CALL PARTICIPANTS

EXECUTIVES

Joseph Armes
Chairman, President, & Chief Executive Officer

James Perry
Executive Vice President & Chief Financial Officer

Adrianne Griffin
Vice President of Investor Relations & Treasurer

ANALYSTS

Jonathan E. Tanwanteng
CJS Securities, Inc.

PRESENTATION

Operator

Greetings and welcome to the CSW Industrials Inc. Fiscal Second Quarter 2021 Earnings Call.

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.

It is now my pleasure to introduce your host, Adrianne Griffin, Vice President of Investor Relations and Treasury. Please go ahead.

Adrianne Griffin
Vice President of Investor Relations & Treasurer

Thank you, Claudia.
Good morning, everyone, and welcome to CSW Industrials Fiscal Second Quarter 2021 Earnings Call.

Joining me today are Joseph Armes, Chairman, Chief Executive Officer and President of CSW Industrials, and James Perry, Executive Vice President and Chief Financial Officer.

We issued our earnings release and presentation prior to the markets opening today, and both are available on the Investor portion of our website at www.cswindustrials.com. During this call, we will reference specific slides in the presentation. This call is being webcast, and information on how to access the replay is included in the earnings release.

During this call, we will be making forward-looking statements. These statements are based on current expectations and assumptions that are subject to various risks and uncertainties. Actual results could materially differ because of factors discussed today in our earnings release, and in the comments made during this call as well as the risk factors section of our Annual Report on Form 10-K and other filings with the SEC. We do not undertake any duty to update any forward-looking statements.

I will now turn the call over to Joe Armes.

Joseph Armes
Chairman, President, Chief Executive Officer

Thank you, Adrianne. Good morning and thank you for joining our Fiscal Second Quarter Conference Call. First, I would like to congratulate each of the over 750 CSWI team members for their ongoing efforts, working together so effectively during times of uncertainty, emerging even better positioned for future growth, and remaining dedicated to delivering results for our shareholders.

I'll begin with a high-level discussion of consolidated results and key end markets, concluding with commentary for the second half of our fiscal year.

Through the cycles, we at CSWI measure our success in many ways, focusing this fiscal year on our 4 guiding objectives that we outlined in May, the details of which are included on Page 6 of the October 2020 investor presentation. Notably, this quarter, as compared to the prior year period, we realized 30% total growth in sales into the HVAC/R and plumbing end market, driving top and bottom line organic growth. In addition to solid growth in revenue and operating income, we reported increased profitability with record quarterly operating income margin of 21.1% and further enhanced our financial position with nearly $300 million of liquidity, including $47 million of cash on hand and our full unfunded revolving credit facility at quarter end. On Slide 8 of that presentation, we outlined the results for the quarter, culminating in earnings per share from continuing operations of $1.10 per share, which is approximately 20% higher than the prior year period. Our strong fiscal second quarter results contributed to a 19.4% increase in operating cash flow from continuing operations in the first fiscal half of 2021 over the prior year period and earnings per diluted share from continuing operations of $1.91, an increase over $1.89 in the prior year period.

I would also like to share a few metrics illustrating the strength of our financial position. In the last twelve months, over $42 million of cash was returned to shareholders in quarterly dividends and share repurchases; and, our net cash provided by operating activities of $78.7 million during that same period represents a nearly 21% cash flow yield. Earlier this month, we celebrated the 5th anniversary of our existence as a standalone public company. In our first five years, our total shareholder return was in excess of 150%. And today, we remain unceasingly committed to being good stewards of your capital.

In recent months, our pursuit of value-accretive growth opportunities has persisted as our companies and brands demonstrate attractive through-cycle durability. We remain active, evaluating organic and inorganic growth opportunities, yet disciplined, especially regarding valuation, prospective synergies, cultural fit, and ease of integration. Our ample liquidity at quarter end, enduring access to capital markets, and our experienced leadership team facilitate our pursuit of accretive, bolt-on acquisitions within our existing end markets to broaden our portfolio of brands and products.

During the fiscal second quarter, our largest end markets outperformed ours and the Street's, expectations. We achieved 33% growth, and record sales into the HVAC/R end market, driven by warmer than average temperatures and work from home trends. A similar trajectory held in our plumbing end market, as distributors restocked their inventory and sales increased nearly 20% over the prior year period. Turning to slide 9 in the presentation, sales into the HVAC/R and plumbing end markets accounted for 42% and 11% of total quarterly revenue, respectively. Looking to the fiscal second half of the year, we anticipate ongoing strength in these markets with modest growth compared to the same prior year period. We anticipate capitalizing on the strength in new single-family housing construction as well as the ever-increasing installed base, which is most important for our repair and replacement products. Longer term, we remain bullish on these end markets as our products are utilized in new and replacement installations, maintenance and repair.

Sales into the architecturally specified building products end market remained at 28% of total revenue in the fiscal second quarter, exceeding sales in the fiscal first quarter and were nearly flat with the same prior year period. Projects originally scheduled for the fiscal second half of the year were accelerated by our customers into the fiscal second quarter, positively impacting results. As we've discussed on prior calls, pandemic driven demand softness resulted in lower bookings earlier this calendar year. During the fiscal second quarter, we experienced a positive inflection point as bookings exceeded those in the fiscal first quarter by approximately 38%, indicating potential, early improvement. As of the end of the fiscal second quarter, our book to bill ratio for the trailing eight quarters was just barely below 1. Given project pull forward into the fiscal second quarter and a reduction in first quarter bookings, we do expect fiscal second half revenue into this end market to be moderately lower than the prior year period with the positive impact of the recent increases in bookings anticipated to be realized in our fiscal 2022, which begins in April of next year.

In our general industrial, rail, and mining end markets, sales declined in the short-term due to pandemic weakened demand, and there are signals of early stage recovery for the types of maintenance and capital investing decisions that drive demand for our products. Quarterly sales into our general industrial end market comprised approximately 10% of total sales, an 11.6% increase over the fiscal first quarter, providing early signs of recovery. Macro indicators for the energy, rail, and mining end markets, which collectively account for 9% of sales, have also begun to stabilize. With this backdrop, we expect sales into these end markets in the fiscal third and fourth quarters to perform much like the fiscal second quarter, with potential for a modest increase.

Regarding the second half of the fiscal year, we expect consolidated revenues to be mid-to-high single digits lower than the prior year period. During the fiscal third quarter, expected performance in HVAC/R and plumbing are anticipated to be more than offset by a decline in architecturally specified building products due to lower bookings in the fiscal first quarter, and a slow recovery in the general industrial, rail, and mining end markets. Fiscal third quarter earnings will be impacted more meaningfully than revenues due to decremental margins and normal seasonality and we expect to return to normalcy in fiscal fourth quarter. We remain diligent in our pursuit of operational excellence and a competitive cost structure and were flexible to initiate swift reaction to the realities of the markets.

During the fiscal second quarter, strength in our served end markets delivered organic revenue growth, increased profitability and enhanced liquidity, resulting in an increase in our net cash position. Our attractive business model and diversified end markets continue to provide financial strength, stability and resiliency, while our team provides thoughtful direction as we execute on our capital allocation policy, ensuring that investments are directed to the highest risk-adjusted return opportunities that will continue to deliver long-term shareholder value.

And with that, I'll turn the call over to James for a closer look at the numbers.

James Perry
Executive Vice President, Chief Financial Officer

Thank you, Joe, and good morning, everyone. Before I begin my remarks about our financial performance, I would like to announce that our Board of Directors authorized a new upsized share repurchase program. The previous $75 million program was set to expire on November 8, 2020, and the cumulative investment under this program was $46 million and approximately 740,000 shares. Our new $100 million authorization replaces the old program, takes effect immediately and expires on December 31, 2022. We welcome the opportunity to continue to support our share price and to execute on our capital allocation policy as described on Slide 20, which includes share repurchases.

Our consolidated revenue during the fiscal second quarter of 2021 increased 3.6% to $104.9 million, compared to $101.3 million in the prior year period. 100% of this growth was organic. The higher revenue was driven by $9.7 million of increased sales in the Industrial Products segment, partially offset by a $6.1 million decrease in the Specialty Chemicals segment. Our profitability metrics remained strong, with consolidated gross profit margin of 46.4%, 40 basis points higher than the same period last year, after removing a prior year gain on sale that did not recur. Consolidated operating income margin was 21.1%, a 130 basis-point increase from fiscal second quarter 2020, due to the stronger than expected growth in sales in some end markets served, combined with cost reduction measures to offset some of the impacts from declining sales in the remaining end markets. We expect margins in the second half of the year to be lower than the prior year period.

Net income from continuing operations in the fiscal second quarter was $16.4 million or $1.10 per diluted share, compared to $8.8 million or $0.92 per diluted share in the prior year period after adjusting for the onetime charge of $0.35 per diluted share after tax to terminate the company's U.S. qualified pension plan.

Turning to slide 10, the Industrial Products segment delivered fiscal second quarter revenue of $72.5 million, 15.5% higher than the prior year period. Segment operating income of $19.7 million and operating income margin of 27.2%, exceeded the prior year period of $16.4 million and 26.1%, respectively. These strong results were driven by sales into the HVAC/R and plumbing end markets that Joe described previously.

Continuing to slide 11, the Specialty Chemicals segment realized fiscal second quarter revenue of $32.4 million compared to $38.6 million in the prior year period. Segment operating income was $5.8 million compared to adjusted segment operating income of $6.4 million in the prior year period, as cost reduction efforts offset a large portion of the decline in sales revenue. The prior year period was adjusted to exclude an $800,000 gain on sale that did not recur this year. Operating income margin in the fiscal second quarter was 17.9%, a 140 basis-point improvement from fiscal second quarter 2020, also due to the cost reduction initiatives deployed to offset the decline in sales.

Transitioning to the strength of our balance sheet, cash balance as of September 30, 2020, was approximately $47 million, approximately $28 million higher than at June 30, 2020. With our solid cash generation and excellent liquidity position, including the full $250 million available on our revolving credit facility, we are well positioned to fund accretive growth.

I'll now cover our fiscal first half consolidated financial results as outlined beginning on slide 13. The strength of our second quarter nearly offset the weakness of the first quarter with fiscal first half revenue of $195.9 million, only a 3.8% decrease as compared to the same period last year. Increased sales into the HVAC/R and plumbing end markets were more than offset by pandemic-driven demand declines in other end markets served. Gross profit margin was 46.7%, or 20 basis points higher than last year's first half of the fiscal year, as the decline in sales was more than offset by cost reduction efforts. Operating income was $38.4 million, a 5% decline over the prior year period as the decrease in lower sales volumes was partially offset by a reduction in expenses. Reported net income from continuing operations was $28.3 million, or $1.91 per diluted share, compared to $28.8 million or $1.89 per diluted share in the prior year period, after adjusting for the one-time charge of $0.35 per diluted share, after tax, to terminate the Company's U.S. qualified pension plan.

Turning to slide 14, the Industrial Products segment delivered fiscal first half revenue of $133.7 million, 6.0% higher than the prior year period, as demand-driven sales in the HVAC/R and plumbing end markets were partially offset by other end markets served. Segment operating income of $36 million and operating income margin of 26.9%, exceeded the prior year period results of $33.5 million and 26.5%, respectively.

Continuing to slide 15, the Specialty Chemicals segment realized fiscal first half revenue of $62.2 million compared to $77.5 million in the prior year period. Segment operating income was $9.8 million and operating income margin of 15.7%, compared to adjusted segment operating income of $13 million and operating income margin of 16.8% in the prior year period as the decline in sales in all end markets served more than offset cost reduction efforts.

The effective tax rate on continuing operations for the fiscal second quarter was 23.8%. We continue to expect our full-year tax rate within a range of 24% to 26% for Fiscal 2021.

Moving to our cash generation and balance sheet, our operating cash flow from continuing operations was $44.8 million in the first fiscal half of 2021, a 19.4% increase over the $37.5 million in the prior year period, due primarily to working capital from increased sales. During the fiscal first half of the year, we returned $13.3 million to shareholders through share repurchases and dividend payments.

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

Joseph Armes
Chairman, President, Chief Executive Officer

Thank you, James. When we think about evaluating the sustainability of our company, we are seeking to generate strong business results despite the challenges our markets face today, and we also want to attract and retain outstanding, diverse talent to propel us into the future. Certainly, this quarter, we've continued to demonstrate CSWI's sustainability, delivering top and bottom line growth above the end markets served and increasing profitability that results in growing EPS, ample liquidity and a strong balance sheet, while maintaining a commitment to our guiding objectives that are consistent with and supportive of our core values.

I'm very proud and honored to announce that during the quarter, CSWI was awarded the Cigna outstanding culture of well-being award for 2020, which is further evidence of our commitment to support the health and well-being of our team members. Our dedicated employees have enabled our operations to continue without disruption. Our employees are essential to our success, and we are committed to providing a safe workplace in an inclusive and diverse environment, supporting professional development through employee education and advancement opportunities, in addition to a compensation strategy where each member of the CSWI team participates financially in the success of our company.

As always, I would like to close by thanking all my colleagues here at CSWI who collectively own approximately 5% of CSWI through our employee stock ownership plan as well as all our shareholders for their continued interest in and support of our Company.

With that Operator, we're now ready to take questions.

Question and Answer
Operator
[Operator Instructions] Our first question is from Jon Tanwanteng with CJS Securities.

Jonathan E. Tanwanteng
CJS Securities, Inc.

Congrats on the record quarter. To start, I was wondering if you had any view of the channel inventory in HVAC and plumbing? And if your customers still need to restock after a very hot quarter?

Joseph Armes
Chairman, President, Chief Executive Officer

Yes, Jon that has not been a major topic of conversation with our teams. I mean, I think that we saw the destocking earlier in the year and then the restocking, and I think the sell-through has been pretty strong since then. And so that's not a driving factor at this point.

Jonathan E. Tanwanteng
CJS Securities, Inc.

Okay. Got it. And then just in terms of the spike in COVID cases around the country, what are you doing to prepare for that with regards to your own operations and how it could impact your demand or supply chain? And have you integrated that into your outlook for the second half?

James E. Perry
Executive VP & CFO

Jon, this is James. Yes. Certainly, we've looked at that a little. I wouldn't say we've necessarily tried to predict what the financial impact of that would be. One thing I would say that we've done and it's kind of the corollary to what you asked a minute ago is we've certainly talked to our businesses a lot about adding a little bit of inventory internally. So you may see working capital move up a little bit this quarter because we do want to be sure whether it's COVID-related, supply chain-related, which may be COVID-related as well. We've seen little issues here and there, nothing substantial, certainly not internal COVID disruptions. But we have told our folks and we support with the balance sheet we have, which is a great reason that we're proud of the strength we have in the balance sheet to invest that in inventory to be sure when our customers do need to stock, when our customers do need the product, we can get it to them in a timely manner and not lose that sale.

Joseph Armes
Chairman, President, Chief Executive Officer

And I would say, Jon, that we continue to have anecdotes where we've been able to pick up business from competitors because of shorter lead times and our ability to deliver during these uncertain times, and that's gaining market share for us.

Jonathan E. Tanwanteng
CJS Securities, Inc.

Got it, thank you. And then just on the chemical business, the margins there were much stronger than I expected. I think you mentioned that it was due to cost cutting. I know that should come down seasonally in the next quarter, but should we think of this quarter's performance as a new base? Or was there a one-off? Or do you think some of those cost reductions get rolled back as you normalize demand there?

James E. Perry
Executive VP & CFO

Yes, Jon, this is James. Again, as you pointed out, you have some seasonality with certain businesses. And as we mentioned, there's certainly a little bit of unpredictability. But the team has done a nice job across the board. I would certainly highlight the Specialty Chemicals segment, but the same is true in Industrial Products. The teams have done a good job reducing cost. I think some of those costs stay out of the system. As we see things start to pick back up, some of that may come back. Clearly, we've continued to reduce travel. And it's an expense that in the near-term release is going to stay low. You could see some of that creep back, but I think we've learned to adjust at some certain levels at the administrative level potentially and some other type costs that maybe you thought were discretionary, but now they're somewhat permanent in the system. So I wouldn't necessarily want to say that we're at a new margin level or that's our new base, so to speak. I think it will take a couple of quarters for that to roll out. But I think the team has gotten very comfortable with this new level of expenses. I'll remind you, and we talked about this on the last couple of calls, we've committed to maintaining employment as a result of COVID. So as we've had attrition and we've been able to right-size operations, but we've not made COVID-related employment decisions. So some of your personnel expenses were up or down here and there. But overall, there are costs that are out of the system that I think we can maintain long term.

Jonathan E. Tanwanteng
CJS Securities, Inc.

Got it. That's very helpful. And then I think you mentioned that architectural, some of the business pulled in from the second half, can you quantify that? And how much it impacted your quarter, both on the top and bottom line?

James E. Perry
Executive VP & CFO

Yes, this is James. We wouldn't quantify that. I know that would help some. Certainly, that helped the second quarter, and it helped us, as we pointed out, almost make up for the first quarter, which, obviously, the first half of the first quarter was tough. So we almost caught all the way back up on a consolidated level and did so on an earnings level. So we had some pull forward. We started seeing that a little at the end of the first quarter. Certainly saw it in our fiscal second quarter. So that leads to this weakness, a bit of an air pocket in the third quarter potentially for us. And that's why we really want to point out the third quarter is kind of where we see the weakness on top of just seasonality. So we wouldn't quantify that, but it was certainly an impact on beating our expectations, so to speak, on the second quarter, along with the HVAC performance that was very strong.

Jonathan E. Tanwanteng
CJS Securities, Inc.

Okay. Fair enough. And obviously, congrats on landing more orders in that business. Can you describe the customers that place those orders and kind of where that came from? Those were something that were delayed and then finally were released? Or is it just more organic demand and kind of what you're expecting in the next couple of quarters there?

Joseph Armes
Chairman, President, Chief Executive Officer

Yes, Jon, this is Joe. I think it's a combination of all of the above. I would say the business that we bought down in Florida a couple of years ago has been really strong in institutional, educational type of end market or categories, which has been stronger than some other areas. So our diversification into that has paid off really nicely, and that's worked well. But it's been a mix of residential, it's been office, and again this is more institutional, educational piece, all of the above. And it's been spread geographically. And so I think it's been a really nice result to see the strength across the board there, and our bookings growing. I've been very pleased with that, Jon, and our team is performing well.

Operator

This concludes the question-and-answer session and today's conference call. You may disconnect your lines. Thank you for participating, and have a pleasant day.