shares in the open market over the balance of 2016 as we continue to be supported by a strong balance sheet. Our guidance and remaining outlook for 2016, while at this point in the year is unchanged from the November guide amounts for EPS as adjusted in the range of $1.90 to $2.00, has obviously helped our Q1 results.

Getting off to a solid start to the year certainly provides additional comfort in our ability to achieve our full-year goals. At the start of the year, we provided a somewhat wide range in our EPS guidance for the year.

With the acquisition of Plastique last week, we are currently in the process of finalizing its net EPS accretion, which is impacted by purchase, accounting, and interest. When completed, we'll determine if the net EPS impact which is at the top end of our range or above it. Obviously we'll have this finalized by the next earnings call in May.

Regarding our Q2 outlook, we're expecting EPS as adjusted to be in the range of $0.31 to $0.36 a share and, when taken together with the Q1 actuals, our current expectations for the first half of the year are above our original forecast both from an EBIT and EPS perspective.

Compared to Q1, filtration is expected to generate higher EBIT dollars in Q2 driven by its expected increased sales volume throughout the individual operating units. The timing impact of quarterly sales volume and the related impact at Test and Doble is expected to result in lower contributions in Q2 compared to Q1. Corporate costs are expected to be lower in Q2 due to lower professional fee spending.

Finally, commenting on our love longer term view, we continue to see meaningful sales, EBIT and EPS growth across the business segments consistent with our previous expectations in earlier communications. And I'll be happy to address any specific questions when we get to the q&a.

And now I'll turn it back over to Vic.

Vic Richey - *ESCO Technologies Inc. - Chairman, CEO*

Thanks, Gary. As outlined in the release, and as Gary commented, our (inaudible) and Test businesses performed well ahead of expectations and Doble delivered its Q2 financial commitments. Our strong results, once again, validated one of the benefits of the multi segment business.

As Gary mentioned, the aerospace business continued to outperform with the Q1 operating results and the order book coming in stronger than expected. The key drivers of the continued strength and confidence in our commercial aerospace business, (inaudible) we're well ahead of our near-term order plan led by the nearly $35 million of bookings received on the A350 which continue to run higher than expected.

TEQ performed well in the quarter with sales and EBIT margins up in Q1 compared to prior year. As TEQ continues to be a solid business with above industry average operating margins. Additionally, Fremont's first quarter contribution came in ahead of our acquisition forecast.

The addition of Fremont in the first quarter certainly firms up tax outlook for the balance of the year. The addition of Fremont not only provides a nice book of profitable business but also it addresses and solves (inaudible) issue we're starting to struggle with in TEQ.

As we announced last week, we acquired Plastique to further augment our technical package in business. This addition now gives us a solid foothold in Europe, more exposure to consumer markets and immediate access to new technology precision both in pulp fiber.

Many of the large global medical customers want or require manufacturing capabilities in both the US and Europe. And this acquisition addresses that requirement.

Additionally, like many industries, the packaging market is becoming more focused on sustainability and reducing their environmental impact. TEQ had already developed an eco-friendly plastic packaging solution for its medical products and now with the addition of fiber pack materials offered by Plastique, we're well-positioned to lead the market in this area.

Bottom line, both companies are great additions to TEQ and to ESCO and now together, TEQ has a more sizable, technical packaging platform, which provides a nice return and better positions us to address this growing market.

Doble reported solid operating performance in Q1 with adjusted EBIT margins of 28%. The Brazil closure is on track and the restructuring activities, we described earlier, are on plan.

Also, a modest slowdown on the hardware side of Doble business, as utilities continue to rationalize their capital budgets. We continue see additional opportunities in our service and software applications that bode well for our outlook. I'm pleased with the success Doble is having with their new solutions and offerings, which effectively augment what was already a market leading set of products, services and solutions.

Additionally, we are hopeful that some of the new regulatory standards recently adopted by American [Firm] will open new windows of opportunity for us to assist utilities in their compliance obligations.

The Test business restructure in Europe is going better than anticipated at the start of the year. We had a tight schedule and a lot of moving parts and our teams, both in the U.S. and in Europe, did a very professional job of working through the challenging process. As of December, we're out of Germany and we're nearing exit date of the U.K. as we wind down a few remaining projects. We should start to see the normalized operating margins and (inaudible) beginning in Q3.

Moving on to our outlook for the remainder of 2016, I continue to be excited about the growth prospects we're seeing materialize across the operating segments as well as their potential impact over the balance of the year. A few items (inaudible) perspective include the ramp-up of the A350 as it transitions from low rate production or LRIP to more meaningful run rate over the balance of the year.

Test backlog today, coupled with the remaining book and ship quantities needed to meet our 2016 goals, are at the strongest level we've seen in several years, at this point in the year. Additionally, we're pursuing several large chamber projects in Test, which could further solidify our outlook for this year and beyond. On the cost side, we continue to see the opportunity to beat our EBITDA margin goals once we pull the exit (inaudible).

Lastly, global continues to see solid opportunities across its global utility platform, which bodes well for their future growth. Regarding additional acquisitions, we continue to be active and we'll continue to be prudent. Our two recent acquisitions have come with reasonable EBITDA multiples, which are in the mid to upper single digits, which allows us to hit our return goals more quickly. We anticipate solid accretion from both these acquisitions.

Our M&A strategy remains unchanged. We'll continue to take a deliberate approach looking for small to medium sized niche players which we can acquire for a reasonable multiple thereby providing EPS accretion immediately and delivering an acceptable ROIC. We continue to evaluate several opportunities as we work toward supplementing our organic growth.

So, wrapping up, we had a strong first quarter and our outlook for the year remains solid. Our actions to reduce our cost structure are (inaudible) as expected and we're on track for a strong 2016 as we are well-positioned for profitable growth in all (inaudible) segments. And our focus remains constant to improve our operational performance and execute on our growth opportunities, both organically and through acquisitions.

I'll now be glad to answer any questions you have.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions). And our first question is from the line of Jon Tanwanteng from CJS Securities. Please go ahead.

Jon Tanwanteng - *CJS Securities - Analyst*

Hi. Thank you. Very nice quarter.

Vic Richey - *ESCO Technologies Inc. - Chairman, CEO*

Hi, Jon. Thanks.

Gary Muenster - *ESCO Technologies Inc. - EVP, CFO*

Thanks.

Jon Tanwanteng - *CJS Securities - Analyst*

I know you guys are basically ahead of your expectations on a six-month basis with the last quarter and the current one you're in. But can you clarify what's going on, what's going to the sequential step down?

I know you have seasonality in Doble with the conference. Did you pull in some business at all in the quarter?

Vic Richey - *ESCO Technologies Inc. - Chairman, CEO*

Yes, there was some of that. I mean, Obviously the first quarter was very strong and there was some pull in. That wasn't the majority of it. There was pull in the first quarter.

As I always say, we've got to take the sales when we can get them so if they were available in the first quarter, obviously, we're going to capture those.

But, as we mentioned, with Doble and with the Test business [pulling], you know, there's always some shifting from quarter to quarter and in addition, in the first quarter, in the Test business, we're finishing a large project in Asia and so that accounted for some of their upsides performance in the first quarter.

So we're not seeing anything that concerns us in the second quarter, we understand it, and then, more importantly, as we look in the second half of the year, that ramp up that we need to make our year, that looks solid.

Jon Tanwanteng - *CJS Securities - Analyst*

Got it. That's very helpful. And, you know, we've seen a number of companies just with issues with timing or general uncertainty in the aerospace sector, I'm just wondering if you're seeing any of that at all and why wouldn't you be exposed to that kind of volatility?

Vic Richey - *ESCO Technologies Inc. - Chairman, CEO*

Yes, interestingly enough, we haven't and I think a lot of it is, with the aerospace business, well, first of all, we're a (inaudible) player and so we're kind of far down in the supply chain in some areas. But more importantly, you have to look at the actual platforms that we're on and the things that we're on, whether it be to the legacy projects that we're on or some of the new projects that we're on, in particular the A350, we're just not seeing that type of slowdown.

And, you know, I get that question a lot because you hear about it. But based on the projects that we're on, the platforms that we're on, we've not seen that. And you also have to remember that we do have the space projects as well, we do some work for the Navy.

So I think everybody wants to paint the aerospace market as Boeing and Airbus. And while, certainly, they drive the (inaudible) in the long term, (inaudible), big driver in the market. With our business, there's a lot more customers that we interface with and so I think that's the primary reason we haven't seen that type of effect.

Jon Tanwanteng - *CJS Securities - Analyst*

Great. Thank you. And then finally, just on the TEQ business, are you planning to break that out eventually, you know, with the revenues approaching $100 million? What is your expected growth rate of margin profiles of that once you finish integrating all of the pieces?

Vic Richey - *ESCO Technologies Inc. - Chairman, CEO*

Yes, so, two pieces, I mean, it's certainly something that we're talking with our monitors about and with the right timing that's the right thing to do as far as breaking it out separately. It certainly is, it's gotten this large, something we have to take a look at.

We have to get our arms a little bit around the overall growth rate. But certainly, the growth rate in those businesses are probably in the upper single digits, I would say. And I think we have the opportunity to maybe do a little bit better than that.

When you look at what we've tried to accomplish by having this foothold in Europe, that the products that Plastique has versus what TEQ historically had, similar products certainly but some of the end markets are different. So our hope is that we can take some of the expertise and some of the customers we have in the U.S. and migrate that to Plastique and vice versa, as well as, you know, with this new technology with pulp fiber.

You know, that's something I think there is an appetite for in the US as well, it's under served now. So, you know, we've to got to get our arms a little bit more around exactly how that's all going to play out.

But this was not just a one plus one equals two. We think by combining those businesses and having extra capacity, that we're getting with Fremont, that that gives us a much better platform and should give us, kind of, out-size growth opportunities.

Jon Tanwanteng - *CJS Securities - Analyst*

Okay, great. Just one quick clarification. Gary, did you mean, when you said that after the impact of Plastique, you would probably see either the top end or, maybe, above the range. Was that before or after the one X acquisition costs and purchase accounting?

Gary Muenster - *ESCO Technologies Inc. - EVP, CFO*

That would be after because I used the word net. Because obviously we're, as we're going through the evaluation of intangibles and all the other stuff that has to get carved out for the pieces that are amortized (inaudible) versus fixed.

So my comment was on a net basis that it would be after the purchase accounting and after the interest expenses where we'll be speaking about it. But we'll also call out the pieces. But that's what I was referring to.

Jon Tanwanteng - *CJS Securities - Analyst*

Okay. Great. That's very helpful. Thank you guys, again.

Vic Richey - *ESCO Technologies Inc. - Chairman, CEO*

Okay.

Operator

And our next question is from the line of Ben Hearnsberger from Stephens. Your line is now open.

Ben Hearnsberger - *Stephens Inc. - Analyst*

Hi, thanks for taking my question. On the Test business, I think, Vic, you mentioned you have large chamber projects in the pipeline. Outside of the large chamber piece of the business, can you speak to, kind of, the rest of the Test pipeline and how it looks? Maybe touch on of some the more economically sensitive areas of the business and how you feel about them.

Vic Richey - *ESCO Technologies Inc. - Chairman, CEO*

Yes, I'd say outside of those the rest of the business is performing well. In fact, we were just down there last week, well, I've been there in the last two weeks. But we just had our board meeting down last week and had our directors down. So we had a deep dive with those guys to understand it.

I'd say, overall, the markets that we're addressing are pretty solid. I mean, there's some ups and downs, (inaudible) the medical market is a little softer. And some of the others, (inaudible) the wireless is stronger and despite all of the concern about what's going on in China, it has been a really great market for us this year and it looks like for the remainder of the year.

So we've not seen anything that's overly concerning to us for that market. In fact, you know, the projections that we have out there seem solid. The good thing is we don't have to get these large projects to make these things happen.

But certainly, it's great to see those because we typically have one large project going through the business at any given time. And so having the number of opportunities like this, I'd say over, it's not going to have a huge impact on this year. Because usually these large projects get delivered over a couple of years.

But, certainly, that adds to the potential upside to the business. But, the underlying business, that's the outside of the medical business, is very solid.

Ben Hearnsberger - *Stephens Inc. - Analyst*

And if you're going to see some of the larger projects convert, when would the expectation be that you see them?

Vic Richey - *ESCO Technologies Inc. - Chairman, CEO*

Well typically, those things play out, you know, we may (inaudible) and we may get some impact in the fourth quarter. But the majority (inaudible) would be in 2017.

Ben Hearnsberger - *Stephens Inc. - Analyst*

Got it. And, I think, you were speaking to kind of mid-teens EBIT margins for the segment. Is there a, kind of, a revenue run rate embedded in that type of guidance that you need to be at?

Gary Muenster - *ESCO Technologies Inc. - EVP, CFO*

I would say, Ben, just to put (inaudible) around it because the margin differentials on each of the product lines, like Vic said, with medical or the wireless or the EMC or anything around that, if you were just to peg this as roughly a $43 million to $45 million revenue a quarter, you'd be at that range. And so, if you look at our seasonality, and we don't want to peg this as annualized, but you can see the leverage you get off of the sales increase.

Historically if our Q4, which has been our strongest quarter, where we're banging around $52 million and $55 million over the past two or three fourth quarters. You can see the margin gets up at 16% to 18%. So that's kind of the band, if you think of $44 million or $45 million at the target we're looking at. At the one off quarters, you get the 50s and whatever, you should get three or four points a margin. So, hopefully you can work around the sensitivity of that.

Ben Hearnsberger - *Stephens Inc. - Analyst*

Okay. That's helpful. One last question on Doble and the international piece of that business. There's obviously a lot of noise internationally on a daily basis, affecting the industrial economy. Can you speak to, kind of, what you're seeing on the ground in your Doble business?

Vic Richey - *ESCO Technologies Inc. - Chairman, CEO*

A couple of things, I mean, the first response is I'm glad that we have a dominant position in the US, (inaudible) serve in the US market is stronger than what we're seeing in Europe right now and even in Asia.

Having said that, primarily what we do are more services, software, with some hardware sales internationally and that does not seem to be impacting quite as much. But, certainly, the European market, the industrials, are more challenging than they are in the us.

Ben Hearnsberger - *Stephens Inc. - Analyst*

Okay.

Vic Richey - *ESCO Technologies Inc. - Chairman, CEO*

As we look at the remainder of the year, we factored that in to what we think is going to happen with the business.

Ben Hearnsberger - *Stephens Inc. - Analyst*

Got it. Thank you.

Operator

(Operator Instructions). And our next question is from the line of Chip Moore from Canaccord. Please go ahead.

Chip Moore - *Canaccord - Analyst*

Thanks. Guys, wondering if you could help us frame Plastique as we layer it in, you know, similar EBIT margins, sort of in the 15% range for a packaging business. How should we be thinking about that as we put that in our models?

Vic Richey - *ESCO Technologies Inc. - Chairman, CEO*

I'm sorry. Will you say that again?

Chip Moore - *Canaccord - Analyst*

For Plastique? As we layer that in, how should we be thinking about EBIT margins on that business? Is that, sort of, similar to other packaging businesses and sort of in the 15% range? Or how should we think about that?

Vic Richey - *ESCO Technologies Inc. - Chairman, CEO*

I would say that today, they're a little bit below that. They're in the teens. A bit below 15%.

Chip Moore - *Canaccord - Analyst*

Okay. That's helpful. And then on the balance sheet after this deal, you know, I guess where does net debt shake out? What are you thinking for dry powder as you go after more targets?

Gary Muenster - *ESCO Technologies Inc. - EVP, CFO*

I'll address that. If you remember right before the holidays, we re-upped our credit facility and basically extended it with a five-year duration. We didn't increase the volume. So we started out with $450 million under a revolver and we have $250 million under an accordion that could be used for acquisition.

So if you start thinking of that in that total range, I mean, yes, we don't have a $250 million acquisition in the pipeline. We have plenty of dry powder. And the other thing is the pricing that we pushed through. We knocked anywhere from 12 to 25 basis points on the higher end of that borrowing, which is libel based. So that gives us a lot more flexibility if we need it to get competitive.

So, you know, I think the general ballpark range of what we paid for Plastique is about 30 and we're generating cash this quarter and so you know, if we were to jump ahead to March 31, we're not in an extraordinarily different position than were at December. And so the dry powder is plenty sufficient to handle what we have in the pipeline.

Chip Moore - *Canaccord - Analyst*

Okay. That makes sense. And just to be clear on the guidance for Q2, there's no step up charges or anything like that in the $0.31 to $0.36.

Gary Muenster - *ESCO Technologies Inc. - EVP, CFO*

Step up meaning purchase accounting?

Chip Moore - *Canaccord - Analyst*

Yes, exactly.

Gary Muenster - *ESCO Technologies Inc. - EVP, CFO*

No. That number there, I would say best way to describe it is that's the operations excluding Plastique because, you know, just we bought it last week and obviously we know the numbers. But before we lock down, what we want to put in our commitment.

So anything that Plastique flushes through, obviously from a sales perspective and earnings perspective will be a net positive to that depending on the purchase accounting amount. And just to size that, and if you remember the release from last week, we pegged it at about $35 million on an annual basis.

And so, obviously we'll have that for eight months of the year. So whatever that pro rata is, as Vic described it, you know, kind of a low to mid teens. So somewhere between 12% and 15% EBIT. Then with the purchase accounting for a few pennies off that so that's kind of the wrap.

But that is not included in here. The revenue is not included in there nor is the earnings. That's the straight up pre-Plastique number.

Chip Moore - *Canaccord - Analyst*

Perfect. Just wanted to clarify. Appreciate it.

Gary Muenster - *ESCO Technologies Inc. - EVP, CFO*

Sure.

Chip Moore - *Canaccord - Analyst*

Nice job, folks.

Gary Muenster - *ESCO Technologies Inc. - EVP, CFO*

Thank you.

Vic Richey - *ESCO Technologies Inc. - Chairman, CEO*

Thanks.

Operator

Our next question is from the line of [Sean Nickelson] from [SDH]. Please go ahead.

Sean Nickelson - *SDH - Analyst*

Hi, Gary, actually my question has been answered. So thank you.

Gary Muenster - *ESCO Technologies Inc. - EVP, CFO*

Okay, Sean. All right. Thank you.

Operator

And I'm not showing any further questions in the queue. I would like to turn it back to management for final remarks.

Vic Richey - *ESCO Technologies Inc. - Chairman, CEO*

Okay. Well thank you, everyone. I look forward to talking to you on our next call.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes the program and you may all disconnect. Have a wonderful day, everyone.

Gary Muenster - *ESCO Technologies Inc. - EVP, CFO*

Thank you.