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ESE - Q2 2019 ESCO Technologies Inc Earnings Call

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CORPORATE PARTICIPANTS

Gary E. Muenster *ESCO Technologies Inc. - Executive VP, CFO & Director*

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

Victor L. Richey *ESCO Technologies Inc. - Chairman, President & CEO*

PRESENTATION

Operator

Good day, and welcome to the ESCO Technologies Inc. Q2 2019 Earnings Conference Call. Today's call is being recorded.

With us today are Vic Richey, Chairman and CEO; Gary Muenster, Vice President and CFO. And now to present the forward-looking statement, 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 the amounts and timing of 2019 and beyond, EPS, adjusted EPS, EBITDA, adjusted EBITDA, cash flow, debt, growth, profitability, sales, costs, competitiveness, efficiency, productivity, tax rate, success in completing additional acquisitions and other statements, which are not strictly historical, are forward-looking statements under 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 risks 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 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 I'll turn the call over to Vic.

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Thanks, Kate, and good afternoon. As noted in the release, and as Gary will describe in more detail, we wrapped up the second quarter in a very solid manner by delivering 11% top line growth coupled with 22% growth in EBITDA and 58% growth in EPS on an adjusted basis with each of these exceeding our expectations. Additionally, I'm pleased with both our second quarter and year-to-date entered orders and how the order growth was spread nicely across our operating segments.

Our Test business was again a highlight as they delivered book-to-bill of 122% and over $103 million in new business through the first half of the year. Given our order volume, we increased our March 31 backlog by $53 million and 14% from the start of the year. Coupled with the strength of our year-to-date operating performance, this bodes well for delivering increased performance over the balance of the year and gives us confidence and support to comfortably raise our 2019 adjusted EPS guidance. Now I'll turn it over to Gary for a few detailed financial comments.

Gary E. Muenster - *ESCO Technologies Inc. - Executive VP, CFO & Director*

Thanks, Vic. During our February call, I highlighted that we began the year with our Q1 adjusted EPS beating the top of our guidance. And today, I'm pleased to report that our Q2 also beat expectations and increased substantially from prior year. This was accomplished through a combination of solid operating performance across the company supplemented by specific tax planning strategies, which lowered our current year effective tax rate versus previous expectations.

It's always great to start the year with the first half performance being stronger than expected as it takes a little pressure off of our historically higher second half loading. Plus given our year-to-date performance and our favorable outlook for the back half of the year, our confidence is reflected by raising our full year guidance, as Vic noted.

Additionally, I think the strength of our second quarter and 6-month results demonstrate the earnings power that we can generate at higher sales volume and continues to support our multi-segment, multi-industry strategy.

Now touching a few financial highlights from Q2 and year-to-date. Since the results of both years presented were impacted by several unique nonoperating items that we called out in previous releases such as the gain on the Doble building sale, certain restructuring and cost-reduction actions that we've undertaken and last year's impact of U.S. Tax Reform, I will once again focus my prepared remarks on the adjusted numbers as these are more relevant measures of our operating performance when compared to expectations and the prior year. Using these adjusted numbers is also consistent with our previous financial statement presentations and related commentary.

We reported Q2 adjusted EPS of $0.76 a share, which is $0.13 above the top of our guidance range of $0.58 to $0.63 a share, is well above the consensus estimate of $0.62 and is $0.28 or 58% above Q2 '18's adjusted EPS of $0.48 a share.

Looking back at our 3 most recent quarters. We wrapped up fiscal '18 with record Q4 operating performance. We followed that by delivering the highest Q1 sales, EBIT, EBITDA and adjusted EPS in our history. And now with Q2, we again increased these same financial and operating metrics by a meaningful amount.

While our tax strategies contributed nicely to our Q2 adjusted EPS performance. I'd like to point out that our Q2 adjusted EBITDA, which obviously excludes taxes, increased 22% over last year led by filtration and USG's outstanding performance.

Comparing our year-to-date performance versus 2018. We increased sales 8% with Filtration being up 16%. We increased our consolidated gross margins. We lowered our SG&A expenses despite ongoing cost inflation. We lowered our interest costs and lowered our income tax rate, all of these contributing to our 50% increase in year-over-year adjusted EPS through March 31. A special note, the increased profit percentages are well above the 8% increase in sales, which, as I said earlier, clearly demonstrates the earnings power we can deliver when we grow our sales.

Since the earnings release lays out the key points and highlights of our Q2 results, I'll dispense with repeating them here, so we can get to the Q&A.

So for my final comments on the quarter, with 5 months remaining in the year, I'm more confident with our full year outlook today than when we last spoke. And given the timing-related softness of our first half cash flows, I clearly see the opportunity to generate a significant amount of second half cash flow from operating activities, which will further reduce our debt.

Coupled with our credit capacity and available liquidity, we are well positioned to effectively execute on our M&A strategy and support our future growth, both organically and through acquisitions, all while remaining focused on ROIC and increasing shareholder value.

With that, I'll turn it over to Vic.

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Thanks, Gary. We had solid operating performance for the first 6 months across nearly all of our businesses with the only real soft spot being our packaging business and the renewal energy space at NRG, both of which are well understood, and we believe are timing related.

We just completed our annual mid-year planning and strategy meetings at each of our operating segments. And after being on-site and seeing the strength of where we are positioned in our various end markets and understanding our growth opportunities, I continue to feel confident that we are well positioned to deliver our projected long-term growth objectives through both organic means and supplemented by target M&A.

I'll now provide a little insight on each of the individual businesses. The aerospace, space and navy markets are all strong and look to remain that way for the next several years. Despite the current issues with the 737 MAX 8, aircraft manufacturers continue to ramp up productions across several airframes on which we have content. And the aftermarket and MRO markets remain strong. Additionally, we continue to identify new opportunities within our space business, and our outlook for increased submarine production shows solid growth for many years to come. The previously announced move of VACCO's space aircraft products to PTI, we expect to be completed by the end of the year.

Our utility business is in a solid position, and the recent acquisitions are making a meaningful contribution, especially Morgan Schafer and Vanguard. We continue to look for complementary businesses to acquire in the utility space, which have products and services that we can add to our expanding global distribution network. We're also investing heavily in internally developed hardware and software applications, which should ensure we remain the market share leader for years to come.

Doble recently held its Annual Global Client Conference in Boston and, once again, reported a record number of clients in attendance. Our customers came away with a high level of excitement as they were able to get an in-depth understanding of Doble's expanded products and solutions being offered as well as hearing about USG's new product road map detailing what's coming to the market over the next few years.

Regarding Doble's headquarter relocation, we expect to be in our new leased facility by the end of the calendar year, which allows us to co-locate all of our Boston area personnel in a single, purpose built facility. This consolidation will improve efficiency, enhance our competitiveness and enable us to better serve our customers.

Our Test business had a solid first half as the core business remains strong and the growth markets we're currently accessing such as 5G, electric vehicle motor testing and EMP shielding are all showing tangible growth.

The Packaging business had a relatively soft first half due to project timing and the disruption related to restructuring actions that we implemented at our European business, which are nearly complete. We remain confident in our ability to show meaningful operational improvement in the second half of the year and going forward.

On M&A front, there continues to be a lot of activity with opportunities being brought to us by investment bankers and with businesses that we've identified through our operating units. We remain hopeful that we will add to our portfolio before the end of the fiscal year. We've taken a prudent approach and not included any nonorganic growth in our remaining '19 outlook.

Our Board remains very supportive of our M&A strategy, and our current credit facility provides us with plenty of liquidity at a reasonable price.

In summary, we delivered a solid first half. The balance of the year looks good. And we're working hard to capture some additional upside.

Now I'll turn it back to the operator for Q&A.

Operator

(Operator Instructions)

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

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

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program. You may now disconnect.