Transcat, Inc.

Fourth Quarter Fiscal Year 2024 Financial Results

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## CORPORATE PARTICIPANTS

**Thomas Barbato,** *Chief Financial Officer*

**Lee Rudow**, *President and Chief Executive Officer*

## CONFERENCE CALL PARTICIPANTS

**Danny Eggerichs**, *Craig-Hallum*

**Scott Buck**, *HC Wainwright*

**Ted Jackson,** *Northland Securities*

**Martin Yang**, *Oppenheimer & Company*

## PRESENTATION

**Operator**

Greetings and welcome to Transcat Incorporated Fourth Quarter Fiscal Year 2024 Financial Results.

At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Tom Barbato. Thank you. You may begin.

**Thomas Barbato**

Thank you, Operator, and good morning everyone. We appreciate your time and your interest in Transcat.

With me here on the call today is our President and CEO, Lee Rudow, and our Chief Operating Officer, Mike West. We'll begin the call with some prepared remarks, and then we'll open the call up for questions.

Our earnings release crossed the wire after markets closed yesterday. Both the earnings release and the slides that we will reference during our prepared remarks can be found on our website, transcat.com, in the Investor Relations section.

If you would please refer to Slide 2. As you are aware, we make forward-looking statements during the formal presentation and Q&A portion of this teleconference. These statements apply to future events which are subject to risks and uncertainties, as well as other factors that could cause the actual results to differ materially from where we are today. These factors are outlined in the news release as well as in the documents filed by the Company with the SEC. You can find those on our website where we regularly post information about the Company, as well as on the SEC's website at sec.gov.

We undertake no obligation to publicly update or correct any of the forward-looking statements contained in this call, whether as a result of new information, future events or otherwise, except as required by law. Please review our forward-looking statements in conjunction with these precautionary factors.

Additionally, during today's call we will discuss certain 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've provided reconciliations of non-GAAP to compared GAAP measures in the tables accompanying the earnings release.

With that, I'll turn the call over to Lee.

**Lee Rudow**

Thank you, Tom. Good morning everyone. We appreciate you joining us on the call today.

Fiscal 2024 was another strong year for Transcat. Our excellent operating results included double-digit organic Service growth, significant and continued gross margin expansion, and dynamic growth in EBITDA and operating cash flow. We fortified our strong position in core markets by enhancing our differentiated value proposition and expanded our addressable markets.

It was a great year and we're very proud of the team, their continued hard work and their accomplishments.

In Fiscal 2024 we generated double-digit organic Service growth of 11% and total Service growth of 17%. Consolidated revenue was up 13% to $259 million as demand for our products and services remained strong.

Consolidated gross margins expanded 270 basis points to 32.3%, driven by organic Service revenue, inherent leverage in our Service operating model, improved productivity in our labs, and a higher rental mix in our Distribution segment.

Adjusted EBITDA, a key metric for us given our acquisition strategy grew 27% from prior year to $38.6 million. Accretive acquisitions played an important role in Fiscal 2024 as we acquired three companies, TIC-MS, SteriQual and Axiom Test Equipment. The acquisitions expanded our addressable markets, widened the breadth of our Service offering and allowed us to leverage our existing infrastructure.

As always, the key differentiator of Transcat's acquisition strategy is the effectiveness of our integration process that enables us to quickly achieve growth synergies and capitalize on compelling cross-selling organic growth opportunities.

In Fiscal 2024, Service gross margins continued to expand. Margins expanded 160 basis points to 33.8%. Service margins benefited from our differentiated suite of services which continues to resonate throughout our highly regulated and expanded addressable markets. Transcat customers continue to recognize and value Transcat's role servicing markets where the cost of failure is high and risk mitigation is a top priority.

I'll touch upon the fourth quarter results for our Service segment.

In the fourth quarter of fiscal 2024 our Service segment recorded its 60th straight quarter of year-over-year growth. We generated 18% total Service growth and 13% organic Service growth, driven by recurring revenue streams and high year-over-year retention. Increases in productivity driven primarily by automation and process improvement drove year-over-year increases in the fourth quarter Service gross margin by 170 basis points to 35.7%.

Turning to Distribution for the full fiscal 2024 year, revenue grew 5% and benefited from the high performing Axiom acquisition. Gross margins expanded 420 basis points from prior year. In the fourth quarter Distribution revenue grew 8% and gross margins expanded 510 basis points, again driven by the increased mix of the Rental business.

With that, I'll turn things over to Tom Barbato for a more detailed look at the fiscal 2024 financials.

**Thomas Barbato**

Thanks, Lee. I'll start on Slide 4, the earnings deck posted on our website, which provides detail regarding our revenue on a consolidated basis and by segment for the fourth quarter and full year.

Fourth quarter consolidated revenue of $70.9 million was up 14% versus prior year on Service segment strength and solid revenue performance in our Distribution business.

Looking at it by segment, Service revenue growth remained very strong at 18% with 13% of the growth coming organically and the other 5% from acquisition. As Lee mentioned, demand for our core calibration business remains strong.

Turning to Distribution, revenue of $24.2 million was up 8% versus the prior year. We continue to see growth in the higher margin Rental business which also benefited from the Axiom Test Equipment acquisition.

Finally, on a full year basis, total consolidated revenue was $259.5 million, an increase of 13% compared to the prior fiscal year. Our Service business saw very strong demand throughout the year, resulting in year-over-year growth of 17%. Distribution segment revenue grew 5%, driven by strong Rental performance.

Turning to Slide 5, our consolidated gross profit for the fourth quarter of $24 million was up 26% from the prior year, and our gross margin expanded 300 basis points. Service gross margin expanded 170 basis points to 35.7%. The Service margin increase further demonstrates our ability to leverage high levels of technician productivity and our differentiated value proposition. Distribution segment gross margin of 30.3% was up 510 basis points.

For the full year, our consolidated gross profit increased 23% to $83.8 million, and our gross margin improved 270 basis points to 32.3%. Our Service gross margin was 33.8%, which represented an increase of 160 basis points compared to the prior year. Distribution segment gross margin of 29.5% was up 420 basis points as the segment benefited from significant growth in the higher margin Rental business.

Turning to Slide 6, Q4 net income of $6.9 million increased 88% from prior year, and our diluted earnings per share increased to $0.77 from $0.48. Net income includes a non-cash adjustment of $2.4 million for the amended NEXA earnout agreement. We reported adjusted diluted earnings per share as well to normalize for the impact of upfront and ongoing acquisition related costs. Q4 adjusted diluted earnings per share was $0.66, up 10% from the same quarter of the prior year.

Full year net income increased 28% from prior year or $0.23 per share, and benefited from $800,000 of interest income driven by the proceeds from our successful secondary offering earlier in Q2 of fiscal '24.

Flipping to Slide 7 where we show our Adjusted EBITDA and Adjusted EBITDA margin, we use Adjusted EBITDA, which is non-GAAP, to gauge the performance of our business because we believe it is the best measure of our operating performance and ability to generate cash. As we continue to execute on our acquisition strategy, this metric becomes even more important to highlight as it does adjust for one-time deal-related transaction costs as well as the increased levels of non-cash expenses that will hit our income statement from acquisition purchase accounting.

With that in mind, fourth quarter consolidated Adjusted EBITDA of $11.7 million was up 30% from the same quarter in the prior year, and Adjusted EBITDA margin expanded 200 basis points. Both segments had Adjusted EBITDA growth and EBITDA margin expansion compared to last year.

Full year EBITDA was $38.6 million, which was up 27% compared to the prior year, driven by the significant year-over-year profit improvement in both segments. As always, a reconciliation of Adjusted EBITDA to operating income and net income can be found in the Supplemental section of this presentation.

Moving to Slide 8, operating free cash flow of $19.3 million significantly improved versus the prior year. Full year capital expenditures were $2 million higher than prior year, primarily to support the growth in Rentals. Capital expenditures in total continue to be centered around Service segment capabilities, rental pool assets, technology and future growth projects. The spend was in line with expectations.

Slide 9 highlights our strong balance sheet. At year end we had total net cash of $31 million with a leverage ratio of 0.1x. We had $80 million available from our credit facility at quarter end, and as previously announced, we acquired Becnel Rental Tools for $50 million just after the end of fiscal year, paid in a combination of $32.5 million in company stock and $17.5 million in cash.

Lastly, we expect to file our Form 10-K on May 28.

With that, I'll turn it back to you, Lee.

**Lee Rudow**

All right. Thank you, Tom.

As I stated at the start of the call, fiscal 2024 was an excellent year for Transcat. Our strategy is to drive meaningful and consistent differentiation into the highly regulated markets we serve. We want to continue to enhance the value we provide for our customers, which as always, includes a concentration of life sciences. We'll continue to leverage our competitive advantages, which include strong leadership and execution, to fortify and grow Transcat's position in the highly regulated markets that we serve.

We expect to continue to benefit from the recurring revenue streams and to generate organic Service growth in the high single-digit to low double-digit range. We expect our high margin Rental business to continue to grow.

We expect to continue to leverage continuous process improvement and automation to enable further sustainable margin expansion in our Service operation.

On the acquisition front, we expect our robust and diverse acquisition pipeline to continue to be a key component of our go-forward growth strategy. We expect to continue to acquire and integrate strategic acquisitions that enhance the value we bring to our customers through expanded capabilities. We expect acquisitions to be accretive and to effectively drive synergies. We expect to continue to expand our addressable markets in areas we believe are strategic and are a good fit for our core operating strengths.

The recent acquisition of Becnel is a great example of that. The acquisition further diversifies our portfolio of services in regulated spaces and increases Transcat's durability. Becnel is essentially a rental platform with a growing service component. It operates in a regulated environmental space with synergistic growth opportunities with large instrumentation users. Becnel is a highly profitable company led by a creative team of strong leaders with a demonstrated track record. We love that.

We are excited about the promotion of John Cummins, former owner of NEXA Enterprise Asset Management, to Vice President of Global Strategic Partnerships. In his new position, John will launch our integrated Transcat TS3 initiative, which stands for Transcat Single Source Solutions. This is an important next step for growth and differentiation. It's about looking ahead, anticipating and adapting to the market and opportunities. It's about being different or better or both.

Essentially, TS3 is the integration of NEXA's asset management and life cyle services with Transcat's core calibration services to provide a comprehensive full suite of services to be sold to high level decision makers for new capital projects and existing operations. One company, Transcat, will be able to offer commissioning, decommissioning, validation, CMMS, calibration, reliability and many other critical services to the life science manufacturing market, among others.

This is a unique approach, capitalizing on both Transcat's very strong brand and our position in the market. Transcat Single Source Solutions' program will launch midway through the fiscal year and we're excited to get started.

And of course, in addition to all these expectations, we expect to generate continued and sustainable long-term value for our shareholders.

With that, Operator, please open the line for questions.

**Operator**

Thank you. At this time we'll be conducting a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is int the question queue. You may press star, two if you'd like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment, please, while we poll for questions.

Our first question comes from the line of Danny Eggerichs with Craig-Hallum. Please proceed with your question.

**Danny Eggerichs**

Hi. This is Danny Eggerichs on for Greg today. Congrats on the good results again.

**Lee Rudow**

Thank you.

**Danny Eggerichs**

Wanted to start on the service side. Obviously you saw good growth again and a seemingly pretty good outlook for fiscal year '25 as well. I guess as we're talking about the margin there, I think a quarterly record that 35.7, and you kind of talked about some of the internal initiatives going on, the process improvements and the automation. Just kind of wondering where we're at in terms of those kind of internal initiatives and how much further we can kind of pull out of that margin moving forward.

**Lee Rudow**

Right. So, things continue to progress. We like the work that we're doing, both in automation—I think that's important. We are certainly no further along than if you were to use an analogy of a baseball game; we're probably in the fourth or fifth inning of that initiative. Process improvement, we're probably not even in the fourth or fifth inning. We're probably closer to third or fourth, so I think there's runway on both of those initiatives. But there are other things as well. We are always developing our operational leaders so the actual leadership in our labs, both at the management level, the assistant management level, we're working on all these things that will eventually make their way into margins.

I think we're looking at—we've sort of established that we're in the mid 30 range at this point. I think we'll get above that over time. As systems continue to improve and some of these other programs I mentioned mature, we'll get into the mid to upper 30s. Beyond that's a possibility but it might be too premature to talk about it. But I think we've got runway to keep getting better. I mean I guess essentially that's the message.

**Danny Eggerichs**

Got it. That's helpful. I guess maybe just sticking with margins, maybe on the distribution side. Over 30% over the last couple of quarters here and that's obviously before Becnel contribution. I maybe previously it was kind of the 28% to 30% range but now as we kind of layer in that higher margin business as well, how should we think about the progression of the distribution margins going forward?

**Thomas Barbato**

Danny, it's Tom. Obviously we're well entrenched in the low 30s and we would expect with the addition of Becnel for that total margin to get into the kind of mid 30s. We can provide some additional guidance as we go forward. We're still digesting Becnel, but we've got a pretty good idea of what impact it's going to have, obviously. But you could think of it in kind of that mid 30s range.

**Danny Eggerichs**

Okay. Great. Just following up on that Becnel, that's an entirely kind of new market that you're entering in on that rental side over there, in kind of the oil and gas. Is that correct?

**Thomas Barbato**

It is but we think about it a little bit differently, right? Is that we believe that the business isn't—and we've done a lot of diligence around this—that the business isn't really tied to the oil and gas industry so much as it's tied to the regulation around the work that has to be done. As Lee mentioned, there's environmental regulation around that industry of decommissioning oil wells and Becnel is providing and renting equipment to support those really important activities.

So, it really more plays with the regulated end markets that we serve, and from that standpoint we see it as more of the same than something different.

**Danny Eggerichs**

Okay. Got it. Appreciate it. I'll leave it there.

**Lee Rudow**

Thanks, Danny.

**Operator**

Our next question is from Scott Buck with HC Wainwright. Please proceed with your question.

**Scott Buck**

Hey, good morning guys. Thanks for taking my questions. Can you tell us what percentage of distribution segment revenue is coming from rentals post the Becnel acquisition?

**Thomas Barbato**

Yes. Post acquisition it's about 35% of the overall distribution business.

**Scott Buck**

Okay. Perfect. That's helpful. Then second one, I wanted to ask you about acquisitions. I'm curious. Just given—and I think we saw it a little bit with Becnel—the strength of your equity, does that change the way that you view potential acquisitions, maybe in terms of size, or how you would finance deals?

**Lee Rudow**

This is Lee. I would say yes and no. It's good. We did the offering. We put ourselves in a position so that if we found an opportunity that was a little bit larger than what we had done in the past and was a good strategic fit, that we'd be in a position to execute upon it. I think as we go forward we continue to look at the strength of our stock. We look at our cash position. Each deal will present a different opportunity and we'll look at them on an individual basis.

But I like the position we're in. Our capital structure allows us to execute our strategy and that's the key. I see us being in a good position to do just that. So, I think it depends on each individual situation how we'll approach it. Equity will always be on the table as a potential tool.

I hope that answers your question, Scott.

**Scott Buck**

Yes. That makes sense. Appreciate that. Then last one, Tom, just on OpEx for '25, how should we be thinking about general growth there versus the strength that you've seen on the top line?

**Thomas Barbato**

Yes, Scott. I think if you look at kind of Q4 numbers as kind of a jumping off point, I think you could continue to expect some level of reasonable growth going forward from there.

In order to be able to continue to grow at the rate we are organically, we need to continue to invest in the appropriate level of selling resources to support that future growth. So, I would use Q4 as a jumping off point. Some level of kind of modest growth from there and you would expect that growth to continue through the fiscal year.

**Scott Buck**

All right, perfect. That makes sense. Appreciate the time, guys. Thank you.

**Lee Rudow**

Thanks, Scott.

**Operator**

Our next question is from Ted Jackson with Northland Securities. Please proceed with your question.

**Ted Jackson**

Thanks. I'm going to beat some dead horses because everyone has asked all my questions basically. Congrats on the quarter. Can we go back over into the rental? One of the comments that was in the press release that I thought was at least worth exploring a little bit was the efforts in terms of trying to bring rental into kind of other parts of your customer base. Maybe my first question would be, could you unpack that a little bit and talk about what you see with that and how that effort is going to unfold? Kind of, what verticals and what kind of penetration do you think you can get out of it? Then I've got a follow-up.

**Thomas Barbato**

Ted, let me make sure I understand the question. Are you saying what sort of additional cross-selling opportunities are for the rental business into our service customers? Is that essentially…?

**Ted Jackson**

Yes.

**Lee Rudow**

One example I'll give you—and something that we liked in the Becnel deal. Clearly this is a company that rents equipment for the decommissioning of the regulated decommissioning space with oil wells, but when we looked at their customer base, of course you know you're going to see Haliburton and Schlumberger. You're going to see Baker Hughes. These are historically large, large users of instrumentation – all process equipment, calibrators, pressure gauges. So it's not just the service component and the rental component; it's also the instrument component. I think that wherever there's instrumentation there's opportunities for calibration growth as well, and sometimes internally here we say, "All roads lead to calibration," and so when we look at an acquisition we like to check that box if we can. I think with Becnel, for example, we were able to do that.

Time will tell. You have to execute well. You have to cross-sell well, but we're certainly capable of doing that and that's what I would expect from the Company.

**Thomas Barbato**

I would just say, going the other way, right, there's always a focused effort on renting to our existing customer base, right? It helps solve customer problems. It builds goodwill with those customers, and obviously it provides us a path to some really attractive margin business. That's something we do as a regular part of our normal course of doing business and our sales efforts.

**Ted Jackson**

Is there any case to be made that buying equipment in your distribution business, that's CapEx and renting is more of an OpEx—I'm turning it into a variable—that with interest rates higher and people managing and looking at their capital expenditures and a little more detail that there's an underlying lift maybe for some of your rental business because of the change in the interest rate environment and such?

**Lee Rudow**

Yes, so there certainly could be, and as we look at our company—and you've heard us, Ted, through the years talk about being recession-resistant. It's all part of how we build our value prop. So our suite of services, which includes rental, certainly has that OpEx/CapEx component to it. Life sciences in general tends to lend itself to some resistance, and so we start—you look at the NEXA business and what they do on the cost control and optimization portion, and all these services together are coordinated and lead towards some sort of resistance to economic cycles and we love that part of the business. We're going to keep making sure that we enhance it and it's part of our value prop.

**Ted Jackson**

Okay. Then just shifting over to Becnel for those of us that actually really incorporated that into their forecasts at this point. It's about a $20 million revenue business. I assume you were kind of layering that into this fiscal year with maybe an adjustment for the first quarter because it's not quite a full quarter. Is there any seasonality to that business that should be taking into account? How do we think about that in terms of how their top line flows through over the course of the 12-month cycle?

**Thomas Barbato**

Ted, I'll take that one. Think of it as a kind of high teens revenue business and I think your point's correct, right? There should be an adjustment for the first quarter of this year because we acquired them part way through April.

There is some seasonality to that business. It's actually almost like somewhat complementary to the seasonality of Transcat's business, right? Because their lowest revenue is in calendar Q1, which is traditionally Transcat's highest quarter. I guess if there's going to be seasonality that's kind of a good fit. But Q1 is definitely the lightest—calendar Q1 is definitely the lightest quarter for their business. It's that way for all the business operating in the Gulf. There's weather concerns in the winter. There's some other reasons behind that. But if you need more detail on that we can discuss it offline.

**Ted Jackson**

Okay. Then—then I'll step out of line—but you've gotten into this business. It sounds pretty interesting. Is there other opportunity for you there in terms of M&A, like the pipeline? Is this something that you can grow through further M&A? And obviously, I'm sure you'll be trying to do it on an organic basis, but it did kind of put you in a brand new market and it's intriguing.

**Lee Rudow**

This is Lee, Ted. I think any time we make an acquisition and we state that it expands our addressable markets, somewhere we have in mind that there's potential beyond the acquired company. That remains to be seen and we certainly have to execute against that, but I think your point is we're in a space that if we operate well in and develop a—demonstrate a track record to grow organically, then we would also look down the acquisitive path as well. That would be a normal course of action for us.

So, yes, we'll keep looking at this market, both organically and through acquisition, and try to make the best decisions to match our strategy as we go forward.

**Ted Jackson**

Okay. Thanks for the time and congrats on the quarter.

**Lee Rudow**

Our pleasure. Thanks, Ted.

**Thomas Barbato**

Thanks, Ted.

**Operator**

As a reminder, if you'd like to ask a question, please press star, one on your telephone keypad. One moment, please, while we poll for questions.

Our next question comes from Martin Yang with Oppenheimer. Please proceed with your question.

**Martin Yang**

Hi. Good morning. Thank you for taking the questions. The first question on CapEx for fiscal '25, is there anything incremental on a year-over-year basis, especially relating to Becnel?

**Thomas Barbato**

Yes. Martin, great question. Obviously we saw an increase in CapEx this past year with the Axiom acquisition. I think we should expect to see a similar increase in '25 with the Becnel acquisition, right? The key to growing a rental business is you've got to have the assets in place to be able to rent. The returns on those assets are very good and you see that in the margin profile of that business. But yes, I would expect a similar increase to support rentals and then the majority of the remainder of the business remains about the same.

**Martin Yang**

Should we think about the similar increase in terms of dollar amount or percentage growth?

**Thomas Barbato**

Dollar amount.

**Martin Yang**

Thanks. Next question on TS3. Can you maybe give us a little more detail on the new brand positioning? With a more integrative service, are you trying to approach customers who were maybe not easy to win without a sister offering? Overall, is this new positioning relating to trying to get customers that are harder to reach without it?

**Lee Rudow**

I think that's the right way to characterize it. So, when you take a look at our value proposition that we've built over the years, both organically and through acquired companies, we look at the strength of that. We're in a unique position now as a result of these activities to be able to present something that is really some comprehensive that if we get to the right level at the right time with the right decision makers—which is what TS3 is all about—we really do have a compelling approach to servicing highly regulated customers.

Historically, we've always had nice growth but it's been at the low, mid and high ranges of what we would call opportunities. We have a transactional business. We've got a business that is anywhere from a couple of hundred thousand dollars to let's say low seven figures or a million dollars. But now with this value prop, if you get in the right place at the right time, there should be, we believe, an opportunity to do something different and to do something large.

It takes a different approach and it takes a different game plan, but that's what TS3 is about – a single source solution that can really save the customer a lot of time and money over time and get their work done properly and all the other features like risk mitigation. That's what it's about. So I think you've characterized it well.

**Martin Yang**

Got it. A quick follow on the way you characterizing large. Is there a potential for—what I'm thinking is two verticals. One is maybe more service offer to customers; the other is maybe the duration of the contract or relationship with the customers. Is any one of the two others gave you confidence that you can maybe grow the potential size of the business you engage with?

**Lee Rudow**

I think the potential is there for both – to grow the length of these contracts and to grow the size of these contracts. Over time, the goal would be both based upon our ability to do something unique and to do it well and to add value. When you do those things, when you have that combination going for you at a fair price, you're going to have a really good relationship with your customer and I think that's going to ultimately make its way to the length of the contract and the size of the contract.

So, you've got to execute well, Martin, but assuming you do that I would agree that both are potentially our goals.

**Martin Yang**

Got it. Thank you, Lee. That's it for me.

**Lee Rudow**

Okay. Thank you.

**Operator**

We have reached the end of the question-and-answer session. I'd now like to turn the call back over to Lee Rudow for closing comments.

**Lee Rudow**

Okay. Thank you all for joining us on the call today. We certainly appreciate it. We'll be presenting at the Craig-Hallum Investment Conference in Minneapolis on May 29. You're welcome to join us there. Otherwise, feel free to check in with us any time. We look forward to talking with everyone again after our first quarter. Take care.

**Operator**

This concludes today's conference. You may disconnect your lines at this time. We thank you for your participation.