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## CORPORATE PARTICIPANTS

**Kate Lowrey** *ESCO Technologies Inc - Vice President - Investor Relations*

**Bryan Sayler** *ESCO Technologies Inc - President, Chief Executive Officer, Director*

**Christopher Tucker** *ESCO Technologies Inc - Chief Financial Officer, Senior Vice President*

## CONFERENCE CALL PARTICIPANTS

**Tommy Moll** *Stephens Inc. - Analyst*

**Jon Tanwanteng** *CJS Securities, Inc. - Analyst*

## PRESENTATION

**Operator**

Good day and thank you for standing by. Welcome to the third quarter 2024 ESCO Technologies earnings call. (Operator Instructions) Please be advised that today's conference is recorded.

On the call today, we have Bryan Saler, President and CEO; Chris Tucker, Senior Vice President and CFO. And now I'd like to hand the conference over to our first speaker today, Kate Lowrey, Vice President of Investor Relations. Kate, you now have the floor.

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**Kate Lowrey** - *ESCO Technologies Inc - Vice President - Investor Relations*

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 and 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.

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**Bryan Sayler** - *ESCO Technologies Inc - President, Chief Executive Officer, Director*

Thanks, Kate, and thanks to everyone, for joining today's call. We are happy to provide an update on a lot of the exciting things that are happening here at ESCO. We are pleased with the third-quarter results and are particularly excited about the continued momentum across all of our business platforms.

Order growth in the quarter was substantial, and we have record backlog of nearly $890 million as of June 30. This is an important indicator of the continuing strength of our end markets and our formidable competitive positions. By talking about the -- before talking about the businesses, I want to briefly highlight some additions to our Board of Directors.

We are fortunate to bring two highly capable individuals with deep backgrounds in the utility industry onto our Board. These additions to the Board will become effective upon approval of the Federal Energy Regulatory Commission.

First is Penni McLean-Conner. Penni is an operating executive with Eversource Energy, a utility holding company based in New England, where she currently serves as Executive Vice President of Customer Experience and Energy Strategy. Penni is a registered licensed professional engineer and has held several positions with increasing responsibility in the utility industry since 1986. In that time, she has worked for Tampa Electric, Duke Energy Corporation, and Eversource.

We are also adding David Campbell to the Board. David is currently President, CEO and Chair of Evergy Inc., a public utility holding company headquartered in Kansas City, Missouri. David has held several executive positions at a number of electric and integrated energy companies in Texas as well as in independent energy resource and investment company. Prior to that, David worked for nine years at McKinsey & Company, the last four of which he served as a partner.

We are thrilled to bring Penni and David on to the Board, both have deep utility industry insight, and it goes without saying how important that will be for us at ESCO as we continue to grow our Utility Solutions group. Penni and David attended our Board meetings last week, and it's clear that they will be great contributors. We have a diverse set of industry and business experiences in our Board and their guidance, insight, and governance are key to ESCO's success. On behalf of the entire Board, I'm happy to extend a warm welcome to Penni and David.

Chris will run you through all of the financial details for the third quarter, but before that, I want to give you a few comments on each segment. Starting with aerospace and defense. We continue to have a strong outlook here. As you saw on the release, we finished the quarter with record backlog driven by significant order increases. The order growth was driven by continued strength from commercial and military aerospace as well as the continued strength of our navy orders at VACCO and Globe.

The underpinnings for the market strength here are well documented, and we remain very positive on the long-term outlook for these markets. The key for us going forward will be to focus on execution and meeting customer requirements as we work to support ongoing production increases.

Before moving on, I do want to address the space business at VACCO. As you saw in the release, we will be reviewing strategic alternatives for this business. Just to frame it up for you a bit, our VACCO subsidiary is comprised of two key businesses, space and navy.

The space business has a 70-year legacy in this market and continues to be a key supplier on many manned space flight and government satellite missions. The business has a great legacy, a tremendous group of committed employees and a great set of technologies. The space business will continue to have a bright future in these NASA centric missions.

For ESCO, this business has sales of approximately $55 million. And we first need to decide how a carve-out from the Navy business would work. And second, we need to decide if it has enough scale as part of ESCO or whether it would fit -- it would be better suited as part of a different enterprise that's more broadly focused on space. We are undertaking this review process now and we'll make further comments when the review is completed or when we have determined that a disclosure is required or deemed appropriate.

Next up is our utility group, where the outlook continues to be bullish. The sales growth here was a bit more modest in the third quarter, but order growth was significant, and backlogs are at healthy levels. You'll recall that the third quarter of June last year was an all-time record orders level for our renewables business.

So that business did see an orders reduction compared to last year's third quarter, but the absolute level of orders at NRG in the third quarter 2024 was still the second highest on record. We still feel great about the renewables business and our core utility market business from Doble delivered significant orders growth in the quarter and continues to see lots of opportunities for future growth.

Finally, I'll touch on the Test business. As we discussed last quarter, we got off to a tough start this year for the business with significant revenue and profitability declines in Q1. It's never fun to go through these kinds of business cycles, but the test team has responded and continues to manage well through this business cycle.

Importantly, we continue to see nice sequential improvements here in both sales and margins. The business delivered adjusted EBIT margins of 16.6% in the quarter, which on a historical basis is very good. It's a real testament to the hard work by the team and shows that the margin benefits anticipated from the MPE acquisition are coming through.

As we have stated before, this business has broad test and measurement capabilities that will apply to a number of end markets, and we certainly expect growth to return in 2025 and beyond.

With that, I'll turn it over to Chris to run you through the financial details of the quarter.

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**Christopher Tucker** - *ESCO Technologies Inc - Chief Financial Officer, Senior Vice President*

Thanks, Bryan. Everyone can follow along on the chart presentation. We will start on page 3, where we'll have overall financial highlights of the quarter. The top of the chart looks good here with all the bars moving in the right direction. Starting on the upper left side of the chart, you can see that order growth in the quarter was tremendous at 46% as all three segments had book-to-bill ratios of over 1.1, which resulted in a record backlog of $889 million.

Next is sales, which were up 5%, comprised of a 4% organic growth and a 1 point contribution from the MPE acquisition. Adjusted EBIT was up 50 basis points in the quarter and adjusted EPS improved by over 6%.

Moving to the next chart, we will cover the A&D segment. You can see this segment was a key driver of overall order growth with an increase of 79%. We were up against a lower comp from last year's third quarter, but still saw excellent order intake on the Navy side with VACCO bringing in over $40 million of Navy orders during the third quarter.

Additionally, the commercial and defense aerospace orders continued to deliver strong growth at both PTI and Crissair.

On the sales side, there was an increase of nearly 11% with growth led by Navy and Aerospace. Adjusted EBIT margins for the quarter came in at 18.7%, which was a decline of 220 basis points. We saw additional margin declines in the quarter from the VACCO space business with additional profitability challenges on developmental contracts. This cost us approximately $2 million against the guidance that was provided last quarter.

Additionally, we had unfavorable mix in the quarter at PTI driven by timing of sales on different OEM and aftermarket platforms.

Moving on to chart 5. We will cover the Utility Solutions Group, where orders increased by 17% during the quarter. The growth was driven by Doble, which delivered a 30% increase as customers continue to request significant service work and do more testing as they maximize uptime of existing assets while continuing to struggle with lead times on new equipment like transformers.

Orders for NRG decreased by $4 million. But as mentioned by Bryan, we were up against a very tough comparison to last year's record third-quarter amount. Sales for the quarter were essentially flat as growth rates moderated after many quarters of double-digit growth. Adjusted EBIT margins for the segment increased by 180 basis points, with favorable mix from the service business and favorable price impacts more than offsetting inflationary pressures.

Next is chart 6, where we will cover the Test business. Orders increased by more than 40% in the quarter for Test. This was great to see after weakness through the first six months of the year. Strong US bookings drove the growth. Sales in the quarter were down 5% on an organic basis with MPE adding 6 points of growth.

Sales grew sequentially compared to the second quarter, which is an important trend as the business works towards recovery. Margins in the quarter were up by 100 basis points as we saw a favorable margin impact from the MPE acquisition and cost reduction savings offsetting volume deleverage and unfavorable mix.

Moving on from the segment details to the next chart. We have our year-to-date order and P&L highlights on chart number 7. Really strong performance year-to-date with orders up nearly 22%. The growth has been led by sizable orders in the Navy businesses as well as continued strength from commercial and defense/aerospace markets.

Sales year-to-date are up 6.6%, with A&D up 13.5% and Utility Solutions up 8.5%, which were slightly offset by an 8.9% drop at Test. Margins have improved nicely with increases from both aerospace and defense and the Utility Solutions group, while we have seen test margins drop on lower volume through the first nine months of the year.

Next is chart 8, where we have the cash flow highlights. You see here an increase of $26.3 million of increased operating cash flow compared to the first nine months of last year. We also have increased capital spending so far year-to-date, mostly related to capacity increases across the A&D businesses.

You can also see on the chart that we have increased acquisition spend this year driven by the MPE transaction. We had a small number of share repurchases during the third quarter, and year-to-date, we have spent $8 million compared to $12.4 million in the prior year.

Last is chart 9, where we have the updated guidance for 2024. Our sales outlook for growth is 7% to 8% for the year and adjusted earnings per share of $4.10 to $4.20. The adjusted EPS outlook excludes any impact of further profitability erosion at the VACCO space business.

As mentioned in the press release, we currently estimate these additional profitability challenges could be worth $5 million to $7 million at the EBIT line, but we have excluded them from the current outlook, and we'll plan to quantify these impacts at year-end.

The midpoint of the $4.10 to $4.20 adjusted EPS range represents 12% growth compared to prior year and would also represent a three-year compound annual growth rate of 17%. A strong record of growth as ESCO looks to close out another record year.

That concludes the financial update, and now I'll turn it back over to Bryan.

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**Bryan Sayler** - *ESCO Technologies Inc - President, Chief Executive Officer, Director*

Thanks, Chris. As you heard, we've had another good quarter, and we're looking at another year of double-digit earnings growth with record backlogs. We continue to feel great about the long-term prospects for ESCO. Before going into the Q&A, I want to give a quick update on the Signature Management & Power acquisition that we announced back in July.

We have completed all of the required regulatory filings in both the United States and the United Kingdom. The timing on those processes can be uncertain. So we'll have to wait and see what happens. But we've been through this before and continue to believe that we can close the deal in the first quarter of fiscal 2025. This is a very exciting deal for ESCO as we bring on a talented group of employees, a key set of technologies and the ability to expand the way that we serve the navy market in both the US and the UK

So that concludes the opening remarks, and we can start the Q&A now.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Tommy Moll, Stephens Incorporated.

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**Tommy Moll** - *Stephens Inc. - Analyst*

Good afternoon and thank you for taking my questions.

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**Bryan Sayler** - *ESCO Technologies Inc - President, Chief Executive Officer, Director*

Hi, Tommy

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**Christopher Tucker** - *ESCO Technologies Inc - Chief Financial Officer, Senior Vice President*

Hi, Tommy

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**Tommy Moll** - *Stephens Inc. - Analyst*

Bryan, a strong quarter on navy orders once again. And my question is, does this show the realization of the upsized shipset content you discussed early in this calendar year, $45 million is right around where I had it pegged. Are there additional shipset awards here? Any context you can give us on what you just reported would be helpful. Thank you.

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**Bryan Sayler** - *ESCO Technologies Inc - President, Chief Executive Officer, Director*

Tommy, no, the orders we got in the prior quarter are mostly navy spares and other pieces. We are still anticipating the larger orders that we've been talking about. Unfortunately, I can't make any news on that, but I'd say we're getting close.

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**Tommy Moll** - *Stephens Inc. - Analyst*

Okay. And then that leads me to my follow-up here, Bryan. Fully aware that this is not the quarter to give formal guidance for 2025, but I'm just doing some simple math here. Your cumulative orders year-to-date across A&D, I'm getting to something like a 50% increase year over year. Now the timing of that record backlog unlocking, we obviously can't see from our side. But is there any reasonable scenario where that segment doesn't grow revenue double-digits next year?

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**Bryan Sayler** - *ESCO Technologies Inc - President, Chief Executive Officer, Director*

Just to be clear, you're talking specifically about the navy piece?

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**Tommy Moll** - *Stephens Inc. - Analyst*

I was -- well, yeah, I shifted there. That was at the A&D segment level is what I was describing.

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**Bryan Sayler** - *ESCO Technologies Inc - President, Chief Executive Officer, Director*

You're right. It's too early to give guidance. But I don't think your math is off in any significant way.

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**Tommy Moll** - *Stephens Inc. - Analyst*

Sure. Any context or insight on big pieces of that backlog that may have a more extended timeline to unlock even if qualitative, not quantitative. Just anything you would highlight for us. It's a pretty big number at this point.

**Bryan Sayler** - *ESCO Technologies Inc - President, Chief Executive Officer, Director*

Yes, I would say that the way you want to think about that is on the commercial and military aircraft side, you generally we're quoting something like a little bit less than a year of lead time out of those factories. And so generally speaking, the aircraft backlogs will convert in about a year.

The navy backlogs do go out a little bit further. I would say, what we have in place right now is probably looking out 18 months to two years. These larger orders that I've been describing will – the award will go out for multiple additional years. So what we're seeing is a steady ramp rate of production for the navy. And I think that, that's certainly on that double-digit path.

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**Tommy Moll** - *Stephens Inc. - Analyst*

Thank you, Bryan. I will turn it back.

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**Operator**

(Operator Instructions) Jon Tanwanteng with CJS Securities.

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**Jon Tanwanteng** - *CJS Securities, Inc. - Analyst*

Hi, thank you for taking my questions. My first one is just on the VACCO Space business. You gave a revenue number for it, but I was wondering, on average, what the profitability of that business looks like on a normalized basis?

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**Bryan Sayler** - *ESCO Technologies Inc - President, Chief Executive Officer, Director*

Yeah, John. I would say, we're probably not going to disclose that specifically. And honestly, we're still working on some of the carve out around that. But I would tell you, it's certainly below segment averages overall.

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**Jon Tanwanteng** - *CJS Securities, Inc. - Analyst*

Okay. Great. And the number that you're excluding from Q4 just in terms of the profitability erosion, is that the expected EBIT in the segment for Q4?

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**Bryan Sayler** - *ESCO Technologies Inc - President, Chief Executive Officer, Director*

It's -- it would be a potential delta of negative EBIT beyond kind of what's in that guidance of $410 million to $420 million.

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**Christopher Tucker** - *ESCO Technologies Inc - Chief Financial Officer, Senior Vice President*

And that's a risk item. It's -- we don't know that that's going to happen. We just wanted to make sure we clearly identified the kind of downside there.

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**Jon Tanwanteng** - *CJS Securities, Inc. - Analyst*

Okay. Can you tell us a little bit more about what's going on in the program that is having this additional cost and the nature of it?

**Bryan Sayler** - *ESCO Technologies Inc - President, Chief Executive Officer, Director*

Yes. So I think that we're still on the same path that we've been talking about for the last few quarters. We have a small number of firm fixed price development programs that we are working through. And so first of all, we're not taking new programs like that. So it's a finite number of programs and what's happening is that we've accepted some requirements that are a little more challenging than normal.

And so as we go into the Test and if the products are when they perform as expected, we're going to be fine. But if we do have additional go backs, it could cost additional money in terms of both engineering time and fabrication and test time. And so that's – what we're trying to do is put a kind of a bottom end on what that would look like.

**Jon Tanwanteng** - *CJS Securities, Inc. - Analyst*

Got it. Okay. That's helpful. Thank you. And then you brought on two new directors from the energy space or the utility space. So I'm just wondering, is that prelude to just a bigger focus on that segment, just given the power demands that we're seeing and growth that we're seeing in the next couple of years from all these EVs and data centers and everything that's going on?

**Bryan Sayler** - *ESCO Technologies Inc - President, Chief Executive Officer, Director*

Yes. So listen, our Board has a really wide range of experiences. And we've had a couple of Board members that have retired over the last year or two. So as the nominating governance committee was kind of going through and determining where do we have strengths and where do we have gaps.

One of the things that we identified is the big area of focus for us is going to be aerospace and defense. We've got really good coverage there. We've got three directors that have worked all sides of that, both at the big primes in the government side and at Tier 1 suppliers.

So we feel really good about our coverage on the A&D side, but we've only got one independent director on the utility side. And he's done a great job. He's kind of been instrumental in helping us build that segment out over the last seven or eight years.

But we felt like that bringing on two new Board members from that segment would be appropriate. And one of the things -- one of the characteristics of that is that folks out of that segment come with a broader set of cybersecurity skills and things like that, that we also found to be quite valuable.

**Jon Tanwanteng** - *CJS Securities, Inc. - Analyst*

Understood, thank you. I'll jump back in the queue.

**Operator**

Thank you. I'm showing no further questions at this time. I would now like to turn the call back to Bryan Sayler for closing remarks.

**Bryan Sayler** - *ESCO Technologies Inc - President, Chief Executive Officer, Director*

Did Jon Tanwanteng jump back in for questions?

**Operator**

Oh, I see he did.

**Christopher Tucker** - *ESCO Technologies Inc - Chief Financial Officer, Senior Vice President*

Yes, we're seeing one on the screen, yes.

**Operator**

Yes. Jon, your line is now open again.

**Jon Tanwanteng** - *CJS Securities, Inc. - Analyst*

Great, thanks. I was just wondering if you could talk about the test business and the incremental improvement you're expecting to see next quarter. I mean, you had some pretty good jumps from Q1 to Q2 and Q2 to Q3, but what kind of --what degree of recoveries do we think you can see that in those markets as we go forward?

**Bryan Sayler** - *ESCO Technologies Inc - President, Chief Executive Officer, Director*

Yeah. Listen, I think that as we've communicated a couple of times, the big downstrokes here were in China. And on the wireless side, we've kind of absorbed that now. The good news is we're seeing good growth out of the balance of the business, particularly in the US, particularly in our medical, in our EMP businesses. And the team has done a really good job of kind of taking cost out of the business and really refocusing on marginal returns. So in terms of expectations, what you should see is continued sequential growth for both revenue and margin. So I would kind of use that 16.5% is kind of your starting point and move up from there.

**Jon Tanwanteng** - *CJS Securities, Inc. - Analyst*

Got it, thanks guys.

**Bryan Sayler** - *ESCO Technologies Inc - President, Chief Executive Officer, Director*

Thanks Jon.

**Operator**

Tommy Moll, Stephens.

**Tommy Moll** - *Stephens Inc. - Analyst*

Hi, I figured out I want to follow up on your guidance for the full year EPS, you took a little bit out. And I'm just curious, was all of that delta explained by the VACCO space trends? Or were there any other factors driving that, Bryan?

**Christopher Tucker** - *ESCO Technologies Inc - Chief Financial Officer, Senior Vice President*

Yes. Tommy, this is Chris. That was the majority of it was kind of what was embedded in that third quarter. I mentioned in my comments, we took about a $2 million hit there in the third quarter versus what we had expected when we gave that guidance at kind of the beginning of the quarter. So that flows through the year. That's the bigger part of it.

And then I would say that the test business is a little bit weaker than whenever we laid out the guidance over the last quarter or so, not a big shift, but we've seen the fourth quarter come down slightly. We still expect some nice sequential improvement there, but just not as quite as much as we had baked in before.

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**Tommy Moll** - *Stephens Inc. - Analyst*

Okay. Thank you, Chris. And while we're at it, I might as well throw one in on Doble, hopefully not overstaying my welcome here. But it looks like you were up a little bit year-over-year and there were some puts and takes within the Doble umbrella.

So whatever insight you can provide for us there would be helpful. And at a higher level, I'm curious if we look across the utility end market this quarter, it does seem like there are more puts and takes this time around versus a quarter ago. And I don't know if you feel like that may be calendar/election uncertainty or if the end market may be slowing a bit. Just any kind of insight you have would be helpful.

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**Bryan Sayler** - *ESCO Technologies Inc - President, Chief Executive Officer, Director*

Well, yes, yes, I don't think there's been more or different puts and takes here. I think that within the Utility Solutions Group, you have seen some softening on the renewable side compared to the prior year. I want to restate the prior year was an incredibly explosive comp to comparison quarter for both orders and revenue. So on the renewable side, that came down a little bit.

Doble was up by a lot. And we're seeing just continued uptake on our services and our hardware as utilities are really pushing hard to maintain their current assets. They're facing big growth in demand and they're somewhat restrained on their ability to add capacity to their system. So what they're really focused on across the board is maintaining their current assets, and that really plays right into the wheelhouse for Doble.

So we've had really good growth at Doble. USG is up 8.5% over the prior year. Doble was up 7% and NRG was up 13.7%. So our perspective is that, that's going to continue. You mentioned the election. We get that question from time to time.

We -- it's one of many factors that we think about that could have an impact on our business, technical, regulatory, economic issues. And we've assessed it, and we frankly don't see a significant benefit or a significant threat to any of ESCO's businesses based on the outcome of the election. So bottom line is we're not rooting for anybody here, and we don't feel vulnerable either way it goes.

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**Tommy Moll** - *Stephens Inc. - Analyst*

Thank you, Bryan. I'll turn it back and appreciate the time.

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**Operator**

Thank you. At this time, I'm showing no further questions, and we'll turn it back to Bryan Sayler for closing remarks.

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**Bryan Sayler** - *ESCO Technologies Inc - President, Chief Executive Officer, Director*

All right. Thanks, everyone. I really appreciate you taking some time. We're excited about what's happening at ESCO, and we'll talk to you next quarter.

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**Operator**

Okay. Thank you for your participation in today's conference. This does conclude the program, and you may now disconnect.