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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Second Quarter 2024 ESCO Technologies Earnings Call. (Operator Instructions) Please be advised that today's conference is being recorded.

On the call today, we have Bryan Sayler, President and CEO; Chris Tucker, Senior Vice President and CFO.

And now, I would like to hand the conference over to our first speaker today, Kate Lowrey, Vice President of Investor Relations. Kate, you now have the floor.

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

Thank you. Statements made during this call, which are 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 company's 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 revise any forward-looking statements, except as may be required by applicable laws or regulations.

In addition, during this 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, I'll turn the call over to Bryan.

Bryan H. Sayler - *ESCO Technologies Inc. - President, CEO & Director*

Thanks, Kate, and thanks everyone for joining today's call. We appreciate you taking time to get an update from ESCO this afternoon. We are pleased with the second quarter results and are especially excited about the continued top-line momentum across our business platforms.

Sales were up by 9% over the prior year second quarter as our aerospace, Navy, and utility businesses continue to see robust end-market dynamics. It's been busy over the last month as we've worked through our annual strategic planning process with each of our subsidiaries. This is a chance for us to step back and examine what's happening in our end markets and to work on strategies to deliver above-market organic growth.

This year's sessions have been particularly energizing as we've seen several long-term trends across the broader economy that support good growth profile as we move ESCO forward.

Chris will run you through all of the financial details on the second quarter, but before that I want to pass along a few highlights from the strategy reviews and give you some sense for some of the longer-term dynamics that we are seeing.

Starting with Aerospace & Defense, we continue to feel very good about the outlook here. As you saw in the release, we still have high levels of backlog and the top-line sales growth has been strong. The most exciting thing here is what remains in front of us. Our key markets are commercial and defense aerospace, Navy, and space. And while each of these have different drivers, fundamentally they all provide a great foundation for future growth.

Commercial and defense aerospace customers are working to execute on long-term build plans to increase build rates, which underpin a strong forecast for ESCO. The Navy remains committed to ramping up submarine production in a manner that will drive significant growth for us. We are also involved in some early-stage developmental projects with positive long-term outlooks. We are driving for high single-digit organic growth from these businesses through the planning cycle.

Next is the Utility Group, where the outlook remains bullish. You don't have to look very deep into the headlines to find the growth drivers here. An aging electric grid, increasing power demand from technology and industrial investments in the U.S., and decarbonization goals around the world are driving the need for even more electrification.

At ESCO, we have a very well-established diagnostic instrumentation business in Doble that is positioned to capitalize on these market factors and deliver continued excellent results. Additionally, our capabilities in the renewables market have already delivered tremendous results for ESCO and there's more to come. These businesses are highly focused on new product and technology roadmaps to continue meeting customer needs while maintaining our lead in these growing markets.

Finally, I'll touch on the Test business. As we discussed last quarter, and as you can see from the press release, Test got off to a tough start to the year at Q1, and although the revenues softness continued in Q2, the business was able to deliver sequential growth and return to double-digit profitability. It's never fun to go through these kinds of business cycles, but the team is really doing a great job of managing through the current challenges.

We've been quick to get cost out of the business, and we are well-positioned as growth returns. We had a great strategy review with this team, and the long-term outlook is bright. This business has broad test and measurement capabilities that apply to a number of end markets, and we certainly expect growth to return in 2025 and beyond.

While our primary focus is on organic growth and driving strategies to grow our existing business faster than the markets they serve, while improving operational effectiveness and expanding returns, we are seeing increased opportunities to add to the business through strategic acquisitions, which increase our exposure to our existing long-term growth markets. Hopefully, that gives you a flavor of the things that we've been working on over the past month and a sense of the excitement that we have for the future.

As we pivot back to the quarter, I'll turn it over to Chris now, and he will go through the specifics for the great quarter that we just announced.

Christopher L. Tucker - *ESCO Technologies Inc. - Senior VP & CFO*

Thanks, Bryan. Everyone can follow along on the chart presentation. We will start on Page 3, where we have the overall financial highlights of the second quarter.

Overall, as Bryan mentioned, the quarter was strong. Starting with orders, you can see there was a 5% reduction in orders compared to last year's second quarter, but the pace of business remains good, and we finished the quarter with $838 million of backlog, which is nearly $100 million higher than March 31, of last year.

Sales in the quarter were up 9%, with organic growth of 8%, and 1% from the MPE acquisition. 2 of the 3 segments delivered double-digit sales growth in the quarter. The sales performance translated to strong earnings growth, with adjusted EBIT up 130 basis points to 13.5%, and adjusted earnings per share up 24% to $0.94.

Moving to Chart 4, we will start on the segment details. Beginning with Aerospace & Defense, these businesses continued to deliver strong results. Beginning with orders, we achieved a 4% order growth in the quarter and finished with $562 million of backlog, which represents an increase of $78 million since the beginning of the fiscal year.

Moving on to sales, overall growth was 16%, which was all organic. The sales growth was led by strength from the commercial and defense aerospace businesses, which were up 14% and 20% respectively. The Navy businesses were also very strong in the quarter, delivering 32% growth.

Adjusted EBIT margins in the quarter increased by 80 basis points as we saw nice leverage on the sales growth and favorable impacts from price, which were partially offset by inflation and mix.

On Chart 5, we have the Utility Solutions Group. We had another great quarter here with orders. Orders were down in the quarter, which was driven by modest reductions at Doble and a larger decline at NRG. The renewables business saw exceptional order growth through June 30, of last year. The strong industry dynamics and government incentive programs spurred customer orders.

Since then, the order pace has moderated and the business has burned down backlog. We are starting to see increasing order pipeline activity in the renewables business and we expect to see order growth return as we move beyond the third quarter.

Sales for USG were up 10% in the second quarter with double digit increases for Doble and NRG. For Doble, we saw strong growth on the services side of the business and for NRG, we continue to see nice growth from solar.

Adjusted EBIT margins were up 230 basis points as the business experienced favorable mix, nice leverage on sales growth, and price increases, which more than offset inflationary impacts.

Next is Chart 6, where we have the Test business. Orders here decreased 21% compared to last year's second quarter. This was driven by lower orders from the U.S. wireless market and delays on a few large projects, which are expected to be booked in the third quarter. Despite the orders drop in the second quarter, you can see the backlog has still grown since the beginning of the year. This business continues to see good levels of activity, but as we mentioned last quarter, the timing to execute on some projects has been pushed out by customers, which is also driving lower sales levels.

On the sales line, the business was down 8% with organic sales dropping by 12% and the MPE acquisition adding 4 points of growth. The largest declines came in the U.S. where we saw reductions in wireless filters and acoustic product lines. Adjusted EBIT margins declined to 12.2% in the quarter. As cost reduction efforts, we're not able to offset de-leverage on the sales drop.

We have executed a plan to take cost out of this business, and this helped drive a nice sequential increase in profitability during the second quarter. We expect this sequential improvement to continue as we move through fiscal 2024.

On Chart 7, we have the cash flow highlights. We continue to show favorability to last year with $19 million of operating cash flow so far this year compared to a cash use of $5.5 million last year. Favorability and accounts receivable was the main driver of the year-to-year improvement in operating cash flow.

Capital spending in the first 6 months did increase driven by investments from the Aerospace & Defense businesses where we are working to increase capacity and productivity to support the robust demand outlook.

You can also see that, we had acquisition spending in both years with MPE this year at just over 56 million while last year we had the CMT acquisition for approximately $18 million. We have completed $7 million of stock buybacks through March 31, of 2024, which compares to $12 million that was done through the first 6 months of last year.

The last Chart today is #8, which is our 2024 guidance. The outlook for the full year remains unchanged, and we remain on track to deliver adjusted earnings per share in the range of $4.15 to $4.30, which represents a growth range of 12% to 16%. This remains predicated on sales growth in the range of 7% to 9%.

2024 is shaping up to be another record year as we push to deliver revenue of more than $1 billion for the first time in ESCO history, and we push for a third year in a row of double-digit growth in adjusted earnings per share. That concludes the financial update, and now I'll turn it back over to Bryan.

Bryan H. Sayler - *ESCO Technologies Inc. - President, CEO & Director*

Thanks, Chris. Obviously, we delivered a very good Q2. The teams here at corporate and across our business segments did a great job in delivering exceptional top-line and bottom-line growth. There are always challenges when executing programs inside a business, and I continue to be impressed by the commitment and dedication shown by our employees around the world.

As always, I want to thank them for their hard work and dedication, which resulted in another solid quarter for ESCO. To close, we have entrenched market positions across growing end markets, and we serve and remain on track to deliver our 2024 commitments for a third record year in a row.

That concludes the opening remarks, and we can open-up the question-and-answer session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Tommy Moll of Stephens Inc.

Thomas Allen Moll - *Stephens Inc., Research Division - MD & Equity Research Analyst*

I wanted to start on Doble. I think orders were down slightly on a year-over-year basis. Revenues, if I'm doing my math correctly, were flattish on a quarter-over-quarter basis, and so the question would be if you could just give us an update on demand currently for that business?

Bryan H. Sayler - *ESCO Technologies Inc. - President, CEO & Director*

Sure. Listen, we still feel good about overall demand at Doble, and we did have very good comps for orders in the prior year, but as you can see, we're moving the revenue up, seeing good demand for our condition monitoring products and for services. We do have a pretty robust order pipeline, and we've already begun to see some progress here in the third quarter.

Christopher L. Tucker - *ESCO Technologies Inc. - Senior VP & CFO*

And, Tommy, this is Chris. I would also say, sequentially, the Doble sales were up from first quarter to second quarter. NRG was down slightly sequentially, but Doble was up inside of there.

Thomas Allen Moll - *Stephens Inc., Research Division - MD & Equity Research Analyst*

Thank you for clarifying there, Chris, and I just can't resist asking here, Bryan, you threw out a bogey high-single digits after your strategy review on the A&D side. Is there anything you want to use to frame the utility outlook after your review?

Bryan H. Sayler - *ESCO Technologies Inc. - President, CEO & Director*

Yes. I would say we're mid-upper single digits over the planning horizon there. Those are markets that are growing very well, and I think we've got strategies, plans, product development in place that's going to allow us to grow faster than those markets.

Thomas Allen Moll - *Stephens Inc., Research Division - MD & Equity Research Analyst*

And a quick one on Test. Chris, I think I heard you say you're looking for sequential improvement as you go through this year. I presume that applies to revenue and EBIT. It looks like revenue's already bottomed and moved a little bit higher, but if you could just clarify what you meant there, it would be helpful.

Christopher L. Tucker - *ESCO Technologies Inc. - Senior VP & CFO*

Yes, that's right, Tommy. So, we had a sequential sales and EBIT increase from Q1 to Q2. We would expect Q3 sales to be higher than Q2, and also margins to be higher than Q2, and then we would expect a similar dynamic as Q4. So, we're kind of still looking for that business to kind of ramp and get better as each quarter progresses.

Operator

(Operator Instructions) Our next question comes from Jonathan Tanwanteng of CJS Securities.

Unidentified Analyst

This is Justin on for Jon. Can you quantify how much risk there is at Boeing and if they've communicated to you any changes in their needs?

Bryan H. Sayler - *ESCO Technologies Inc. - President, CEO & Director*

Sure. Listen, Boeing is clearly having a tough time of it, and we certainly look closely at the impact that Boeing might have both in the near-term and over the longer term planning horizon during our strategic planning process. Our determination is that this is going to be a short-term problem that will work itself out over several quarters. Boeing's build rates are expected to remain modest for 2024 and begin ramping up in 2025. The signals that we're receiving are to continue to produce at the rates that we've been contracted to do so. We have seen a little bit of a fall off in new orders at one of our 3 businesses that are serving the commercial aerospace side of Boeing. Nothing to be too concerned about, but definitely a noticeable change.

The good news is that we're prepared to match their demand as needed, and we have the ability to reallocate the capacity that would have been devoted to Boeing to other programs and to meet our projected growth rates.

Listen, I'd end by saying, a healthy Boeing is good for our industry, and once they can get past this current crisis, we anticipate that that will serve to raise our overall growth projections.

Unidentified Analyst

One more, if I could. Should we read anything into the lower book-to-bill this quarter across the segments? And if you think there's any demand weakening or pushing out, or is it more the lumpy nature of orders?

Bryan H. Sayler - *ESCO Technologies Inc. - President, CEO & Director*

I would say that, on the Test business, we've definitely seen lower orders in China and lower orders in wireless. So that would be -- I would not put that in the lumpy category, but I would say that renewables, maybe the Doble business, and certainly a lot of what's going on over in Aerospace & Defense, those are all pretty lumpy. As I said, we've got a strong pipeline in all of those categories, and some of them are tracking some pretty large orders that would really make a big difference in terms of our book-to-bills?

Christopher L. Tucker - *ESCO Technologies Inc. - Senior VP & CFO*

Yes, and I would just add on, especially Aerospace & Defense, it was still over 100%, and that's after 2 quarters that were way over 100% as we've had some pretty big Navy orders over the last prior, 6 months, so really still pretty strong there, I'd say.

Operator

Our next question comes from John Franzreb from Sidoti & Co.

John Edward Franzreb - *Sidoti & Company, LLC - Senior Equity Analyst*

Congratulations on another nice quarter. If I heard you properly in your prepared remarks, it sounded like you were getting pricing in Utility and Test. Can you talk a little bit about what kind of pricing you're pushing for?

Bryan H. Sayler - *ESCO Technologies Inc. - President, CEO & Director*

Do you want to take that one?

Christopher L. Tucker - *ESCO Technologies Inc. - Senior VP & CFO*

Yes, I mean, I think generally what we're getting in those places is still kind of in the 3% to 4% range, and we see that kind of ahead of inflationary numbers, so we kind of try to track what we're seeing on the commodity material side and people inflation as well, and we're still favorable on those measures as far as more price than cost.

John Edward Franzreb - *Sidoti & Company, LLC - Senior Equity Analyst*

Got it. And coming back to the Test segment, you mentioned that there's been delays on a few large projects. I'm wondering, is there any common theme in those delays that you're seeing in your customers?

Bryan H. Sayler - *ESCO Technologies Inc. - President, CEO & Director*

Well, I think that there's been, as I said before, there's a general slowdown in the construction industry in terms of permitting, being able to get some key raw materials, and I think labor availability has been a big issue. So the buildings that we're waiting on are really large, big projects, and so we are seeing some improvement there, but nothing like a return to normal.

At this point, though, we believe that we have the access that we need to deliver significant sequential growth in the second half of the year. The projects that are moved out to next year, we've kind of set those in the next year's plan now, and we anticipate that those will be executed on the revised schedule.

John Edward Franzreb - *Sidoti & Company, LLC - Senior Equity Analyst*

I'm also hearing a lot about permitting, but do you expect everything to fall into fiscal 2024 still and not be pushed to the right of that?

Christopher L. Tucker - *ESCO Technologies Inc. - Senior VP & CFO*

Yeah, I mean, we've already pushed a fair bit out to next year. That was kind of, some of the reduction in the outlook for Test that we kind of did after the first quarter, and yes, we haven't seen that get worse necessarily, but we also haven't seen it get better. And I would also just say, John, that as far as some of the delays on orders and such, as Bryan mentioned, I mean, we do see a path to pretty big sequential improvement in orders as we go into Q3 versus Q4, and it looks like, frankly, some of that might even happen in April or has happened in April, I should say. So, we expect that to get better, but again, a lot of those bigger orders that would be coming in now would likely be more, kind of '25 revenue type things.

John Edward Franzreb - *Sidoti & Company, LLC - Senior Equity Analyst*

Great. And one last question, if I may. On the M&A front, can you kind of give us an update on targets and size and what kind of product lines you'd like to end? Maybe a little refresher, that'd be helpful.

Bryan H. Sayler - *ESCO Technologies Inc. - President, CEO & Director*

Sure. Well, first of all, I would say that in the past, since our last call, we've seen a sharp increase in the investment opportunities that kind of meet our target profile, if you will, and we're actively engaged in those processes. We don't have anything to announce. We're not, you know, particularly close, but we are optimistic about our ability to get things done.

When we talk about M&A, I think the first thing I want to remind you is that, organic growth and operational execution are our primary focus, so we're not taking our eye off the ball there. Our organic growth profile over the planning horizon is really, really good. Having said that, several of those end markets that we talked about earlier have superior long-term growth characteristics, and those are the ones that we would be -- the most focused on, and that would be, commercial and military aerospace, Navy, and electrification.

Operator

I see no further questions at this time. I would now like to turn the conference back to Bryan.

Bryan H. Sayler - *ESCO Technologies Inc. - President, CEO & Director*

Thanks. I apologize. I lost my place here.

Christopher L. Tucker - *ESCO Technologies Inc. - Senior VP & CFO*

No, I think. We're good.

Bryan H. Sayler - *ESCO Technologies Inc. - President, CEO & Director*

All right. So, thanks a lot, guys. We really appreciate you answering the questions or taking the quick questions with us. We look forward to another good quarter.

Christopher L. Tucker - *ESCO Technologies Inc. - Senior VP & CFO*

Thank you.

Operator

Thank you. This concludes today's conference call. Thank you all for participating. You may now disconnect. Have a great day, everyone.
