Operator: Good day, and welcome to the Allied Motion Third Quarter 2022 Conference Call. All participants will be in listen-only mode. After today's presentation, there will be an opportunity to ask questions. Please note this event is being recorded. I would now like to turn the conference over to Craig Mychajluk, Investor Relations. Please go ahead.

Craig Mychajluk: Thank you. First off, I just want to apologize to everyone for the delay. We had some technical difficulties. We certainly appreciate your time today as well as your interest in Allied Motion. Joining me on the call are Dick Warzala, our Chairman, President and CEO, and Mike Leach, our Chief Financial Officer. Dick and Mike are going to review our third quarter 2022 results and provide an update on the company's strategic progress and outlook, after which, we'll open up for Q&A. You should have a copy of the financial results that were released yesterday after the market closed. If not, you can find it on our website at alliedmotion.com, along with the slides that accompany today's discussion.

If you are reviewing those slides, please turn to Slide 2 for the safe harbor statement. As you are aware, we may make forward-looking statements on this call during the formal discussion as well as during the Q&A. These statements apply to future events that are subject to risks and uncertainties as well as other factors that could cause actual results to differ materially from what is stated on today's call. These risks, uncertainties and other factors are discussed in the earnings release as well as with other documents filed by the company with the Securities and Exchange Commission. You can find these documents on our website or at sec.gov. I want to point out as well that, during today's call, we will discuss some non-GAAP measures, which we believe will be useful in evaluating our performance. You should not consider the presentation of this additional information in isolation or as a substitute for results prepared in accordance with GAAP. We have provided reconciliations of non-GAAP to comparable GAAP measures in the tables accompanying the earnings release and slides.

With that, please turn to Slide 3, and I will turn it over to Dick to begin.

Dick Warzala: Thank you, Craig, and welcome, everyone. We delivered strong results during the third quarter, which demonstrated the power of our strategy as our global teams executed very well in a challenging macro environment. We continued to leverage our diversified end market mix, benefited from new solution offerings, both organically and inorganically, and further developed our One Allied global platform to drive record sales.

Third quarter revenue grew 30% to $134.4 million, with strong organic growth of 15% on a constant currency basis. While we have seen broad-based demand across each of our target markets, two were the primary drivers of our growth. Aerospace and defense revenue grew 159%, due to incremental demand from acquisitions, defense program timing and solid organic growth. Revenue from industrial markets was up 39% in the quarter, benefiting from new solutions offerings, acquisitions and strong end market demand with industrial automation, pumps, and oil and gas.

We continued to strengthen our margin profile despite ongoing macroeconomic headwinds. We delivered gross margin of 32.2%, which represented a 130 basis point increase from the year ago period. Operating income grew 35% to a record $11.7 million with a margin of 8.7%, and adjusted EBITDA margin expanded 80 basis points to 14.8%.

While our recent M&A activity is certainly helping, we also equate this performance to our global teams that continue to manage supply chain issues and inflationary pressures on logistics, energy, material and labor.

We achieved adjusted net income per share of $0.60, which was up 22% from $0.49 per share in the prior-year period.

We continue to have a solid pipeline of opportunities and are encouraged with coating and order levels from each of our target end markets.

The integration of our recently acquired businesses has progressed well. Each have enhanced our value proposition and we are working hard to maximize the opportunities and realize the full potential of these margin-enhancing businesses.

And with that, let me turn it over to Mike for a more in-depth review of the financials.

Michael R. Leach: Thank you, Dick. As a reminder, our results include the acquisitions completed during the fourth quarter of 2021 and the second quarter of 2022.

Starting on Slide 4, we provide some detail regarding our top line. Third quarter revenue increased 30% to $134.4 million, a record level, which reflected strong demand in the A&D and industrial markets as Dick discussed and incremental sales from acquisitions. The unfavorable impact of exchange rate fluctuations on revenue was $7.2 million in the quarter. Excluding FX, revenue was up 37% and organic revenue growth was 15%.

Revenue in the vehicle and medical markets each grew 4%. Vehicle market sales growth reflected higher demand from the commercial automotive and trucks, while Medical markets have now largely lapped pandemic-related sales and are benefiting from the return of elective surgeries and recent acquisitions. The distribution market, while a small component of our total revenue, increased 25% during the quarter.

Sales to U.S. customers were 59% of our total compared with 56% in last year's period. The balance of sales was to customers primarily in Europe, Canada and Asia Pacific. The shift in mix continues to reflect the impact of our recent acquisitions that largely sell to the U.S. market.

Slide 5 shows the change in our revenue mix by market on a trailing twelve-month basis. Sales to Industrial markets were up 39%, driven by the verticals noted on the slide. Industrial has seen nice growth over the last year and now makes up 38% of our total sales. Our second largest market is Vehicle, which contracted 4% as strong truck and agricultural vehicle demand was offset by broad supply chain challenges in other market verticals. Medical market revenue was relatively flat on a TTM basis, reflecting similar impacts as the third quarter. And as noted, while acquisitions contributed to the Aerospace and Defense growth, we are driving solid organic business and benefiting from some defense market program timing.

As depicted on Slide 6, our gross profit was 32.2%, up 130 basis points from the year ago period and down just 20 basis points from our record high achieved last quarter. Higher volume, pricing and margin accretive acquisitions more than offset continued global supply chain disruptions, rising material and labor costs. Consistent with our stated objectives, you can see the progress we are making in the annualized chart on the right.

Moving on to Slide 7, third quarter operating income reached a record $11.7 million, or 8.7% of sales, compared with $8.7 million, or 8.4%, in the year ago period. Operating costs and expenses as a percent of revenue were 23.5%, up 90 basis points, largely attributable to our M&A activity with step up amortization expenses as well as added engineering and development costs that we have not yet fully leveraged.

Helping to offset was the leverage gained on the SG&A line, which decreased 60 basis points to 13.9% of revenue, our lowest level in more than three years. As we have stated, we anticipate growing our margins over the long term with the disciplined execution of our lean toolkit, AST, combined with leveraging higher volume.

On Slide 8, we present our bottom line and adjusted EBITDA results. Our GAAP net income and diluted EPS have been adjusted for certain items, including amortization of intangible assets related to acquisitions. We believe that adjusted EPS provides a better understanding of our earnings power, inclusive of adjusting for the noncash amortization of intangible assets, which reflects the company's strategy to grow through acquisitions as well as organically.

Third quarter adjusted net income was $9.7 million or $0.60 per diluted share. That was an increase of 22% over the adjusted $0.49 per diluted share in the prior year period. The effective tax rate was 27.5% compared with 24.6% as the prior period included a discrete benefit for an investment tax credit. We expect our income tax for the full year 2022 to be approximately 25% to 27% based on changes to the geographic mix.

Adjusted EBITDA increased 37% to nearly $20 million, or 14.8% of revenue, which was up 80 basis points. We use adjusted EBITDA as an internal metric and believe it is useful in determining our progress and operating performance.

Slide 9 and 10 provide an overview of our balance sheet and cash flow. Total debt was approximately $232 million at quarter end. During the second quarter, we used about $45 million in cash to complete three acquisitions, net of cash acquired, which was largely funded with debt. The debt increase also reflects the new finance lease that we highlighted during the first quarter of 2022 for a manufacturing facility expansion to support continued growth. At the end of the third quarter, debt net of cash was about $212 million or 51.3% of net debt to capitalization. Our bank leverage ratio was approximately 3.75x.

Based on our cash flow projections, we expect to deliver over time in a manner that aligns with and is consistent with our historical performance.

So far this year, we have utilized $5.8 million of net cash from operations and invested $11 million in capital investments, which largely focused on growth opportunities and new customer projects. As we round out the end of the year, and based on the pace of some projects, we have refined and slightly lowered our 2022 CapEx expectations to range between $14 million and $18 million.

Inventory turns were 3.1x in the third quarter, up slightly from our 2021 performance as our teams continue to manage our inventory to meet increasing customer demand, combat sourcing and lead time challenges. Our DSO saw a jump to 55 days in the quarter, largely due to timing and mix of customers.

With that, I will now turn the call back over to Dick.

Dick Warzala: Thank you, Mike. Our backlog and bookings remain solid as highlighted on Slide 11. Orders were more than $126 million in the quarter, representing a book-to-bill ratio of just under 1x. This level also reflects a noted FX headwind of $7.3 million.

Our backlog was up 67% over the prior year period, although we saw a 4% decline from the sequential second quarter, which reflected the loosening of some supply chain constraints. The time to convert the majority of backlog to sales is within the next nine months. While there are still some components with long lead times, generally speaking, we are starting to see some stabilization within our supply chain.

Turning to Slide 12 for our outlook, we are a stronger company today and expect to see further benefits as we leverage the full potential of our recent acquisitions.

As a reminder, our M&A strategy has delivered approximately $100 million annually of new business to our platform that will be fully realized in 2023 with an incrementally higher margin profile.

Equally important, we have created a stronger long-term competitive position across our targeted markets.

Specifically, demand is expected to continue at relatively strong current levels across our many industrial end markets. Overall, our Vehicle demand has been stable with the most significant increase in volume occurring in our automotive market. This is an indicator that the supply chain is improving as demand schedules from our customers continue to firm up for 2023. Medical markets have largely lapped the strong pandemic-related levels and should continue to be solid. Aerospace and Defense will be bolstered by our recent acquisitions and we anticipate further organic growth given our exposure and program participation.

As a reminder, in the past, we did experience seasonality in demand reflecting modest reductions in our fourth quarter shipments. This was primarily due to the typical holiday shutdowns and customer inventory adjustments occurring in December. Now that business conditions seem to be normalizing, we may see some minor seasonality creeping back into the business in Q4.

We will continue to innovate and invest in each of our target markets as the various end markets within each offer significant opportunities for long-term growth. While the global outlook may have softened, we continue to remain highly confident in our ability to navigate through these unique challenges. We will stay focused on executing our strategy and serving our customers while continuing to capitalize on opportunities to drive growth and improve our operational execution throughout the company to deliver enhanced earnings.

With that, Operator, let's open the line for questions.

Operator: [Operator instructions.] Our first question comes from Greg Palm with Craig-Hallum Capital Group.

Greg Palm: Congrats on the good results, especially in light of some severe FX headwinds. Could you maybe just start with a broad commentary on the demand landscape? Are you seeing anything out there that gives you caution? The bookings were still strong and your initial commentary suggests that things are still holding up. I just wanted to dig into that a little bit further.

Dick Warzala: Sure. I would tell you that, again, our bookings are continuing to stay fairly strong. As we mentioned, there has been some reduction sequentially, quarter over quarter, and all along we have been saying that we would expect that some of that would start to occur as deliveries were getting back to normal, lead times were becoming more predictable and the supply chain was improving. All of those are occurring and, in light of all of that, we are still seeing some robust demand going forward.

Greg Palm: On the supply chain, specifically, what pain points are still out there? In the past, you have been able to quantify some of that impact to margins. Has that normalized at this point or are you still seeing some margin headwinds related to supply chain that could further boost margins from here, assuming they abate?

Dick Warzala: Electronic components have been the major challenge throughout the company, with the shortage in supply, very long lead times and everyone attempting to get into the pipeline and scooping up the parts that are out there. This caused some very significant PPDs with regard to specific components when you had to go to secondary markets. We are still seeing some of that; however, I would say that it's the exception now, While, previously, the floodgates were open and we were battling a significant number, now it's not happening as frequently, but it still happens. As I mentioned, we are seeing the supply chains improving. We are starting to see reliability of delivery, and we are seeing more signs that our customers are experiencing the same thing, because they are not getting their components, they are not placing demand for us in the overall assembly. Therefore, we are starting to see that stabilize. I would say, overall, it is definitely improving. It is not just electronic components. At times, we are running into specific issues. In addition, I would say to you that COVID has not gone away. We have experienced in a couple of instances where there has been an uptick at our suppliers where demand has slowed down. We have also seen where some value decisions have been made by suppliers, meaning that they're going end of life on certain types of commodities or products and they're giving you long notices, but you're scrambling to find an alternative that could be approved by customers. It has not totally gone away, but it has definitely improved.

Greg Palm: Yes. Understood. On the margins, the operating leverage has become impressive. Moreover, I think the EBITDA margin was definitely the highest quarterly amount since we have been following the company. Nevertheless, just broadly speaking, as you look ahead, how sustainable is that? I know that has been a focus point over the years, but it seems like, the last couple of quarters, you have really broken out to the upside, partly just due to some internal initiatives, but the acquisitions probably help just given their higher margin in nature, right?

Dick Warzala Yes. I will let Mike speak to that.

Mike Leach Yes, Greg. We definitely have seen that movement and we do think it is sustainable. Obviously, part of that is the gross margin expansion, but we are leveraging more effectively. I think we have been broadcasting all along, right, that will be part of the margin expansion that we have been talking about. I would tell you that we still have a ways to go, we think, in the sense that we do have backlog that is tied up and some of the acquisitions are not yet being fully leveraged. That we expect to see at some point in time, just given pushing additional revenue across. I would caution you that, as Dick noted, we do expect to see some level of seasonality in the business return; that was very common in the past. That will ultimately effect, on a singular quarter basis or potentially in Q4, our ability to leverage those costs. However, generally speaking, yes, we expect to continue to drive leverage in those over time

Dick Warzala: Yes, and to add on to what Mike said here, I would like to emphasize the fact that we're not where we think we could be. We think there is significant room for continued improvement.

Greg Palm: How much of that is a by-product of just volume continuing to increase revenue versus additional internal initiatives that can help drive further margin improvements on their own?

Dick Warzala: Certainly, volume is going to help that, but we are utilizing, as we have said in the past, our AST tool set to drive out cost. We've been focused on rationalization activities with our manufacturing footprint and are starting to see some gains there. So, we think there are multiple paths there that we'll leverage.

Operator: Our next question comes from Gerry Sweeney with ROTH Capital Partners

Gerry Sweeney: I have a question around engineering development acquisitions. You are adding a lot of technology around solutions and, I think, that is where you want to drive the company longer term. I was just wondering if you could give a little bit of detail on how these efforts maybe have changed your positioning over the last couple of years. You made a series of acquisitions that I think really position you well. I am just curious how that's driving revenue, backlog, how the integration of those acquisitions is going and where this could take you, 12, 18, 24 months out?

Dick Warzala: It definitely was, and is, a focus within the company where we saw six acquisitions within the last twelve months. As we mentioned, some of those acquisitions were more technology-oriented versus adding a large revenue base. What is exciting, Gerry, is that putting together the plans going forward here into next year and beyond is when we look at, let's just call it, a market-specific opportunity. We look at all of the technology that we can bring to bear in terms of products and our solutions and it just continues to expand. In the past, we would look at it and say, 'okay, we can put a motor in there, maybe a motor and a gearbox, and maybe some electronics.' Now, the whole solution set has driven much higher, at a much higher level, where we are talking in terms of value per solution in a particular application. That is the way we are looking at it, the whole combination. It is very exciting to see how the One Team strategy is really pulling together across all the TUs and across all technologies and how the commitment that we made and the investment we made and what we call get the global engineering team to pull it all together.

First off, to standardize and establish platforms of building blocks that we could utilize and leverage; secondly, to really come up with leading-edge solutions. So, we've identified areas of opportunity where we think we can bring a unique solution to the market that the market may not even see or understand yet. In addition to that, existing applications where the incremental or increased value of what we could bring to each unit we are selling is significant. And so, it's definitely an exciting change in the company. If you went back three or four years ago and looked at the programs or projects we were working on, they were very exciting; nevertheless, if you look at them again today, you'd say, wow, it's really incredible. Our Board does travel to our operations, and we rotate that. We are very interested in letting our Board meet management at different facilities to get their inputs, what they are doing and have a one-on-one conversation to better understand where we are headed. The Board has mentioned that they can see that culture driven throughout the entire company. Whether it is a corporate support function, a technology unit itself or a centralized solution center, it is the same and it's consistent. That is what is really exciting. Again, with doing six acquisitions, the integration piece became very important and had to be handled quite a bit differently. We do one or two a year and it is quite simple; it just happens naturally. Well, in this case, we had to drive the process, so you have seen a substantial uptick in the training side of it. You're starting to see changes that are going to be made to the website to prepare ourselves and the market for who Allied is today and who Allied will be in the future. I think it is very exciting. You can think about one of the smaller acquisitions where, let's call it, a technology play, with a lower level of sales and limited resources, to go out there and penetrate the market to generate more opportunities in sales. Well, they get on a training session and there is 150 people sitting on the other end from within Allied and, all of a sudden, you have tentacles reaching everywhere. The excitement is quite high and what we have to do is manage that to ensure that we are focused on the right opportunities as a company. So, it is moved from acquisition to a high focus on integration and on making sure that we are picking the right opportunities to really invest the money from a corporate standpoint and there's no shortage of those. So, it's really exciting times.

Gerry Sweeney: Yes. Does this change how you go to market in terms of sales or is it just a gradual process?

Dick Warzala: That is a great question. It will not change because we're not eliminating. We are not against our custom developments and most of our work is custom. We actually have standard platforms that we build off of that we can leverage, but it really is tailored to an end user or an end customer. That's not going to change and the way we go to market with that will not change. We have been successful at it and we'll continue to be. I say it's a very good question, because, as you get into the higher levels of sophistication in terms of system integration, there's a different skill set necessary. Systems engineering becomes a more important part of that process. Program management becomes a more important part of that project and program. So, you do see that we're adding resources in certain places and realignment of technology units and our operations to better support that. That is actually what we're working on internally as we move into 2023 and later this year, all part of the integration process. We have the distribution channel that was opened up in between TCI and Spectrum with Rockwell Automation, and their automation fair will be there, and I know that there are opportunities for more folks, not just Rockwell, but others that have brought to the systems integrators and the automation companies that we're working with. Also, we have to say that it's the higher-level systems integration, system engineering and program management that will change how we go to market for those opportunities. That is what you're starting to see as we go through this integration process with everybody becoming familiar as we're laying out those plans moving into the future, and we're getting really focused on some significant major opportunities that leverage technology from several of our technology units.

Gerry Sweeney: I'm not sure how to ask this question, but, if we were to sit here and track this evolution, how much component sales were of revenue, we'll say, two or three years ago versus component sales versus solution sales today? Would that be an adequate or appropriate question to ask to see how you're moving along with this transition, knowing that you're not getting rid of some of that component sales?

Dick Warzala: You are correct. Here is the challenge and what we are seeing internally. What we called the system sale three or four years ago is something we would call a component sale today, having a motor and gearing. We would have said that was a system sale, with motor, gearing and some embedded electronics. The system sales that we talk about today are much more sophisticated. There is software development that goes on. There is multi-access control. There is all kinds of IO support. There could be many types of motors. It could be composite materials for light weighting in vehicles. So, what we called the system before, we now look at it and say, "that's no longer a system." That became a way of life where we had to train our sales force to say, "Hey, you're not just selling a motor. You're selling a motor and gearing and feedback and control or drive electronics." That became a way of life. So, in many cases, what we called the system before perhaps we look at as a component today and the real true higher-level system integration that becomes a part of either a machine or a process.

It is much more sophisticated, we are much more embedded in the logic, and the value of that is much higher. There is some incredible knowledge that goes into their software development and it really does drive the value. So, what might have been, let's just say, a $1,000 sale could now be $3,000 sale, a $50,000 sale could be a $100,000 sale and beyond that. That is really what the difference is. So, to answer your question, if we go back to our original definition, we would tell you that more than 50% of our sales are solution-oriented, but really, it's approaching more like 60%, 70% in the future as we're looking at these major programs that we're investing in to go after, with much higher value content and much more sophistication and so forth.

Operator: This concludes the question-and-answer session. I would like to turn the conference back over to management for any closing remarks.

Dick Warzala: Thank you, everyone, for joining us on today's call and for your interest in Allied Motion. I would also like to apologize for the late start as our hosting company did have some technical difficulties in getting the call initiated. For those of you that are interested, we will be participating in-person at the Baird Industrial Conference in Chicago next week on Thursday, November 10th. Otherwise, as always, please feel free to reach out to us at any time and we look forward to talking with you all again after our fourth quarter 2022 results. Thank you for your participation and have a great day.

Note: This transcript has been edited slightly to make it more readable. It is not intended to be a verbatim recreation of the Allied Motion (AMOT) financial results teleconference and webcast that occurred on the date noted. Please refer to the webcast version of the call, which is available on the Company's website (www.alliedmotion.com), as well as to information available on the SEC's website (https://www.sec.gov/) before making an investment decision. Please also refer to the opening remarks of this call for AMOT's announcement concerning forward-looking statements that were made during this call.