Myers Industries(Q1 2023 Earnings)

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Corporate Speakers:

- Monica Vinay; Myers Industries, Inc.; VP of Investor Relations, Treasurer & Interim Chief Financial Officer
- Mike McGaugh; Myers Industries, Inc.; President, Chief Executive Officer & Director

Participants:

- Jonnathan Navarrete; TD Cowen; Analyst
- Steve Barger; KeyBanc Capital Markets; Analyst

PRESENTATION

Operator^ Good morning, and welcome to the Myers Industries First Quarter 2023 Earnings Conference Call. All participants are will be in listen only mode. (Operator Instructions) I would now like to turn the conference over to Monica Dana. Please go ahead.

Monica Vinay^ Thank you. Good morning, and thank you for joining us. I'm Monica Vinay, Interim Chief Financial Officer and Vice President of Investor Relations and Treasurer at Myers Industries. Joining me today is Mike McGaugh, our President and Chief Executive Officer.

Earlier this morning, we issued a press release outlining the financial results for the first quarter of 2023. We have also posted a PowerPoint presentation to accompany today's prepared remarks. If you've not yet received a copy of either the release or the PowerPoint, you can access them on our website at www.myersindustries.com under the Investor Relations tab. This call is also being webcasted on our website and will be archived along with the transcript of the call shortly after this event.

Please turn to Slide 2 of that PowerPoint presentation for our safe harbor disclosures. I would like to remind you that we may make some forward-looking statements during this call. These comments are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Such statements are based on management's current expectations and involve risks, uncertainties and other factors, which may cause results to differ materially from those expressed or implied in these statements.

Also, please be advised that certain non-GAAP financial measures, such as adjusted gross profit, adjusted operating income, adjusted EBITDA and adjusted EPS may be discussed on this call. Further information concerning these risks, uncertainties and other factors is

set forth in the company's periodic SEC filings and may be found in the company's 10-K and 10-Q filings.

Now please turn to Slide 3 of our presentation. I'm pleased to turn the call over to Mike McGaugh.

Mike McGaugh^ Thank you, Monica. Good morning, everyone, and welcome to our first quarter 2023 earnings call. I'm pleased to report that our self-help initiatives and operational excellence efforts continue to deliver results. We expanded our adjusted gross margin for the fifth consecutive quarter, and we delivered significant free cash flow, and I'm proud of these accomplishments.

I'd like to specifically call out our injection molding businesses that continue to deliver record levels of profitability. Their great results were due to strong demand and also ongoing improvements in commercial and operational excellence. The injection molding teams are hitting on all cylinders.

Within the remainder of the Material Handling segment, however, we experienced mixed end market demand, which ultimately led to a marginal decline in revenue. Over on the distribution side, sales were higher primarily due to the Mohawk acquisition last summer.

Now I'll provide a brief financial overview of the quarter before Monica outlines our results in greater detail. We achieved net sales of $215.7 million, a decrease of 4.3%. From a market perspective, we saw strong demand within our food and beverage end market, mixed demand within our industrial end market, but we continue to see reduced demand in the recreational vehicle, marine and consumer end markets where inflationary trends are impacting overall consumption and performance.

To help offset demand headwinds, we have been laser focused on further diversifying our customer base and increasing our concentration into higher growth end markets. We are pursuing growth, and we are winning new business in the auto aftermarket, industrial and food and beverage end markets. Examples include a recent $1.5 million new business win providing reusable Buckhorn boxes to an electric vehicle manufacturer, a $4 million new business win to an industrial reusable container supplier and a multimillion dollar large auto aftermarket customer win.

We also continue to make progress testing and qualifying our sector cases for military lightweighting projects around the world. This new business development project has the potential to be a large economic success in the near future.

Now back to our first quarter results. Adjusted gross profit was $71.2 million or 33% of sales, a decrease of 1.6% on a dollar basis but an increase of 90 basis points on a percentage basis. The increase in gross margin is a result of the self-help initiatives we implemented in Horizon 1 and our actions on implementing our Myers business system, a business system that crystallizes our best practices and helps ensure they are sustainable and repeatable across the company.

You'll notice that SG&A is higher in the first quarter compared to the same period last year. Some of that is due to the Mohawk acquisition and some is due to a success fee paid on a legal win this quarter. We are pleased with the outcome, and it was a significant win relating to a patent case in the Material Handling segment.

Overall, the first quarter of 2023 was solid. We still have some work to do growing and optimizing our distribution segment. As you recall, we acquired Mohawk last summer, and we continue to integrate the business, grow the business and take cost out. We're expanding our geographic coverage and improving our service level to our customers.

To provide these improved service levels, we need to grow our margins. And to do this, we have several price increases underway and expect to see positive margin movement over the next quarters.

On the Material Handling side, we continue to take costs out of our operations, and we continue to combine parts of the commercial organizations to lower cost and improve our sales effectiveness across all of the material handling business units. On the strategic front, we continue to transform the company, nearly doubling the size of Myers in the last 3 years.

Over this period, we've built lasting competencies in pricing, in purchasing and in sales and operations planning. We've executed bolt-on acquisitions and improved both our acquisition and integration capabilities. Strategically, we are right where we want to be. Our capabilities are strong and our balance sheet is strong. We are well positioned to pursue the larger and more impactful acquisitions that we've outlined as a part of Horizon 2.

At Myers, morale is high. Our employees are fired up about a once-in-a-lifetime opportunity to really build a special company. It's an exciting time to be here at Myers Industries. Now I'll turn the call over to Monica for a review of our first quarter financial results and full year 2023 outlook. Monica?

Monica Vinay^ Thank you, Mike. Please turn to Slide 4 for a summary of our first quarter results. While we continue to successfully execute our long-term strategy, economic challenges are impacting near-term results. Our first quarter net sales were down $9.8 million or 4.3% compared to the first quarter of 2022, primarily due to lower sales in the Material Handling segment, which were partially offset by higher sales in the distribution segment.

On an organic basis, the contribution from higher pricing was more than offset by a decline in volume mix. Quarterly adjusted gross profit decreased $1.2 million or 1.6% as contributions from pricing actions, lower raw material costs and the Mohawk Rubber acquisition were not enough to offset lower volume and a change in sales mix.

However, adjusted gross margin for the quarter increased 90 basis points to 33% compared with 32.1% in the first quarter of 2022. First quarter adjusted operating income decreased $5.5 million or 21.4% compared to the prior year as a result of lower gross profit and higher SG&A expenses. SG&A expenses increased $4.1 million or 8.5% to $52.1 million. The increase in SG&A was primarily due to the Mohawk Rubber acquisition. And as Mike stated, higher legal fees, including $1.4 million of success fees payable in conjunction with a favorable patent trial results. SG&A as a percentage of sales increased to 24.1% compared with 21.3% in the same period last year.

Adjusted EBITDA was $25.9 million in the first quarter, a decrease of $5.1 million or 16.5% compared to the prior year period. Adjusted EBITDA margin decreased 180 basis points to 12% for the first quarter compared with 13.8% in the same period last year. Lastly, adjusted EPS was $0.38 compared to $0.50 in the same period last year.

Next, please turn to Slide 5 for an overview of our segment performance for the first quarter. For the Material Handling segment, net sales decreased $24 million or 13.6% compared to the prior year. Net sales increases in the food and beverage end market were more than offset by decreases in the consumer vehicle and specific demand from industrial end markets.

Material Handling adjusted EBITDA decreased $6 million or 16.5% to $30.4 million. Lower sales volume and a change in sales mix more than offset lower raw material costs. Net sales for the distribution segment increased by $14.3 million or 29.3% year-over-year. Excluding the incremental $13.9 million of net sales from the Mohawk Rubber acquisition, organic net sales increased 0.9%.

Distribution's adjusted EBITDA decreased $0.5 million or 11.9% to $3.4 million, primarily due to higher product freight and SG&A costs. SG&A expenses were higher year-over-year as a result of the Mohawk Rubber acquisition and higher labor costs at distribution centers. The segment continues to integrate the Mohawk Rubber acquisition and to implement price increases to offset cost inflation and expand margins.

Turning to Slide 6. Free cash flow for the first quarter of 2023 was $16.7 million compared to $2.2 million for the first quarter of 2022. The increase in cash flow was primarily the result of a decrease in working capital. Working capital as a percentage of net sales decreased 60 basis points compared to the same period last year, primarily due to contributions from our self-help initiatives and stronger cash collections.

On a sequential basis, working capital as a percent of net sales decreased 20 basis points. Capital expenditures for the first quarter of 2023 were $9.1 million and cash on hand at quarter end totaled $28.2 million. Our balance sheet remains strong and continues to support our growth runway with the debt to adjusted EBITDA of 0.9x.

Now please turn to Slide 7 for an update on our outlook for fiscal year 2023. We are maintaining our guidance for the full year with the net sales anticipated to increase in the low to mid-single-digit range. We expect that higher sales in the distribution segment will

more than offset sales decreases in the Material Handling segment due to softer demand in some of the segment's key end markets.

In the second quarter, we expect sales to be sequentially higher than in Q1, but to be lower year-over-year as a result of continued soft demand. In the back half of the year, we expect to deliver organic growth through price increases and the new business wins that Mike outlined. As always, we will continue to monitor market conditions and provide updates throughout the year.

We continue to expect SG&A expenses to approximate 22% of net sales. We are also still projecting approximately $6.5 million of interest expense and an effective tax rate of 25% for the year. Finally, we continue to expect an adjusted EPS range of $1.55 to $1.85 per share. As Mike noted earlier, we have made significant progress on our self-help initiatives and are seeing results. We expect cash flow from operations to continue to benefit from these initiatives and result in stronger year-over-year free cash flow generation.

Before I turn the call over to Mike, I'd like to thank the entire Myers team for their efforts and hard work in the first quarter. With that, I'll turn the call back over to Mike to provide an update on our strategy.

Mike McGaugh^ Thank you, Monica. Please turn to Slide 8. As I've noted on prior calls, this slide outlines our 3 Horizon strategy, which serves as our road map to transforming our company into a high-growth, world-class organization. Additionally, our efforts against this strategy have yielded meaningful financial, cultural and operational improvements, and we'll build on those improvements as we continue to grow the company.

Turning to Slide 9. We've outlined the 4 pillars that Horizon 1 is predicated on organic growth, strategic M&A, operational excellence and a high-performing culture. These pillars serve as our foundation and support our efforts to accelerate growth in Horizon 2 and 3. Let's take a moment to look at our recent progress within each pillar as shown on Slide 10.

Starting with organic growth. Due to strong demand for our seed boxes, we were able to drive year-over-year growth of 19% in our food and beverage end markets. We've also had success in winning a number of significant new accounts, helping offset weaker demand within consumer-facing verticals.

Additionally, we've implemented price increases across our distribution segment. We have more work to do here, but increasing price and expanding margin is in our wheelhouse, and we will get it done. We also remain focused on our internal initiatives to drive organic growth.

As I mentioned on our last call, we are focused on customer-driven innovation, how we can take existing products and extend them, make them higher performing or make them

fit better with our customers' aspirations or needs. This approach is paying off with specific targeted organic growth wins.

Shifting to our second pillar, strategic M&A. I continue to be optimistic about the Mohawk Rubber acquisition that we made in the distribution segment. It provides us more channel power and the ability to serve our customers better than ever. As we continue to integrate Mohawk, I expect our Distribution segment to deliver stronger EBITDA margin than it ever has.

Moving on to our M&A playbook. While we continuously refine it with each additional acquisition, we view it to be repeatable, scalable and able to deliver fast and accretive results. Additionally, the health of our balance sheet provides us with the flexibility to continue pursuing bolt-on opportunities as well as the enterprise level M&A we expect to complete as a part of Horizon 2.

With respect to the operational excellence pillar, we are focused on the implementation of our Myers business system, which is integral to Myer's transformation. Myers business system makes the company more resilient and documents and ensures all the progress we've made over the last 3 years and ensures that those improvements are repeatable and lasting.

I want to ensure the significant gains we've made at Myers are institutionalized and have longevity. A perfect example of this comes from our purchasing team, whose approach, aggression, and best practices to lower our total costs are unique and very effective. I've spoken about this model, we call the SALT model, before. Standardize the buy, aggregate the buy, leverage your suppliers and titrate the cost. The SALT model is key to Myers success and it's part of the Myers business system. It sounds simple, but I found that in many companies, it's not applied fully, rigorously or even at all.

As we evaluate other peers or competitors in the market and as we evaluate potential acquisitions, we often see that there are raw material cost reductions left on the table. We also see there are price increases left on the table as well. Squeezing both of these levers is what we do well and what gives me confidence in our ability to execute and implement the EBITDA performance of our acquisition targets.

Last, moving to our high-performing culture. To start, we recently announced the appointment of our new Chief Financial Officer, Grant Fitz. His prior experience in driving company transformation, increasing top line growth, expanding margins and successfully integrating acquisitions will be invaluable to our transformation and to our 3 Horizon strategy. I look forward to Grant joining our team on May 8.

Additionally, Grant's hiring echoes our ability to attract large cap talent to our small-cap company, fueling our strategic progress. While we are benefiting from an influx of strong talent to the company, we also continue to invest in our internal talent through our employee development and training programs. These training programs and investments are improving our capabilities across the board.

In conclusion, I remain confident in the strategic progress in the future direction of buyers. Before we open the call for questions, I want to thank Monica Vinay for doing a tremendous job as our interim Chief Financial Officer. Monica has been a great partner and has done a nice job leading our finance team through this interim period. Thank you, Monica. With that, I'd like to turn the call over for questions. Operator?

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) Our first question comes from Jonnathan Navarrete with TD Cowen.

Jonnatahn Navarrete^ Jon on for Lance. I would like to start off with the trends in April and May, particularly -- so I understand that there's been some weakness in RV, marine consumer end markets. But overall ahead of the summer season, are you seeing this pick up in the first 2 months of the second quarter?

Mike McGaugh^ Yes. We're seeing some of the continued trends. Food and beverage is still strong. Parts of industrial are still strong. Parts are a little more balance of industrial. RV and consumer, RV in particular, continues to stay weak, Consumer, our outlook for the lawn and garden season is to be expected. That's coming in, in meeting our expectations in lawn and garden, which is a part of consumer.

Some of the higher ticket items we talked about, whether it's your decorative high-dollar items that we make for various retail outlets, there's still pressure. The consumer doesn't have the discretionary dollars that they had a year ago. Monica, anything additional?

Monica Vinay^ Yes, I would just add that on the consumer -- the part that Mike talked is coming in as we expected. I would say that's just starting here in May. I think we've had kind of a late start to the spring season, so that's impacted April a little bit.

Jonnatahn Navarrete^ Now I see that there's more focus on food and beverage, as you mentioned, this quarter, and there's some more opportunity there. To what extent can that offset the weakness in the other end markets? Like I don't expect it's going to take up all of this lag, right? I just kind of want to know how much can we see food and beverage take on.

Mike McGaugh^ Yes. So a lot of that's driven by ag and the box -- seed box sales we have. Now we also have good traction in IBCs and a number of our business units make IBCs that go into food and beverage, and that's doing quite well also. We expect the back half of the year to be strong for both of those end markets from a volume standpoint and a margin standpoint.

So how much can it cover? Right now, I think we're on an upward trend. So we didn't cover totally on a revenue basis in the first quarter. I think second quarter would probably be a repeat of the same. But the back half of the year, we see price taking root in these

end markets like auto aftermarket. I've talked a lot about price increases that were driving in distribution on the heels of the Mohawk acquisition. You'll see that come through in the second half of the year.

Monica Vinay^ Yes. I would just add that -- so I talked about on the prepared remarks that in the second half of the year, we anticipate delivering organic growth. That will be a combination of the price wins, the customer -- or the price increases, the customer wins that Mike talked about and the increase in food and beverage. But we do anticipate mid to high single-digit growth in both Q3 and Q4.

Mike McGaugh^ Yes, that's right. And we've got confidence on those numbers.

Jonnatahn Navarrete^ And last one for me. Just looking at your cash flow statement, I see that CapEx is a little bit higher than what it has been in prior quarters. And I'm wondering, is this because there was some type of small acquisitions during the quarter?

Mike McGaugh^ Some of that still is catch-up capital from '16, '17, '18. We've brought in some really capable experts in operations who are helping us run our plants better, schedule our machines, load our machines better. But we also need to step it up on maintenance and do some catch-up capital expense. Some of that as well is spending for growth capital, particularly in food and beverage, in some of the industrial end markets. So that's where you see the capital. I don't anticipate over the long term, us running as rich CapEx expenses as it appears we will be in the back half of this year. A bit of that is catch up, Jon.

Operator^ The next question is from Steve Barger with KeyBanc Capital Markets.

Steve Barger^ What kind of industrial end markets are you pursuing? And would that be displacing another competitor or for new product applications?

Mike McGaugh^ A bit of it is some of both. A lot of it is larger markets, the niche applications. It's fuel tanks, hydraulic fuel fluid tanks that are going into construction application, agriculture application and industrial applications. So it's the area we know well, Steve. We make high-quality tanks at a high volume. We can do that really well, but it was kind of moving ourselves out of too much of an RV focus, too much of a consumer focus and more into industrial or infrastructure, construction and agriculture, heavy equipment and providing the hydraulic fluid tanks, fuel tanks, water tanks for that type of equipment.

We've had a lot of wins there. The wins are a long time coming, and they are $1 million, $2 million, $0.5 million here and there. And it's hard to cover the dramatic decline in RV as quickly as we would like.

Steve Barger^ Yes. I understand that, but you should have a pretty good runway on industrial. I think pretty much every machinery company I cover has a record backlog right now.

Mike McGaugh^ You got it. That's right. So we're having some wins there with specific customers that are big names. And that's part of also the capability we brought in on engineering and manufacturing over the last 2 years. Those guys have our plants humming and our quality is up, and there's a lot of runway there. You are correct. I just wish I could see it sooner.

Steve Barger^ You mentioned a military program. Can you talk about any more detail on that? And just how big could that be over time?

Mike McGaugh^ Yes. It's for the armament, for the various munitions. And so globally, there's rearmament, not only in the U.S. but the Ukraine wars depleted reserves, but it also has heightened everyone's awareness that we need to rearm. And so we're making the cases for the various munitions. We've had some favorable results on testing. So Steve, in the past, there's been some hesitancy to go to plastic from metal or wood, but the demand now is so great that the hesitancy has declined. And the interest now is high. And even as recent as this week, we've had some favorable results on some qualification tests.

The dollar amount, it could be $10 million, I think, longer term, $20 million or $30 million over the next, let's say, next 24 months. I'll look to Monica. She may be a little closer to that than I.

Monica Vinay^ I think in the near term, it will be probably closer to or a little below the $10 million range, and in the next 12 to 24 months, closer to $20 million.

Mike McGaugh^ Yes. Steve, what we're doing there is we're using those assets as your portable fuel containers shrink 3% a year, whatever it is with electrification, it's like, all right, where else can we take our expertise. And military has filled in. Military has really good margins. And also that volume has taken off. And it looks like for the next decade or 2, military is going to be really, really strong. So we pivoted some of our engineers and sales capability to kind of move beyond portable fuel containers and move into military. And we're really pleased with what we're seeing so far.

Monica Vinay^ We just need to get to the final.

Steve Barger^ Yes. Understood. No, that sounds good. And I know you've been doing a lot of sales force training and realignment. Do you have the right number of salespeople for the footprint and the product lines you have right now?

Mike McGaugh^ Yes, that's a good point. What we're finding, Steve, is combining the sales forces of rotational molding and blow molding, there's so much overlap there. And we have so much capability now. Getting those teams to work together or consolidating them, we're actually finding we can reduce cost and actually it gives us more effectiveness with the customer.

If we're repping One Myers and all these capabilities we have. I've been talking about it for 2 years, we're making progress. It's still a journey. Over on the distribution side, again, we're going to test price. We're going to test price. We bring a lot of value to our customers. And ultimately, if we test price and we get higher margins but less volume and that lessens the need for some salespeople, we'll take action there.

Steve Barger^ Got it. And one last one for me. As you start to think about those larger and more impactful acquisitions you mentioned, can you talk about what those could look like? Or does that mean multisite, multi-process, just bigger in terms of revenue?

Mike McGaugh^ Yes. We talked a little bit in the past about, all right, how do we view the company with the strategic lens. And we've talked about you've got auto aftermarket. You've got this storage handling and protection vertical. And then you have customer-specific engineered solutions, engineered products. We still are thinking about that way. Our expertise is in metal and plastic right now. We're going to build on that expertise.

So clearly, look, we're not going to go off the reservation and do something too drastic there. I want to be sure that's clear. But there's a lot of capability we can bring in terms of we're really good at operational excellence. We're pretty good at commercial excellence. And so how can we acquire these companies, even larger ones, and bring in our expertise in purchasing and pricing and S&OP. We think that's a winning market.

We're also seeing valuations come down. We're seeing private equity on the sidelines. And we think it's just a great time to have our act together strategically to have any of the kinks worked out on the small acquisitions to have a great balance sheet. We're ready to go. I kind of feel it's going to be a buyers market here over the next year or 2, and we're seeing that.

Steve Barger^ Do you feel like you're ready to do a more sizable acquisition right now? Or is that still something back half '23, early '24?

Mike McGaugh^ We're ready. Capability-wise, we're ready. We just have to find the right deals with the right economics. But we continue to get more calls. But capability-wise, Steve, operations and commercial and then financial capacity, we're ready.

Operator^ At this time, there are no further questions. This concludes the question-and-answer session. I would like to turn the conference back over to Monica Vinay for any closing remarks.

Monica Vinay^ Thank you for joining us today. We appreciate your interest in Myers Industries. Have a great day.

Operator^ The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.