

STRT Earnings Call Transcript

Date: 2025-02-07

Quarter: 2

Operator: Greetings, and welcome to the Strattec Security Corporation's Second Quarter Fiscal Year 2025 Financial Results. At this time, all participants are in listen-only mode. The question and answer session will follow the formal presentation. If anyone today should require operator assistance, please press star zero from your telephone keypad. A reminder, this conference is being recorded. It's now my pleasure at this time to introduce Deborah Pawlowski, Investor Relations for Strattec Security Corporation. Please go ahead.

Deborah Pawlowski: Thank you, and good morning, everyone. We greatly appreciate you joining us for Strattec Security Corporation's second quarter fiscal 2025 financial results conference call. With me on the call today are Jennifer Slater, President and CEO, and Matthew Pauley, Vice President and Chief Financial Officer. For those of you who may be newer to the story, Matt just recently joined us as CFO in mid-November last year. Jennifer Slater and Matt are going to review our second quarter 2025 financial results and provide an update on the progress being made to transforming Strattec Security Corporation. You can find a copy of the news release and the slides that accompany our conversation today on the Investor Relations section of the company's website. If you are reviewing those slides, please turn to slide two for the Safe Harbor. As you are aware, we may make some forward-looking statements on this call during the formal as well as during the Q&A.; These statements apply to future events that are subject to risks, uncertainties, and 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 as well. I want to point out 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, if you would turn to slide three, I would turn it over to Jennifer Slater to begin.

Jennifer Slater: Thank you, Deborah Pawlowski, and welcome everyone. I am encouraged with the progress we are making to transform Strattec Security Corporation into a stronger, sustainable business with improved earnings power. I appreciate your time today to learn more about this progress. Let me first touch on some highlights of our second quarter results. We had another solid quarter of performance and generated \$9.4 million in cash from operations in the quarter, bringing us to about \$21 million in the first half of our fiscal year. This is much improved over the use of cash for the first half of fiscal 2024. Revenue grew almost 10% despite last year's second quarter benefiting from \$4 million in retroactive pricing. Margins also improved with adjusted EBITDA margin expanding 180 basis points. Of note, we continue to execute on our strategic priorities of stabilizing the business, optimizing costs, and evaluating our product portfolio to advance our transformation. I'll address this more fully if you would turn to slide four. Our focus on operational excellence in our Milwaukee operations. This change will provide \$1.2 million in annualized savings that will be partially recognized beginning in the third quarter for the quarter we are operating in now. We recognized \$300,000 of restructuring costs resulting in a very quick payback. We also identified that our Milwaukee facility, which is 350,000

square feet, is roughly twice as much manufacturing space that we require for the stamping, die casting, plating, and other operations we have in the facility. The building has been listed for sale, and the results of the process will help inform our next steps. We are continuing to review our manufacturing operations to identify more ways to reduce costs in the business. And, yes, the elephant in the room is tariffs. While this continues to be a fluid situation, our ongoing efforts to optimize our costs will help in some respects. Along with our strong balance sheet. Regardless, we are being proactive in conversation with our customers and suppliers to better understand the implications and develop any necessary countermeasures. Shay Bardo, our new chief commercial officer, has hit the ground running and our commercial team recently captured about \$8 million in new annualized pricing. Of course, the pricing gains are dependent on customer demand and the volume of related products being shipped. But we expect that we should begin to realize the improved pricing in the third quarter. We continue to improve our working specifically by working down our preproduction tooling cost balances. The strong effort of the team has reduced the balance by \$10.5 million or nearly 50% since the start of this fiscal year. Importantly, I believe the investments we are making in accelerating the pace of change here at Strattec Security Corporation. Much of what we are discussing on the call today such as rightsizing our operation and the pricing gains and the metrics to better understand our underlying performance are direct outcomes of our investment in our team. Let me talk to the drivers behind our revenue growth on slide five. Second quarter sales increased \$11 million as a result of new product launches, higher demand for our products that more than offset end of life programs. Much of this growth is higher value content in power access and latches. In addition, we have customers that are building inventory to address their production plans. Sales of power access products were 27% year over year on new programs, higher value content, and volume. Engineered latches grew 20% over last year's second quarter for the same reasons. This more than offset the continued decline in our mature product line of keys and locksets. Let me turn it over to Matthew Pauley now to cover our financial results in more detail.

Matthew Pauley: Thanks, Jennifer Slater, and good morning, everyone. Moving to slide six, gross profit was up \$3.7 million to \$17.2 million, a 27% increase compared to the second quarter last year. The \$3.5 million benefit of favorable FX and higher production volumes more than offset headwinds from the prior year one-time net pricing recovery of \$2.9 million and increased labor costs. Labor costs were up \$1.4 million reflecting the 20% government mandated wage increase in Mexico. We also accrued \$600,000 for bonuses this year. Gross margin expanded to 13.2% with a 270 basis point benefit of favorable foreign exchange. Excluding the impact of currency and the prior year one-time pricing recoveries, we delivered about 100 basis points of margin expansion. I should touch on tariffs here a little. As is true with the majority of the automotive industry, we are heavily reliant on our assembly operations in Mexico and our global supply chain to provide product to our customers. Approximately 70% of our sales are shipped to the U.S., picked up by a customer at our distribution center in El Paso. The remaining 30% are sold to OEMs globally. We have certain actions we can take and a few levers to pull. Where the tariff situation lands will also feed into our strategic evaluation of our footprint from a longer-term perspective. Moving to slide seven, engineering, selling, and administrative expenses or ES&A; totaled \$15 million, a \$1.6 million increase compared with last year's second quarter. Half of the increase was related to an \$800,000 annual bonus provision. Of note, no bonus provision was taken in the comparative period. We also had \$300,000 of incremental non-cash stock compensation expense, \$300,000 of restructuring costs, and \$200,000 of costs related to the transformation of Strattec Security Corporation. We are investing in people and processes to drive greater predictability and a stronger earnings profile. On slide eight, net income for the second quarter was up 29% to \$1.3 million or \$0.32 per diluted share. Offsetting the benefit of higher operating income, a \$300,000 increase in investment income, related to gains and losses on our FX hedging activity. As you will notice in the news release, we are now presenting two non-GAAP measures of adjusted EBITDA and adjusted net income. Given the investments being made to turn Strattec Security Corporation into a more predictable and better-performing business, we believe these metrics will help you understand the underlying performance of the business. We are also using these metrics internally as well to measure our performance. We have provided the reconciliation tables for each period and the full year of fiscal 2024 for your information. Adjusted EBITDA for the quarter was \$8 million, up 60% compared to the same

period last year. Adjusted EBITDA margin expanded 180 basis points to 6.1% due to higher sales volume, favorable changes in FX rates, and cost management initiatives. On an adjusted non-GAAP basis, net income for the second quarter was \$2.6 million or \$0.65 per diluted share. This was up 81% from the prior year second quarter. Lastly, Slide nine highlights our solid balance sheet, financial flexibility, and capital priorities. Free cash flow increased by \$12.5 million versus last year's second quarter due to improved operating performance and reduced net working capital. Most of the working capital decline was related to the continued effort to recover preproduction costs from our customers. We ended the quarter with \$42.6 million in cash. I'm reevaluating the capital expenditures for the year and expect to have a better understanding of our needs when we report the third quarter. In the meantime, CapEx of just under \$1 million in the second quarter and \$3 million in the first half of the year primarily related to new product programs and equipment upgrades. Our capital priorities as we advance through the transformation of the business are internally focused on operational efficiencies and organic growth initiatives. While the current tariff situation creates a potential challenge in the near term, we are encouraged with the actions we are taking to advance Strattec Security Corporation through operational excellence, strengthening our commercial initiatives, capturing the value of our innovation, and creating an energized and experienced team. With that, operator, we can open the line for questions.

Operator: Thank you. We'll now be conducting a question and answer session. If you'd like to ask a question at this time, you may press star two. If you'd like to withdraw your question from the queue, it may be necessary to pick up your handset before pressing the star keys. One moment please while we poll for questions. Thank you. Our first question comes from the line of John Franzreb with Sidoti and Company. Please proceed with your questions.

John Franzreb: Good morning, everyone, and thanks for taking the questions and congratulations on a good quarter. Jennifer Slater, I'd like to start with your assessment of the progress that you've made as far as the evaluation of the company. In your opinion, how far along are you? And do you think the process will finally be, you know, initially completed at least?

Jennifer Slater: Hi, John. Thanks for the question. I feel really positive about the progress that we're making, but I still think we're really early in the process. I'm seven months in, and I would say we're making good progress. We're proud of some of the things that we're doing, but there's a lot more work to do, John.

John Franzreb: Okay. Fair enough. And in the prepared remarks, you mentioned the benefit of higher value products as far as benefiting the top line, but I'm assuming the margin profile. Can you give us some examples of those products and maybe talk a little bit about why they're doing better today than they were a year ago?

Jennifer Slater: Yeah. So in our Power Access products with our power sliding doors and power lift gates, we've seen some good growth in just demand from customers and program launches there.

John Franzreb: Understood. You mentioned about \$8 million of new pricing starting in the third quarter. Can you give us a little background on how you're able to achieve that kind of new pricing after getting a fair amount recognized last year?

Jennifer Slater: Yeah. I think, as you know, with our automotive customers, we enter into longer-term agreements. And one of the things that Shay Bardo has done is really worked with our customers and understood where we were in our contract life and where they wanted us to continue to support them as they may be extending those programs. So really, that pricing is just a representation of some of the work that she's done with the team and where customers are extending programs or outside of the time contract life, and we're recognizing near-term economics.

Matthew Pauley: This is Matt. I just add that, you know, the pricing that we achieved is across multiple different of our product categories and across multiple different OEMs.

John Franzreb: That's good to hear. It's good to see the balance. And regarding the tooling, should we kind of view this as probably a stable go-forward level, or do you think there's more to achieve as far as tooling benefits?

Matthew Pauley: I think we've made significant progress on the tooling balance in the first half of the year. I think there's a little bit left to go, but the pace of change or the pace of reduction will level out here in the back half of the year.

John Franzreb: Okay. I'll actually end it there and let somebody else ask some questions. Thanks for answering my questions, everybody.

Jennifer Slater: Thank you, John.

Operator: Our next question is from the line of Guy Baron with Spring View Capital. Please proceed with your questions.

Guy Baron: Hi, Jennifer Slater and Matthew Pauley. Thank you. The prior John Franzreb already asked some of the questions that I had, but on the \$8 million in annualized pricing, is that a midpoint of a range? Because you said that it depends on customer demand. So how did you—is that a midpoint or is there a range to that \$8 million of pricing that you expect to get?

Jennifer Slater: Yeah. It's the projected annualized value of the impact based on our projected sales.

Guy Baron: There's some upside and some potential downside to that based on demand.

Jennifer Slater: Yeah. Based on our customer production.

Guy Baron: Okay. And then when do you expect to cycle the 20% wage increases in Mexico?

Matthew Pauley: Yeah. We saw the last impact of that here in our second quarter. So that was the 20% increase was the mandated increase last January. This January, the merit increase was much less than the 20%. It was close to 12% in Mexico.

Guy Baron: So the impact of that will kind of diminish as we go forward? On a quarterly basis.

Matthew Pauley: You'll still see the impact of the 12% merit increase as we go through the balance of the year here.

Guy Baron: Okay. And then on the real estate on the headquarters, I saw you listed it for \$17 million. How's that been received so far? What are you seeing out there in terms of market?

Matthew Pauley: Yeah. We just listed the facility in January, so we're early in the process. But I'd say I think the brokers are happy with the activity and the interest in the facility right now.

Guy Baron: Okay. How long do you see that process taking?

Jennifer Slater: It's really hard for us to anticipate, but, you know, it's still gonna take us some time to get through the full process.

Guy Baron: Okay. And then a high-level question really is on your run rate EBITDA power. Right? So you did adjusted EBITDA \$18 or \$19 million in the first half of this year. And, typically, your seasonality is such that you generate, like, 30 or 35% of your annual EBITDA in the first half and 70% or so in the second, which implies full-year EBITDA range can be, you know, \$50, \$55 million. It's based on the performance that you have achieved so far this year. Is that a good run rate? Because that would be a really nice number.

Matthew Pauley: No. I don't think that's necessarily the run rate. I think if you look at it, our sales are slightly higher in the back half of the year than the first half of the year. I think if you're looking at historical periods, keep in mind there was a lot of one-time retro pricing in the prior year, which makes that comparison maybe a little bit difficult on a go-forward basis.

Guy Baron: Got it. Great. Thank you so much.

Operator: Our next question is from the line of Brian Sponheimer with Gabelli Funds. Please proceed with your questions.

Brian Sponheimer: Hi. Good morning, Jennifer Slater, Matthew Pauley, and Deborah Pawlowski. Thanks for getting me on here. Couple quick ones about the balance sheet. Obviously, with quite a bit of cash now on the balance sheet. Obviously, you have some needs as it relates to wanting to potentially move the footprint. But, you know, assuming that the Milwaukee headquarters is a positive sale and then continues to improve, you know, how are you thinking about financial structure for the business going forward?

Jennifer Slater: Yeah. Thanks for that question. Obviously, the cash is important for us right now as we navigate through potential tariff impact. But as we think about our strategic priorities, we're focused on some of the things that we need from a cash perspective to realize our operational efficiencies and making sure we've got the right processes and technologies in place. We're also looking at our product portfolio and where we may need to invest organically for our customers to continue growth. And then I think we get, you know, the more longer-term focus after that.

Brian Sponheimer: Okay. One off the balance sheet. The accrual for post-retirement. Didn't ask that

last quarter, but can you just talk about that? That's a little bit bigger than it's been in the past.

Matthew Pauley: Yeah. In the quarter, we did make a reclass. So it's associated with our Mexican post-retirement benefits. Previously, the balance was reported as short term, and it properly should be reported as a long-term liability. So it's just a balance sheet classification.

Brian Sponheimer: Anything change about it? Did you do anything, or was it just improperly classified?

Matthew Pauley: It's just a balance sheet classification. The liability was properly stated, and the expense was properly recorded in the past.

Brian Sponheimer: Got it. Okay. Just kind of thinking about products and what you're finding. Clearly, power access is doing great. You have some headwinds on the lock and key set side. But as you're kind of getting your—you know, really planting your roots here, Jennifer Slater. Anywhere in particular that outside of power access, you see some opportunities to really grow the production base from a customer standpoint?

Jennifer Slater: We are, you know, as we're working on our internal focus on operational improvement, we're parallel passing our strategic work on our portfolio and our customer base. So you talked about Power Access. That's the easy part for us to look at to see what other addressable customers within transportation could use that product portfolio. And then we go out from there, Brian, and look at what other opportunities do we have organically on our products to grow with the current capabilities that we have today.

Brian Sponheimer: Okay. Alright. Thanks. Any other questions? I'll take offline.

Jennifer Slater: Okay. Thanks, Brian.

Operator: Thank you. Our next question is from Guy Baron with Spring View Capital. Please proceed with your question.

Guy Baron: Hey. Quick follow-up. On the customer side, you mentioned really good progress with Ford and GM and Kia. What about Stellantis? They've been having problems. They're a big customer. Are you seeing that? I assume that was a headwind over the last couple of quarters. Where do you see that going? How's that business, that customer trending for you?

Jennifer Slater: Yeah. A lot of our sales are dependent on what platform, but, you know, we haven't seen—while they've been managing their inventory, we haven't seen any significant changes with the platforms that we're on with Stellantis and the products we provide.

Guy Baron: Okay. How are your sales with them year over year?

Matthew Pauley: They were down about 10% in the quarter on a year-over-year basis.

Guy Baron: Okay. Alright. Thank you.

Jennifer Slater: Thanks, Guy.

Operator: This will conclude today's question and answer session and also will conclude today's teleconference. Thank you for your participation. You may now disconnect your lines at this time and have a wonderful day.