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PRESENTATION

Operator

Good day. And thank you for standing by. Welcome to the fourth 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 Saylor, 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 - 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 security 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. The reconciliation of these measures to the most comparable GAAP measures can be found in the press release issued today on the company's website at www.escotechnologies.com under the link, investor relations.

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

Thanks Kate and thanks everyone for joining today's call. We are happy to give you an update as we close out another great year at ESCO. We are pleased with our fourth quarter and fiscal 2024 results. We hit a significant milestone this year with orders and sales, both eclipsing $1 billion. This is a great achievement, but we feel like there's still a lot of momentum in our business and in the markets we serve. So, while we feel great about 2024, we feel even better about the future.

Chris will run you through all of the financial details for the quarter and the year. But before we get to that, I want to give you a few comments on each of the segments. Starting with aerospace and defense, we continue to have a strong outlook here. As you saw in the release, we finished the quarter with record backlog of just over $600 million. The backlog growth in 2024 was substantial on continuing strength from commercial and military aerospace as well as continued strength of navy orders at VACCO and Globe.

Notably, we did make progress during the year on reducing past due backlog. That's been a big focus for our teams and it's nice to see this start to move in the right direction. Probably in anticipation of some questions we might get later, I'd like to address the Boeing strike. We did not see any impact in our fourth quarter and now that the strike is resolved, we do not anticipate any financial impacts to 2025.

There could be some movement between quarters as the business ramps up and things are rescheduled. But with the overall backlog strength that we have, we anticipate that the outlook for 2025 can remain intact. Next is our utility solutions group, where we had another good quarter and also another year of nice top line growth and margin improvement.

The sales growth here picked up a bit when compared to the third quarter and we were happy to see the margin expansion that the team delivered. Taking a second to parse out the different markets here, we see ongoing market strength on the regulated utility side of our business. The customer base here continues to increase its capital spending forecast in order to meet demand for increased electricity and they also have to be sharply focused on running their current assets as efficiently as possible.

These are both good trends for our Doble business. On the renewable side, the team delivered really nice orders and sales growth in the fourth quarter. We are still positive on our outlook here as we feel renewables will continue to have a role to play as overall demand for electric power increases. Finally, I'll touch on our test business. We are really happy with how the year turned out. We saw a nice sequential improvement from the business as we move through the year.

Certainly, the growth here is less than our other two businesses, but the team responded quickly when the business softened up at the beginning of the year. We saw profitability recover and we also saw sales increase sequentially as each quarter progressed. The good news is that we've seen strong activity from our medical and industrial shielding customer segments of the business. And when the key wireless markets begin to recover, the team will be ready to capitalize on that activity.

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

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 have the overall financial highlights of the fourth quarter. Starting with orders, where you can see we had a decline of 15% in the fourth quarter. We will go through the segment details in a moment, but the decline was driven by the aerospace and defense group which had a tough comp with high navy orders in last year's fourth quarter.

And it should be noted that we ended the year with record backlog of $879 million. Sales in the quarter were up 9.5% which was comprised of 8.5% organic growth and one point of growth from the MPE acquisition. Adjusted EBIT margins were up 130 basis points to 17.4% with margin increases from all three segments. Adjusted EPS was $1.46 per share, an increase of 17%. Guidance was for $1.38 to $1.48 per share which excluded potential profit erosion from the VACCO Space business of $0.15 to $0.21 per share.

The actual erosion was at the high end of the range or unfavorable $0.21 per share. So, it was great to close the quarter at $1.46 per share on an adjusted basis inclusive of the issues in our space business. Next is chart four which covers the aerospace and defense business.

As mentioned previously, we had tough comparison here to last year's fourth quarter orders. So, we show a sizable drop, but you can see at the bottom right of the chart for the year we ended with backlog of just over $600 million, an increase of 24%. So certainly we still have good momentum inside of the business. Sales in the quarter were up 16%, tremendous growth from navy, commercial and defense aerospace. Adjusted EBIT was also quite good, improving 160 basis points to 19.4% of sales, really good performance across the group that was able to more than offset the project profitability issues mentioned previously in the VACCO Space business.

Moving on to chart five, we have the Utility Solutions Group, a really solid quarter here with orders up 2%, sales up 6%, and adjusted EBIT up 70 basis points to 26.4% of sales. Total sales growth was 6% as we saw continued growth from service offerings and condition monitoring products. Additionally, the renewables business had a strong quarter with sales growth of 9%.

The sales growth overall helped drive the margin improvement, so it was a good close to another strong year for the utility solutions group. Next is chart six and the test business. Overall, it was a really nice quarter for test. Orders were down 8.5%. The backlog ended at $159 million, which is a slight increase compared to September of 2023.

Importantly, we saw sales growth and adjusted EBIT improvement in the quarter. Sales were up 4% with organic sales down slightly, and the MPE acquisition adding approximately five points of growth. Margins increased by 80 basis points to 18.3%, a really nice result as the team's quick action earlier this year on cost reductions has helped mitigate the impact of lower volumes.

We have been watching for sequential improvement from this business throughout 2024 and the fourth quarter continued that trend nicely. Moving on to chart seven which summarizes the full year financial highlights.

It was another record year for ESCO and this chart illustrates that very nicely. All the bar charts across the top of the page here show really nice trends with orders up 10%, sales up over 7%, adjusted EBIT up 14% and adjusted earnings per share up 13%.

The order growth was led by the Navy and the aircraft component businesses and ending backlog was up over $100 million or 14% compared to prior year end. Sales growth was led by aerospace and defense with a 14% increase. The Utility Solutions Group was also quite strong with an increase of 8% coming after two strong years in '22 and '23 for that group. Notably, sales exceeded $1 billion for the first time in ESCO's history.

An important milestone that we're excited to build on. Profitability metrics were strong, with good margin improvements from A&D and utility which were somewhat offset by a drop for the test business. Next is Slide 8, with cash flow highlights.

We finished the year very well in operating cash flow and the full year came in at over $127 million. This was a substantial increase from last year as earnings growth and working capital performance drove the increase. Capital spending finished the year at just over $36 million, with the increase primarily from the A&D businesses who are investing to support their strong growth outlooks. Acquisition spend increased this year with the MPE transaction being a bit larger than the CMT deal that was closed in 2023 and share repurchases moderated somewhat compared to 2023 and were $8 million in 2024.

The final chart will be our guidance chart for 2025. You can see from the charts at the bottom that we've had a nice trend in sales and earnings over the last couple of years. And we expect that to continue this year with sales growth in a range of 6% to 8% and adjusted earnings per share growth in the range of 12% to 17%. By segment you can see we expect high single digit sales growth for the A&D and USG segments next year. For test, the growth is a bit more subdued at 3% to 5%, as we expect growth for medical and industrial customers to be somewhat offset by continued softness in the wireless market. We are driving for double digit growth in both EBIT and EBITDA for 2025 and that gets us to the full year adjusted EPS range of $4.70 to $4.90 per share.

Also for the first quarter, we expect adjusted earnings per share in the range of $0.68 to $0.75.

Lastly, I want to be clear that this guidance is based on how the company is currently configured. That means no impact from the SM&P acquisition and no impact from the strategic review of the space business at VACCO.

We are hopeful that the SM&P acquisition can close in our fiscal second quarter, but since the timing is uncertain, we will wait and provide an update, an updated outlook after closing. That concludes the financial portion of the call and now I'll turn it back over to Bryan.

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

Thanks Chris. So, as you can see, we had another good quarter and are 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 moving to Q&A, I wanted to give a quick update on the signature management and power acquisition that we announced back in July. Chris touched on this a minute ago, but I want to let everybody know that we have completed the required regulatory filings in both the United States and the United Kingdom.

And as was mentioned in the press release, conditions for closing in the US have been met. We're still waiting on securing the UK approvals and are optimistic that this process will be successful in the near term. Timing is always hard to predict on these things, but we're hopeful of getting a deal done in our second fiscal quarter and we'll keep you all updated as we get news on that front.

As I said last quarter on this call, signature management power is a very exciting deal for ESCO as we bring on a talented group of employees and expand our capabilities to serve the growing Navy market in the US and in the UK. That concludes the opening remarks and we can open up the lines for question and answer period.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions) Tommy Moll, Stephens Inc.

Tommy Moll - *Stephens Inc - Analyst*

Good afternoon and thank you for taking my questions.

Hey, Tommy, Bryan, I wanted to start on the A&D outlook you provided for the 7-9% growth in the coming fiscal year. You mentioned on Boeing that there shouldn't be any big impact for the full year. But I also suspect that you may have some conservatism embedded in there, just given the state of play. So, if there's anything you can do to unpack your commercial arrow assumptions that would be helpful. Thank you.

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

Well, yes, I would say that we've always been prudent to forecast at a build rate that's a little bit less than the published build rates that Boeing puts out. And frankly, that's because historically, you know, they have been underperforming that a little bit. I think there is impact, or there could be some impact on the Boeing specific contracts this year, but we feel confident that we'll be able to offset that with work from other customers. Two of our businesses did work down their past due backlog, so we're running a little bit closer to their requirements at this point. Listen, we're rooting for the guys at Boeing. We think they're going to get this squared away with the strike behind us. I think that the path is clear to see good growth this year and we would expect to see significant growth in the years to follow.

Tommy Moll - *Stephens Inc - Analyst*

Thanks, Bryan. And Chris, I wanted to circle back to your comments about what the fiscal '25 guidance excludes, which is helpful context specifically on the SM&P.

It's excluded for now, but presuming you close in fiscal second quarter at some point, you'll need to adjust, and I just want to make sure we're prepared with whatever information you can provide. Originally, when the deal was announced, you indicated it would be accreative in the first year, excluding the one timers and excluding the M&A amortization.

So I guess it's a two part question there. Do you anticipate that when you do update guidance, you'll do it accordingly, excluding both of those items, that's [0.1] and then [0.2]. Chris, you'll have only a partial year impact from the asset once you fold it in, and so if there's anything noteworthy in terms of the seasonality there that we should be prepared for, that might be worth mentioning as well. Thank you.

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

Yeah, I would say Tommy, we definitely when we give you the, the updated guide inclusive of the acquisition, we'll break down the components there. So, you'll understand, you know, kind of the acquisition amortization and other sizable impacts on the outlook. As far as seasonality, you know, we don't, there's nothing there I would highlight right now.

And again, if there, if we need to kind of flag that for you, whenever we do give guidance that there's going to be a ramp through what's left of the year or any other unusual dynamics, you know, we'll certainly let the let you guys know about that as we issue the guide, but we don't have anything to flag there today.

Tommy Moll - *Stephens Inc - Analyst*

I resisted asking if you'd like to adjust any of your underwriting assumptions, post elections, but we'll just sit tight and see how it goes. I'll step back.

Operator

John Franzreb, Sidoti and Company.

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

Good afternoon, everyone and thanks for taking the questions. I'd like to pivot over to the test business and your assumptions of 3% to 5% growth. Is there any expectations there of better results in China embedded in that outlook?

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

We have not been embedded significant improvement in China. I think we're you know, things are still, I would say relatively uncertain over there. So, no, we have not baked in a big turnaround or anything like that there. We think it's going to be steady as it goes. Longer term, I think there is an opportunity for some improvement there, but we haven't baked that in the forecast at this time.

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

And I'll put an administration change question out there in utility and NRG, What's the thought process of maybe a less friendly administration towards, you know, renewable energies? How do you kind of think about that on a go forward basis?

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

Sure. Well, so listen, we start by thinking about the underlying market demand, which is steadily increasing. And so regardless of policy, the market is requiring more electrification, more build out of generation, more, build out of transmission. So, we think of that, you know, but that's really reflected on the regulated utility side of our business. What we're seeing as we watch, what our customers are doing from a capital investment perspective, they're steadily increasing, you know, those investments.

And, as we watch that, I think you're seeing a more balanced approach from them with a good mix of new gas assets, new solar assets, and in some cases some wind assets. But, on the renewable side, I think there is a little bit of a threat that the incentives that are in place with the IRA could be diminished. But we do think that renewables will have a role to play.

In the meantime, the most imperative thing for our customer base is really to get the most out of the assets that they already have. And that really plays very, very well to our utility solutions group story. And, we anticipate continued growth in all of those markets regardless of what the policy changes might be.

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

I tend to agree and just a question on the adjustments on what line items are they coming out of the debt refinancing and the restructuring. Are they all coming out of SG&A or is there a mix there and SG&A and cost of consult?

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

Yeah, there's a mix and actually the debt financing hit the interest expense line. So, we had to pay for our you know, kind of revolver backstop and for a kind of a bridge loan to kind of show our committed financing when we announced the acquisition. So those items were worth about $3 million and hit the interest line and then on the restructuring side that's going to hit OI/OD. So that comes in at the EBIT line. So, those were the two main places where you saw the adjustments come in this quarter.

Operator

Jon Tonwanteng, CJS.

Jon Tanwanteng - *CJS Securities, Inc - Analyst*

Hi, good afternoon. Thank you for taking the questions and really nice performance even with the space headwind that you had. If I could, I was asked to dig a little bit more into that. Do you think you've completely run through all the issues there? And that Q1 should be a clean quarter? Or is there more to work through, number one and number two, what are the prospects for the business you know, just where are you in the strategic review?

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

Sure. Well, listen, we've been making really steady progress on these troubled development, you know, fixed price development contracts. We've been working through, a few of those are behind us now. We’ve still got a couple that we're working on, but the good news is that we're actually delivering product now. And so we have a solid basis for really being able to estimate the cost on a go forward basis.

And so we've adjusted all the EACs accordingly. So we're no longer anticipating, you know, what's it going to take to develop the thing? We're now working on, you know, what's the cost to produce a product? And it's a little bit higher than we had originally estimated, and that's why the EACs had to be adjusted. So I would never tell you that there's zero risk, but we do believe that the risk has been largely mitigated. After your second question, you know, we did take a really deep look at the business throughout the most recent quarter with a view towards what it would it take to split the business up into two.

And, frankly, we came to the conclusion that we can't do that economically or efficiently. And so now, really the question is, you know, what are our options going forward? And we're considering whether we would sell the entire VACCO business. We don't have an answer to that question today, but we believe that by the time we get back together with you in February, we should have an answer to that question and be able to communicate what our plans will be going forward.

Jon Tanwanteng - *CJS Securities, Inc - Analyst*

Okay, great helpful. Thank you. And maybe just to add on to the administration question, is there a little bit more risk to VACCO space with the administration change and kind of how it might support NASA or private contractors that are out there?

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

I would say in the very long term, there could be some risk. I mean, we, our backlog is really solid for, you know, really for a few years to come. But in the very long term, I think there could be some risk to the SLS program.

Operator

Josh Sullivan, Benchmark company.

Josh Sullivan - *Benchmark Company - Analyst*

Hey, good evening.

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

Hi, Josh.

Josh Sullivan - *Benchmark Company - Analyst*

Just as far as the A&D outlook for '25, what are you assuming on the aftermarket growth side? You know there's a growing conversation around momentum transitioning from aftermarket to OEM. I'm just curious about what you're you're baking in the '25 there.

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

Sure. as you know, the navy part of our business doesn't have a substantial aftermarket. So, we're really talking primarily about commercial and military aerospace. The part of our business that has the biggest exposure here would be our PTI business where we make, you know, the aftermarket filters that go on things like Black Hawk helicopters and things like that. And then our Mayday business where we build bushings that are used in the rebuilds and maintenance of landing gear systems and that sort of thing.

We are putting on a pretty significant effort to grow those pieces of business and we do anticipate that we'll have some success. You know, as an example, just, you know, an anecdote, the 787 aircraft are kind of getting to that age where they need to have a full rebuild of their landing gear systems. And we're targeting that, that's a pretty significant ship set content for us each time one of those happens, we've already won a few of those and we think that that's going to be a big driver for the Mayday business.

Josh Sullivan - *Benchmark Company - Analyst*

Got it. And then maybe jumping over the naval side of the outlook, you know, there seems to be an issue with some of the larger ship builders just getting the labor they need, you know, negotiating with the Pentagon for higher wages to attract the talent that they need.

But from a supplier perspective, it seems like the suppliers that have longer lead times are weathering, you know, the, the issues a little bit easier than others. You know, just curious, maybe if you're seeing any impact to that right now or whether you kind of fall into that group with some longer lead times and it's not as big of an issue.

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

Yeah, we're not seeing any impact at this point. What we're being told is to go as fast as we can. You know, we are not yet, we have not been building at the rate that they're targeting. So, we, you should anticipate some acceleration in our you know, in our build rates that will be reflected in revenues going forward.

We are seeing some backfit opportunities and things like that could be meaningful on the navy side, there's always navy spares and that sort of thing. But listen, we don't believe that there's any reason that you'll see a slow down in our business as a result of some of the things you might be hearing from the primes right now.

Josh Sullivan - *Benchmark Company - Analyst*

And then just one last one just on the S&P acquisition. I mean, what, what is the big large tent pole and, you know, to get over to close the deal at this point? Anything we should be watching out for.

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

Yeah, you may be aware that in the United Kingdom, back in '21 or '22 they implemented a new law called the National Security Infrastructure Act and that requires them to do a comprehensive and detailed strategic review of any acquisition that has national security implications. And obviously as a submarine builder, you know, that this certainly is implied there. So they, they normally will take at least 30 business days, after receiving our inputs. We've had a back and forth with them. We're kind of in a period now where I think that they are reviewing our responses to them and we would anticipate hearing from them in the next probably 30 days. They do have a unilateral right to extend that review period additionally. And so nothing out of the ordinary here. We don't anticipate there being a problem but it's kind of moving forward at, you know, what feels to us like you kind of normal, you know, bureaucratic pace.

Operator

Thank you. I would now like to turn the conference back to Bryan Saylor for closing remarks, sir.

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

Well, listen, everyone, thanks for the update. We're really excited about the prospects for our business. I want to extend our thanks to our entire, you know, worldwide team of employees who have worked really hard to make these results and are going to continue to work hard to build our business into the future. Thanks a lot for the time today.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.
