

# **Powell Industries, Inc. (POWL) Q3 2024 Earnings Call Transcript**

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**Body**

Powell Industries, Inc. (POWL)

Q3 2024 Earnings Conference Call

July 31, 2024 11:00 AM ET

Company Participants

Ryan Coleman - Alpha IR

Brett Cope - Chairman & CEO

Mike Metcalf - CFO

Conference Call Participants

John Franzreb - Sidoti & Company

Jon Braatz - Kansas City Capital

Presentation

Operator

Good day and welcome to the Powell Industries' Fiscal Third Quarter 2024 Results Conference Call. All participants will be in a listen-only mode. [Operator Instructions] Please note, this event is being recorded.

I would now like to turn the conference over to Ryan Coleman with Alpha IR. Please go ahead.

Ryan Coleman

Thank you and good morning everyone. Thank you for joining us for Powell Industries' conference call today to review fiscal year 2024 third quarter results. With me on the call are Brett Cope, Powell's Chairman and CEO; and Mike Metcalf, Powell's CFO.

There will be a replay of today's call and it will be available via webcast by going to the company's website, powellind.com, or a telephonic replay will be available until August 7th. The information on how to access the replay was provided in yesterday's earnings release.

Please note that information reported on this call speaks only as of today, July 31st, 2024, and therefore, you are advised that any time-sensitive information may no longer be accurate at the time of replay listening or transcript reading.

This conference call includes certain statements, including statements related to the company's expectations of its future operating results that may be considered forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

Investors are cautioned that such forward-looking statements involve risks and uncertainties, and that actual future results may differ materially from those projected in these forward-looking statements.

These risks and uncertainties include, but are not limited to, competition and competitive pressures; sensitivity to general economic and industry conditions; international, political and economic risks; availability and price of raw materials; and execution of business strategies. For more information, please refer to the company's filings with the Securities and Exchange Commission.

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

Brett Cope

Thank you, Ryan and good morning everyone. Thank you for joining us today to review Powell's fiscal 2024 third quarter results. Before we get started, I'd like to take a moment to recognize the devastating effect at Hurricane Beryl has had on the Greater Houston area and most importantly, the effect it has had on our Powell team members, many of whom were impacted by the storm's initial hit to the city, as well as the well documented and lengthy impact of power availability in the Houston region, which is home to our company and so many of our employees.

Our concern for the safety and well-being of our employees is not only our number one priority, but also extends beyond the job site and the time they spend here at our facilities. They have shown incredible resolve dealing with the adversity of the past month and each of them have Powell's full support as the Houston area returns to normalcy.

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Operationally, our facilities here in Houston were without power for varied lengths of time, the longest impact was nearly five working days. We are working with our clients to minimize any subsequent impact on production schedules and do not expect a material impact on our revenue outlook for the fiscal fourth quarter.

With that, let's review our quarterly results. Our fiscal third quarter reflects the strong operational execution the Powell team continues to deliver and further validates our strategy as well as our unique market position as an integrator of complex engineer-to-order electrical solutions.

Revenues in the quarter were 50% higher than the prior year as we saw strength across nearly all of the market sectors we serve. The revenue growth was driven by our core industrial end markets as oil and gas and petrochemical revenues grew 56% and 158%, respectively. Our utility sector also delivered a strong performance. Mike will provide further detail on our results by sector in a moment.

We booked $356 million of new orders in the quarter, the highest quarterly total of fiscal 2024 and orders were spread broadly across our key end markets. We saw a significant increase driven by our electric utility sector, further underscoring the strength we are seeing in that market. While we were also awarded a notable petrochemical order for a greenfield project to be located in North America.

In addition to the higher revenues, our focus on project execution and operational efficiency continued to support improved gross margins. Our gross margin -- our gross profit in the quarter nearly doubled versus the same period in fiscal 2023, achieving a gross margin of 28.4% of revenue. This is an improvement of 620 basis points compared to the same period in fiscal 2023 and is the highest quarterly gross margin Powell has recorded in over a decade.

Another encouraging dynamic we are observing is the improvement in gross margins across the whole of our business, including many of our nonindustrial markets. Historically, projects in these markets tend to carry a slightly lower average gross margin than highly complex electrical solutions.

However, we are now seeing that gap narrow as the economics of these nonindustrial markets are improving and Powell becomes more effective in our manufacturing and delivery process.

Our backlog was effectively unchanged sequentially at $1.3 billion and remains the highest in Powell's history. We continue to be very pleased with the overall composition of our backlog as well as the timelines and margin profile of the projects that constitute our order book.

On the bottom-line, we recorded net income of $46.2 million or $3.79 per diluted share, which was more than double the $18.5 million or $1.52 per share in the prior period.

Our capacity initiatives continue to move along as planned to help further facilitate the execution of our current backlog as well as planned for modest volume growth going forward.

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Last year, we completed the expansion of our Houston facility on the Gulf Coast, which is providing us with incremental fabrication and integration support for large power control rooms especially for projects that support delivery and transport by water access.

The previously announced expansion of our electrical products factory in Houston is also progressing as planned. This $11 million factory addition is expected to be completed in the middle of fiscal 2025 and coincides with our initiative to release new products in support of our future growth across the customers and markets we serve.

Most recently, in early July, we acquired nine acres of property neighboring our Houston headquarters location for a total consideration of $5.5 million. We are currently undertaking some minor remediation work to get the space prepared for productive use and we expect this additional property to contribute incremental revenue in fiscal 2025.

Year-to-date, our R&D spend is up 49% as we advance our innovation initiatives to develop new technologies and broaden our product portfolio. We remain comfortable with our current staffing levels and are confident that we have the right people in place to meet the demanding project schedules of our backlog.

However, as we've stated before, a critical area of focus for Powell remains the acquisition of talent at all levels to support Powell's long-term growth strategy along with opportunities we see across most of our key markets.

Looking forward, expectations for project activity and new orders across our markets are relatively unchanged. Overall, quoting activity remains very healthy and balanced.

Within the oil and gas LNG market, the fundamentals of the U.S. natural gas market remain favorable and support many global economic and environmental goals over a long-term horizon.

Natural gas price spreads across global markets remain conducive to U.S. export activity. Near-term activity remains subdued as a result of the U.S. Department of Energy policy regarding LNG export permitting. However, we have not altered our long-term planning for this market.

The fundamentals for our oil and gas and petrochemical markets continue to support our expectation for continued strength for these sectors. This sector includes energy transition projects, such as biofuels, carbon capture, and hydrogen, areas where Powell has not historically participated, but where we are seeing a substantially higher volume of project activity.

Activity within our commercial and other industrial market also remains attractive, which includes activity within the data center market. As we outlined on our second quarter call, we believe the strong growth that we have seen so far in this market for Powell has a larger potential as we continue to qualify more of our products and services for the future of this important end market.

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Lastly, the outlook for our utility market remains very positive, supported by our recent return of new generation work in addition to Powell's leadership and utility distribution substations. We've been very pleased with both the volume of projects coming to market as well as our win rate on the orders we have booked thus far.

Overall, we are very happy with our third quarter performance and we remain confident in the composition of our current backlog, the near and medium term outlook for our key end markets, as well as our strong financial position.

Altogether, we continue to expect a favorable operating environment for Powell as we focus on successfully delivering the projects in backlog to our customers and advancing our strategy.

With that, I'd like to turn the call over to Mike to walk us through our financial results in greater detail.

Mike Metcalf

Thank you, Brett and good morning everyone. As Brett noted, our revenues for the third quarter of fiscal 2024 were $288 million compared to $192 million or 50% higher versus the same period one year ago, and higher sequentially by $33 million.

New orders for the third fiscal quarter were $356 million, $121 million or 51% higher sequentially and $149 million or 30% lower versus the same period one year ago and a challenging comparison as the prior year period contained two LNG mega project bookings.

While there were no similar sized projects booked in the current quarter, there were a number of significant bookings in the third fiscal quarter as we continue to experience strong demand across most of the end markets and geographies that we compete in.

As our efforts to broaden our penetration into tangential markets outside of our core industrial end markets continues, we experienced order growth sequentially across all market sectors, but most notably in the utility and commercial and other industrial sectors, increasing 77% and 63%, respectively.

As a result of the sustained strength across all of our market sectors, we recognize a 1.2 times book-to-bill ratio in the third quarter of fiscal 2024 resulting in ending backlog of $1.3 billion, which was flat versus one year ago and higher by $64 million sequentially.

Compared to the prior year, domestic revenues improved by 59% to $244 million, while international revenues were 14% higher, driven by increased project volume across both of our international operations in Canada and the United Kingdom. In total, international revenues were up by $5 million to $44 million in the third fiscal quarter.

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From a market sector perspective versus the third quarter of fiscal 2023, we experienced healthy growth across the majority of our market sectors. Revenues across our core industrial, oil and gas and petrochemical sectors sustained their positive momentum with the oil and gas sector higher by 56% and the petrochemical sector higher by 158% as we continue to benefit from the revenues exiting the backlog on the large petrochemical order that was booked in fiscal 2023.

We also experienced solid growth in both the electric utility and the commercial and other industrial market sectors, increasing by 30% and 18%, respectively, reflecting our focus on thoughtfully expanding our presence in these markets. The light rail traction power sector was lower by 25% as this continues to be a market sector that we demonstrate discipline and selectivity.

Gross profit in the third quarter of fiscal 2024 increased by $39 million to $82 million versus the same period one year ago. Gross profit as a percentage of revenue increased by 620 basis points to 28.4% versus the same period a year ago and was 380 basis points higher sequentially.

The current quarter margin rates all across our business benefited from a higher volume of project closeouts, strong project execution, and operational leverage. We have also been steadily building a healthy order book in geographies and market sectors that historically carry lower margin rates, but today are adding to the overall margin story as they exit the backlog.

Selling, general, and administrative expenses were $22 million in the current period, higher by $2 million as we had higher spending and infrastructure improvements this quarter versus the same period a year ago. SG&A as a percentage of revenue decreased 260 basis points to 7.6% in the current fiscal quarter on the higher revenue base.

In the third quarter of fiscal 2024, we reported net income of $46.2 million, generating $3.79 per diluted share compared to a net income of $18.5 million or $1.52 per diluted share in the third quarter of fiscal 2023.

During the third quarter of fiscal 2024, we generated $13.8 million of operating cash flow driven by higher earnings generated in the quarter, partially offset by an increase in working capital as we allocate capital to the projects in the order book.

Investments in property, plant, and equipment in the fiscal third quarter totaled $1.4 million. At June 30th, 2024, we had cash and short-term investments of $374 million compared to $279 million at September 30th, 2023, and $365 million at March 31, 2024. The company does not hold any debt.

Looking forward, we remain very encouraged with where Powell is positioned as we enter the last quarter of fiscal 2024. Commercial activity across most of our market sectors remains strong, providing a tailwind as we close out the fourth quarter of fiscal 2024 and prepare for fiscal 2025.

Operationally, we are confident that we have the necessary infrastructure and resources to execute our growing backlog, while also continuing to progress our plans to thoughtfully expand our capabilities.

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Notwithstanding the typical challenges associated with a project-based business, based upon the quality of our backlog and our liquidity position, we are well positioned to sustain the year-to-date financial performance through the fourth quarter of fiscal 2024 while also providing a strong entry point as we look forward to fiscal 2025.

At this point, we'll be happy to answer your questions.

Question-and-Answer Session

Operator

We will now begin the question-and-answer session. [Operator Instructions]

Our first question comes from John Franzreb with Sidoti & Company. Please go ahead.

John Franzreb

Good morning Brett and Mike and congratulations on another stellar operating results in the quarter.

Brett Cope

Thanks John.

John Franzreb

I'd like to start with -- in the second quarter, you seem to suggest that you are at max capacity. However, revenue exceeded that threshold. How should we reset our expectations of what max capacity really is?

Brett Cope

So, we are definitely coming up against limits. I mean there are still capacity initiatives as we shared in the prepared comments today John. And still if you think back in time, some of the facility investments we did over a decade ago provides a different profile when you kind of build the model looking back over time.

But in Q3, being a projects business, there were some really healthy closeouts. There were some timing effects on -- given the wide breadth of project and the size of the backlog. There's always an element of buyout timing when we hit the POC accounting. So, little choppiness, I think, in the Q3 it sort of hit on the top side.

John Franzreb

How much do we have in project closeout revenue in the quarter?

Mike Metcalf

Yes, John, I would -- given this is a project-based business to kind of tag on to what Brett said, it's not unusual for us to experience choppiness across the quarterly landscape, project closeouts, buyouts, things of that nature making their way through the system.

And with this in mind, we exited the third quarter on a year-to-date basis at 26.1% gross profit, which is probably the appropriate barometer as we calibrate what's exiting backlog. With respect to precisely the amount in the discrete 3Q that was accretive to that base margin rate, it's probably roughly 150 to 200 basis points.

John Franzreb

Got it. That's very helpful, Mike. And then regarding the gross margin, the new bookings, is it fair to assume that there are higher margin than bookings that you've taken in a year ago?

Brett Cope

I wouldn't say that. I'd say that coming out as we ramped up last year with the two big quarters and then sort of stabilized in the latter part of the calendar year and into this year from even previous quarters. It's continued to hold pretty constant, John, on the market pricing.

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And if anything, we've shifted our outlook to cracks in the story. And through this quarter and the last quarter, as we noted, haven't seen them, but we do have our radar up for changes in the markets where we are competing.

John Franzreb

Okay. Just -- Brett, it sounds like you're more constructive on the utility market than you were, say, six months ago. Can you talk a little bit about what's going on there? And what's the opportunity profile as you see it?

Brett Cope

Yes, I did -- you're absolutely spot on, I appreciate the question, John. The utility market, as you know, over the last -- over the long haul, we've intentionally built a strategy, especially on the distribution side with the infrastructure spend and the hardening, if you will, and the resilience that the utilities are building in U.S., Canada, U.K. specific where we're really focused. There's some international there, but that's the bulk of our core market.

More recently, we are seeing some new generation of market. I won't say it sort of went away, but it's coming back a little stronger and then our participation rate is stronger. And so thus in the prepared comments about our increased win percentage.

There seems to be a little bit longer profile with some of the -- whether it's an IOU or a public or a co-op outlook and how they're planning for the future, and it's kind of brought pile back into the mix on some of these discussions and very healthy chat, and we're pretty excited by the researchers.

John Franzreb

Okay. And one last question, I'll get back into queue. It's hard to ignore how quickly cash is building. Historically, there was a use of cash during times of large project work, but it doesn't seem that the same magnitude seems to be playing out in the current results. Can you talk a little bit about use of cash, how should we think about the cash flow going forward? Any additional color there would be really helpful. Thank you.

Brett Cope

I'll start there, and I'll let Mike jump in. So, on the cash, I mean, you raised a good point. We do expect the working capital part to grow and Mike will provide some color there.

When we have a nice quarter like we did in Q3 with the bookings, the payment milestones -- well believe that until that gets put to work in a later period. So, that is sort of raising the overall profile of cash and certainly providing good free cash flow quarter-over-quarter.

As we look forward, if you look at the capital side, we -- it is ramping 2022 to 2023 to 2024 I think when we get through Q4, you'll see the land that we just shared that we acquired, that will hit. So, capital spend along with equipment will continue to rise in the coming quarters.

The R&D spend, I believe, is up 50% from our prepared remarks. That will continue to rise incrementally. And then we talked a lot about last couple of years on the M&A side, that continues in earnest.

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And while there's nothing that we're announcing today, there's a number of active areas out in the world that we're looking at to figure out if and how they fit into the portfolio and what that means for the future.

So, it's a pretty active area, and we're hopeful that in the next 12 to 24 months, that will true up some of that cash. And then also the continuing discussion on increasing the dividend. That's an active discussion every quarter with the Board.

Mike Metcalf

Yes. And to follow-on, John, you are absolutely right. Traditionally, this business, as you win big projects, you've got a lot going on in the shop. We do chew up a lot of the cash with working capital, which is happening today.

But as you see from our current discrete 3Q results, a book-to-bill ratio of 1.2, we stay at that 1, 1-plus book-to-bill ratio, the -- you kind of stay ahead of the curve from a cash inflow perspective.

So, -- and keep in mind that of the $374 million of cash balance, roughly $175 million of that, so just under half of it will be deployed at some point in time to support the execution of these projects.

John Franzreb

Great. Thanks Mike, thanks Brett. I'm getting back to queue.

Brett Cope

Thanks Jim.

Operator

And the next question comes from Jon Braatz with Kansas City Capital. Please go ahead.

Jon Braatz

Good morning Brett, Mike.

Brett Cope

Hey good morning Jon.

Jon Braatz

Brett, you mentioned a couple of times in your commentary that your win rates are improving. And you compete against a lot of big guys. And I guess my question is, specifically, what do you ascribe to that your win rates are getting better? You're taking share -- what can you pinpoint that improve win rate to?

Brett Cope

Well, I'll go back to -- let's start with utility, Jon. The intentionality on the distribution side has been going for 10-years plus. As a lot of the infrastructure in the U.S., Canada, and U.K. has come up for renewal and they're looking at the longer term reliability.

We've been there with the enclosed PCR power control room solution, and of course, Powell's breakers, the swift of the power back and the pullback as the core value proposition. And that's working really well for 10, 12 years as the--.

The generation has historically been a very, very tough area to compete in. It became fewer and fewer engineering firms that were competing. The price point really changed. It does seem to have changed a little bit here. It isn't all just what I'll call traditional generation.

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There's -- as I look at the numbers, there's a little bit of new transitional. I'm not going to sit here and tell you we're going all out in battery energy storage systems, but I do see it in the numbers. we're winning through different channels as well.

We're not maybe always going after the full power control is Powell taking out the best part that makes sense for us and letting others do things in that market that are better than us. And so we're winning the higher quality part that makes sense for the company and the shareholder. So, there's a little bit of that extent there as well.

When I look at the other segments, as LNG came back, post-pandemic, yes, I think we did very well. I think it's sort of moderated now to more of a run rate on that market.

And then our traditional customers, very big focus of Powell as I talk about executing and meeting our dates, just something that we can't ever take our eye off. It is one of the value differentiators at Powell versus other models that don't have the under one roof approach that Powell have.

And when customers need something under a critical time element, that's an area that we are I just -- I don't intend losing that argument. We're going to go hard at that and ensure that if the client needs it, when they say they need it, we're the best option in the market.

Jon Braatz

Okay. All right. Thank you. And Mike, your backlog was flat year-over-year at your rates, you had a book bill 1.2. Can you talk a little bit about your sort of your book-to-burn business during the quarter? I think we've, in the past, sort of thought it was sort of like $40 million or $35 million per quarter, seems like it must be better than that. What can you tell us about that?

Mike Metcalf

No, it -- really roughly, that hasn't changed substantially, Jon. What has changed in what you're seeing elevating the revenue is the convertibility aspect of our other backlog.

Last quarter, if you looked at the $1.3 billion of backlog, the convertibility over the next 12 months was in the mid-50% range. this quarter, as you'll see in the Q, when we publish it right after this call, that's up in the 60-percentage range. So, we're getting a little bit more out the door from our backlog, and that's helping elevate the revenue level as well.

Jon Braatz

Okay. Okay, all right. And one final question. You've ramped up your R&D spending. What can you tell me sort of like what might be in your R&D portfolio and what the what might be the expectations of that investment in the next two, three years. Can you give us an idea of what you're working on and the potential impact?

Brett Cope

So, the first -- new development just rolled out this year, Jon, just to give you an example. It's a station breaker product. It's targeted to the utility renewable market. It's not new technology. There are many folks out there that make a station breaker.

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We think we've got some unique value proposition in what we've come up with. We've targeted the higher end of the Powell strategy on the 38 kV, so a very robust design for the high end of the curve on the voltage.

So, if you then look at all the segments that that's kind of what we're looking at is what's out there is a problem that needs to be solved. I think Marshall and his team are doing a great job on working with product management and sales and helping us figure out that roadmap.

And so subsequent quarters in the next year, you'll see things that are very electrically-centric on the switchgear side, product-based, supporting not only in the projects business, but also supporting a product strategy through other channels into the market.

So, as I noted on some of the win rate stuff, where can we help all parts of the strategy of the business. So, the market sectors as well as the channels to fulfill our goal of getting back to our electrical roots and being a go-to supplier for solving that distribution need.

Jon Braatz

Okay, all right. Thank you bunch.

Operator

And our next question comes from John Franzreb with Sidoti & Company. Please go ahead.

John Franzreb

Thanks for taking the follow-up guys. I'm actually curious about the nine acres of property that you purchased. I mean put it in terms of acreage, is there a facility located on that you convert? Are you going to greenfield something. What's your intended use and capital outlay that you're thinking about in addition to the property purchase?

Brett Cope

Yes. So, that was an opportunity that came along. We were out in the market, John, looking at some warehousing options short-term initially really to how some of the material that comes into Powell, the engineered -- especially the engineered equipment that we spec and acquire that goes into the integrated offering. And so it was just an opportunity that when it came open right behind our main facility, our largest facility of the seven here in Houston.

We looked at it at good chats over almost two quarters worth of back and forth, and did it really make sense. And so as we look forward, it needs a little bit of work. It's quite a bit of land. There are several office buildings.

There is some warehousing capability there that we'll use immediately, where we can offload some of the some of the third-party kit that's sitting in and around a couple of our factory locations in here, so that will give us the ability to free up and do some productive work in the existing facilities by just getting some of the clutter better organized.

And then longer term, we have some ideation going on about expanded capacity and lines we could move over there to build. You could move one of our gear lineups over there, start staffing it. It is -- it's about -- it's across the street, so it's not contiguous, but it is immediately behind the facility.

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And then as we think about the previous question from Jon Braatz, what others coming down the pipeline that we might be able to put there or even rationalize it in other parts of our footprint.

John Franzreb

So, no more equipment in the parking lot. Is that what you're telling me?

Brett Cope

Well, we're pretty full in the parking lot if you come here today, but we are definitely going to try that.

John Franzreb

Okay. You don't want to put a number on how much additional CapEx it would take to get everything up to the way you want it?

Brett Cope

I think less than $1 million. I mean we spent a lot in diligence. It will come out in Q4. It will be a little higher than 5.5%. And then to get it up and going productively, the warehousing side will be pretty quick.

If we start to invest and actually add fabrication or, say, some assembly windup material, that would be something we'll share with you and the shareholders in the coming calls. But that would be a minor capital increase unless we actually go into fabrication and expand on Mosley to put it over there.

John Franzreb

Got it. Understood. Thank you for taking my follow-up. Congratulations again.

Brett Cope

Thanks.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Brett Cope for any closing remarks.

Brett Cope

Thank you, David. Overall, it was a solid third quarter, and I am very proud of every one of our 3,100 employees. Thank you for your hard work and quality execution and for your exceptional commitment to the success of our customers.

Our current backlog, combined with the broad market activity, we continue to experience across most of our market sectors, provides us excellent momentum as we plan fiscal 2025.

Thank you all for your participation. We appreciate your continued interest in Powell and look forward to speaking with you next quarter.

Operator

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

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