

Operator

Greetings, and welcome to the Allient Inc. Second Quarter Fiscal Year 2024 Financial Results Conference Call. [Operator Instructions] As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Deborah Pawlowski of Investor Relations for Allient.

Deborah Pawlowski *Investor Relations*

Thank you, Joe, and good morning, everyone. We certainly appreciate your time today as well as your interest in Allient.

Joining me on the call are Dick Warzala, our Chairman, President and CEO; and Jim Michaud, our Chief Financial Officer. In fact, join me in welcoming Jim to his first earnings call with us. He just joined Allient on June 3 this year. Dick and Jim are going to review our second quarter 2024 results and provide an update on the company's strategic progress and outlook, after which, we will open up the line 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 allient.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 and 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 as well as the slides.

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

Dick Warzala *Chairman, CEO & President*

Thank you, Deb, and welcome, everyone.

Before we delve into this quarter's discussion, I'm excited to be on the call with our new CFO, who as Deb mentioned, has been with us now for just over 2 months. During this time, Jim has been intimately engaged with our team to gain an understanding of our processes and to support the advancement of our Simplify to Accelerate NOW strategy, especially given his experience with similar types of initiatives in his previous roles. As a financial leader in both multi-national public and private companies, Jim brings an extensive background of establishing high-performing finance operations and transforming organizations, which makes him a valuable addition to our team. We're confident that Jim's contributions will be instrumental in helping to ensure we achieve our strategic goals.

Moving on to the quarter. I am proud of the efforts of our team to address the market headwinds that we've had to face. While the quarter started off decently, we saw a significant shift in

demand in June. This decline was broadly evident across most of our served markets but was felt most acutely in industrial automation where destocking continues as well as the powersports market, which reflects a reduction in consumer demand. As you may have noticed, several public companies in similar markets have already reported their end market demand challenges and, ultimately, a reduction in year-over-year revenue.

I should also note that we believe the push-out in orders is the result of inventory adjustments, the extended level of higher interest rates, especially with apparent reductions in not-so-distant future, combined with political uncertainty. Our diversification does help somewhat as we continue to benefit from the macro trends of electrification, energy conservation and automation. Nonetheless, our actions to Simplify to Accelerate NOW could not be more timely. As we have discussed, we are on an accelerated path to reorganize to be more productive and drive stronger earnings power, and given current market conditions, our approximately \$5 million in annualized cost savings realized to date are even more relevant.

Our decremental margin reflects top-line softness, unfavorable mix and inventory reserves. The mix impact included the replacement of higher margin incremental industrial automation sales with lower margin sales from our most recent acquisition. We expect our simplification process, combined with the implementation of our integration plans and the capacity gain with the acquisition of SNC, will drive an improved margin profile in the future.

As noted on **Slide 4**, our Simplify to Accelerate NOW plan is even more meaningful given the current market conditions. As we mentioned, we executed \$5 million in annualized cost reductions in the second quarter, and we're working on implementing an additional \$5 million in annualized cost savings in the second half of 2024. A key focus of the restructuring involves transferring specific production activities from various U.S. operations to our existing lower-cost facilities in Mexico.

Additionally, we have reduced our workforce across most global operations to align with expected demand. Jim will further discuss the restructuring charges and inventory adjustments in the quarter related to these actions. While we are moving decisively to reduce our cost structure, we continue to implement programs aimed at driving future growth. We remain confident in our long-term strategy and the fundamental strength of our value proposition.

With that, let me turn it over to Jim for a more in-depth review of the financials.

Jim Michaud

Senior VP & Chief Financial Officer

Thank you, Dick, and good morning, everyone. As this is my first earnings call with the company, I want to start by expressing my gratitude for the warm welcome I've received from the team and for the opportunity to work with such a talented group. In my short time here, I've been impressed by the dedication and resilience of our team. I'm excited to be part of Allient and to contribute to our ongoing success. Today, I will provide an overview of our financial performance for the quarter, including key highlights in areas where we are focusing our efforts.

Starting on **Slide 5**, second quarter revenue of \$136 million was down year-over-year by 7%. The impact of foreign currency exchange rate fluctuations was nominally unfavorable by \$700,000. During the quarter, our Vehicle markets experienced a 17% decline in sales, primarily driven by reduced demand in powersports and continued weakness in the agricultural vertical. These impacts were partially offset by increased demand in commercial automotive, thanks to the ramp up of new programs that we have won over the years.

The Industrial market saw a 3% decrease, despite strengthened power quality sales, notably to the HVAC and data center market and additional sales from our recent acquisition. These bright spots were counterbalanced by lower demand in industrial automation, as Dick noted, and within our pumps and material handling markets.

Our Medical markets also saw a decline, which was broad-based, but primarily due to the persistent softness in medical mobility products and solutions, a trend that has persisted over the past few years. The bankruptcy of a large customer in this space has also had an impact on demand.

In the Aerospace and Defense sector, sales declined primarily due to program timing within the space industry; however, we are seeing positive movement on the defense side with several notable opportunities that we are working.

Slide 6 highlights the shift in our revenue mix across markets over the trailing 12 months along with the catalyst for each change. The Industrial vertical maintained its position as our largest market, accounting for 46% of the total trailing months' sales, a notable expansion of 500 basis points. The 14% growth in the space industry reflects strong demand for power quality. On a trailing 12-month basis, industrial automation had benefited from supply chain environment improvements, but has recently fallen back as the industry resets with inventory levels.

Vehicle market revenue remained flat on a trailing 12-month basis, with higher demand in commercial automotive offset by lower demand in powersports and agriculture. Both Medical and Aerospace and Defense saw a decrease on a trailing 12-month basis, reflecting the same impacts as the past quarter. Lastly, sales to the Distribution channel, a small component of total sales, accounted for 4% for the trailing 12-month period.

As detailed on **Slide 7**, gross profit was \$40.7 million and gross margin was 29.9%. The 140-basis point decline was primarily due to under absorption on lower volume and unfavorable mix, including the expected margin dilution from the SNC acquisition and \$1.2 million in non-cash inventory reserves. Half of the inventory write-down was related to the bankruptcy I mentioned earlier, and the rest was mostly due to changes in projected demand. We believe our underlying business can command a higher margin profile, but we have to work in order to get there.

On **Slide 8**, you can see the lower gross profit. \$1.5 million of restructuring and business realignment costs and higher engineering expenses impacted operating income, resulting in income of \$4.9 million and operating margin of 3.6%. Costs related to the restructuring were primarily severance. Operating costs and expenses were 26.3% of revenue, an increase of 320 basis points, of which 110 basis points were attributable to the restructuring costs. We are intensely focused on improving our profitability despite market conditions.

Slide 9 shows net income was \$1.2 million and earnings per diluted share was \$0.07. Adjusted net income of \$4.9 million, or \$0.29 per diluted share, adjusts for the non-cash amortization of intangible assets to address the accounting requirements of an innovative and acquisitive company. The effective tax rate for the quarter was 20.6%. We anticipate our income tax rate for the full year 2024 to be approximately 21% to 23%. We use adjusted EBITDA as an internal metric to gauge our progress and operating performance. Given margin pressures, adjusted EBITDA came in at \$13.9 million, or 10.2% of revenue. We expect to improve our EBITDA margins through our simplification actions.

Let me talk to cash generation and our balance sheet on **Slides 10 and 11**. Year-to-date, cash from operations was \$17.4 million, improved over the prior year as working capital efficiencies and non-cash adjustment helped to offset lower net income. Capital expenditures for the first

6 months totaled \$5.3 million. While we continue to invest in several growth opportunities, we are fine-tuning our plans to concentrate on high-potential, high-value projects. Consequently, we have revised our 2024 capital expenditure forecast to a range of \$11 million to \$15 million, down from our previous expectation of \$13 million to \$17 million.

Inventory turns declined to 2.9x from year-end, while our days sales outstanding stayed flat at 56 days. Total debt of approximately \$237 million increased from year-end 2023 due to the SNC acquisition. We paid down \$3.3 million in the quarter. Debt net of cash was about \$206 million, representing 43.6% of net debt to capitalization. As defined in our credit agreement, our bank leverage ratio was 3.29x. Our financial priorities are to strengthen cash conversion and reduce debt.

With that, if you advance to **Slide 12**, I will now turn the call back over to Dick.

Dick Warzala

Thank you, Jim. Orders increased 12% sequentially in the quarter, driven by power quality projects and the ramp up of our commercial automotive programs. The sequential improvement in demand is somewhat encouraging; although, there is an impact on orders as our customers continue to reduce inventory levels. Additionally, we are experiencing delays in the launch of certain projects, which may be a result of the upcoming election and expected decrease in interest rates.

Importantly, while we are getting some order push-outs, order cancellations are minimal and being addressed appropriately. We expect the slowdown will extend through this year and into 2025. The decline in backlog is attributed to continued improvements within the supply chain as lead times were reduced and we ship products that were in our backlog as a result of the previous market conditions.

Our outlook is outlined on **Slide 13**. We are taking decisive steps to align our business with current market conditions. We anticipate the challenging environment to persist through the second half of 2024, with our annualized revenue run rate expected to fall below \$500 million over the next few quarters. This projection reflects substantial inventory rebalancing by our customers as the supply chain returns to normal, some market erosion and a relatively weak industrial automation environment. We expect that the reduction of uncertainties, settling of lower interest rates and normalized inventories should get us back to stronger revenues sometime in mid-2025.

As we streamline our operations, we believe we can enhance customer service and strengthen our long-term competitiveness. Our goal is to make Allient easier to do business with and accelerate our speed to market with new product innovations. This strategy is also expected to position us to better handle the current macroeconomic environment and industrial challenges. We aim to achieve our target of \$10 million in annualized savings this year and to identify and execute further actions beyond this target to ensure we emerge as a stronger, more resilient enterprise with higher earnings power.

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

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Greg Palm with Craig-Hallum.

Danny Eggerichs

This is Danny Eggerichs on for Greg today. I guess, maybe just digging into more of what you saw with the kind of significant fall off in demand in June and what you're seeing. You said that was weighted towards industrial automation and powersports. As we've moved through July now and into early August, how has that changed? Are you seeing some of that weakness spread across the other end markets? Is there anything more you can give on end market, geography, what you're seeing quarter-to-date so far?

Dick Warzala

Sure, Danny. I would say that we see a continuation of what we experienced in June, and just to be clear, we had mentioned that we started the quarter quite well. April and May were relatively solid and then June was a significant drop off. We do expect that to continue, as we mentioned here, through the remainder of the year and potentially into 2025.

Looking at the incoming order rates, and as you're asking to look out at what has occurred in July and so forth, there were some mixed signals. We did see a couple of encouraging signs that maybe things will come back, but it's hard to gauge based on 1 month. I would caution us to not get carried away that we did see a couple of positive signs there and that things were going to change drastically.

So, sticking with what we've stated here, the industrial automation, the rebalancing that we saw for inventories and the impact it had, especially on us and the other markets, we didn't talk much about geographic markets, but certainly, Europe was impacted. Again, some mixed signals. So, for us right now, our emphasis is going to be on getting the business adjusted, readjusted and aligned, to take cost out, to become a more profitable company based on a lower cost base. That's really our focus and it will continue to be our focus this year and into next year.

Danny Eggerichs

Just based on the mixed signals and it sounds like maybe some uncertain visibility, the \$500 million run rate through the second half and I think you even said maybe over the next several quarters, but there's also a chance that maybe the inventories start returning in early 2025 before maybe normal run rates in mid-2025. So, I guess, looking out into 2025, should we expect gradual improvement starting early in the year before getting to more normalized levels or do you expect that \$500 million run rate to last into Q1 next year as well before starting to really improve?

Dick Warzala

Based on what we know today, I would expect that to continue into Q1. If something changes there and we see the dynamics of the market start to change, we certainly will keep everybody abreast of it. But saying that and running the business with, I think, the anticipation that that would be the case, the \$500 million annualized run rate, it just makes it more important for us to continue to streamline, to reorganize, and to make sure that we take the cost out. That's our focus and that will continue to be our focus.

So, we talked about, in the second half of 2024, the additional \$5 million, and that's substantially already identified and will be fully executed very early here in the second half; cost adjustments, realigning the business, just not to take the market swings and the uncertainties we talked about. Things could change and they could change pretty rapidly if certain things fall into place, but we're not running our business in that manner. We're running our business that we'll take control of what we can control and we'll get it done.

Danny Eggerichs

Sure. And on that added \$5 million, now \$10 million of cost take-outs, I know you mentioned you're still looking for additional opportunities. Do you feel like there are more levers to pull if things continue to worsen or stay at this level for longer than you're expecting? Are there more cost take-outs just to buoy some of that profitability?

Dick Warzala

Yes, and it will have nothing to do with whether markets continue to worsen or not. We've taken a really hard look at everything, structure-wise and so forth, and there are definitely some additional opportunities identified. It's just a matter of how much can we execute and get implemented in the short period of time.

Operator

The next question comes from the line of Brett Kearney with American Rebirth Opportunity Partners.

Brett Kearney

Great to hear some of the new commercial vehicle awards are ramping up. I am curious, with the puts and takes in the global economy, what are you hearing from customers and some of the other recent new vehicle programs you've won and what are customers looking for in pushing forward with those ramps as well?

Dick Warzala

Well, I think it's been in the news about the EV side or the electric vehicle side of it. Most of our solutions are agnostic. Whether it's a combustion engine or an electric engine, we're agnostic to that. We did see that there had been a downshift in demand and we experienced that in the second quarter, so it was essentially a push-out of one month. They've adjusted for it and, going forward, we should see steady demand there. I wouldn't suggest that it's going to increase beyond where we are today, but we do have some other programs that we're working on,— but not for this year, that should ramp up next year.

So, there was an impact there; although, it was relatively short and, hopefully, that's all been adjusted for and moving forward we'll see the steady-state demand. The big challenge was some inventory adjustments at key customers where it was go, go, go, go, go, ship, ship, ship everything you've got and then, all of a sudden, hold on, we have some challenges here we're going to have to adjust and they were quite significant.

Brett Kearney

Excellent. Very helpful. And then, if I can just ask one more on A&D, as you look out over the next year or two, what are you seeing, I guess, in both space market as well as traditional defense opportunities for the company?

Dick Warzala

It's very encouraging. We have mentioned in the past that we've worked on several applications, and, at some point, they had to ramp up. Some of the projects were pushed to the right in decision-making and so forth, but there's a significant number of projects and we are starting to see a slow ramp-up in demand in some of the areas where we would have expected to have already seen that. So, A&D is a bright spot, as well as medical. We've seen some good opportunities in medical too.

Operator

[Operator Instructions] Our next question comes from the line of Ted Jackson with Northland Securities.

Ted Jackson

So, my questions are on a couple of things. First of all, on the \$5 million cost savings that you've already done and the \$5 million that's coming, how should we think about how that rolls through the model with regards to OpEx and gross margins?

Dick Warzala

Primarily, we focused on fixed cost. Maybe Jim can answer this with a little more granularity as far as the fixed manufacturing costs that were reduced, but also, primarily, it's in OpEx and that's where our focus was. Needless to say, as volumes reduced, the variable costs were reduced as well, but that's not a number we're reporting.

We're strictly reporting what we saw as incremental savings; although, we did take the differential in direct labor cost between U.S. labor and Mexican labor as part of that, but that was a relatively small portion. Most of it has been in the operating expenses and, certainly, there's been some fixed manufacturing overhead as well.

Is your question beyond that as far as the timing?

Ted Jackson

That was the next part of my question, how would we think about it? I mean, it sounds like your \$5 million is already done, so we can think about that coming into play in the second half of this year. And then, the next \$5 million sounds like we'll see maybe some of that in the fourth or first quarter. That's what I interpreted, but some color on that would be great too, Dick.

Dick Warzala

You're absolutely correct on the first \$5 million. It's already in and we've taken the charges against it and we'll be realizing the benefit of that immediately. The next \$5 million that we talked about, some of it has already been implemented here in the second half. Most of it will be done early in the second half, so we will start to see some benefit of that as well. Going into next year, we'll have the full benefit of the \$10 million in cost reductions, and as we mentioned, there are other actions that we can take. It's just that we need a little bit more time to make sure that we execute them in a proper manner, but there's more to come.

Ted Jackson

Okay. My next question is just going into revenue mix and guidance. You saw weakness pretty much across the business, generally speaking, with the ones that really stood out for you being industrial automation and let's call it, recreational vehicles. When you look at your outlook, this \$500 million run rate that we are to expect to see for the next several quarters, can you provide some color with regards to where that weakness will be concentrated from an end market perspective? I'm going to assume it's the markets that have already been addressed, but I want to make sure. And then, from a geographic perspective, where that weakness might be? And if you can kind of tie all that together, that would be great.

Dick Warzala

Again, we pay attention to what our customers are saying in the market and what they see the trends and the future trends coming, so I would say that's certainly one that we expect to have weaker demand from and it's pretty much across the board. The industrial piece is the wildcard. We're taking a cautionary approach here. We're planning our business that it's not going to come back rapidly, but has the potential, as we get in the fourth quarter of this year, to return to certainly a much better level for us.

As far as the other markets go, I think, overall, we see a decrease, but we mentioned already that the aerospace and defense, space, applications are seeing an uptick and also in medical. So, we're planning cautiously and we're acting aggressively to make sure that the foundation just gets stronger. It needs to get stronger to achieve the goals that we're not forgetting about but that we've established for ourselves in the past of margin improvement.

On the geographic side of it, I have to be careful, because, as you know, Ted, we play in pockets and niche markets and so forth, and while the overall market can be classified as industrial, you really have to look at the specifics of what is it that we do in industrial or vehicle, because, as we mentioned, it's not automotive, it's agricultural. You can see the information out there in the downturn in the agriculture equipment markets and so forth.

So, I think, as we look at that, and you say, geographic, other than where we've had some strengths in new programs kicking in and/or the acceleration of some others, the general market in Europe is down and it's down 8% to 10%. While we have some increases, we have further decreases that go beyond the 8% to 10% in some specific markets, but again, we're starting to see some mixed signals there that perhaps it is coming back. I'll just repeat myself; we're going to plan cautiously and we're going to react really aggressively to get the cost structure in line where it should be to achieve the margins we said we were going to achieve and have been talking about for the last couple of years.

Ted Jackson

Okay. My final question probably makes logical sense, but given you have a full plate right now with a challenging macro backdrop and a fair amount of business restructuring going on, is it fair to assume that the M&A side of the growth strategy is going to be set aside while you get the ship rightsized and things battened down? Or are you still keeping a pretty active effort on that front? That's my last question.

Dick Warzala

It's fair to say that. We're focused on cash, and we're focused on getting the debt paid down and so forth. So, yes, we continue to identify and groom opportunities for the future, but it's in the short-term here. It would have to be something totally exceptional, and we'd have to go after it in a different way than what we've done in the past. So, our focus is on internal operations, continuing to groom for the long-term, the acquisitions, but in the meantime, we're not aggressively going after things open in the market right now.

Operator

This concludes our question-and-answer session. I'd like to turn the call back to Dick Warzala for closing remarks.

Dick Warzala

Thank you, everyone, for joining us on today's call and for your interest in Allient. As always, please feel free to reach out to us at any time, and we look forward to talking with all of you again after our third quarter 2024 results in November. Thank you for your participation and have a great day.

Operator

This concludes today's conference. You may now disconnect your lines.

Note: This transcript has been edited slightly to make it more readable. It is not intended to be a verbatim recreation of the Allient, Inc. (ALNT) 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.allient.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 ALNT's announcement concerning forward-looking statements that were made during this call.