

# **STERIS plc (STE) Q4 2024 Earnings Call Transcript**

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**Body**

STERIS plc (STE)

Q4 2024 Earnings Conference Call

May 9, 2024 09:00 AM ET

Company Participants

Julie Winter - VP, IR

Mike Tokich - SVP and CFO

Dan Carestio - President and CEO

Conference Call Participants

Patrick Wood - Morgan Stanley

Brett Fishbin - KeyBanc

Mike Matson - Needham & Company

Jason Bednar - Piper Sandler

Presentation

Operator

Good day, and welcome to the STERIS plc Fourth Quarter 2024 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 Ms. Julie Winter of Investor Relations. Please go ahead.

Julie Winter

Thank you, Jack, and good morning, everyone. As usual, on today's call, we will have Mike Tokich, our Senior Vice President and CFO; and Dan Carestio, our President and CEO, and I do have a few words of caution before we open for comments.

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Some of the statements made during this review are -- or may be considered forward-looking statements. Many important factors could cause actual results to differ materially from those in the forward-looking statements, including, without limitation, those risk factors described in STERIS' Securities filings.

The company does not undertake to update or revise any forward-looking statements as a result of new information or future events or developments. STERIS' SEC filings are available through the company and on our website.

In addition, on today's call, non-GAAP financial measures, including adjusted earnings per diluted share, adjusted operating income, constant currency organic revenue growth, and free cash flow will be used.

Additional information regarding these measures, including definitions, is available in our release as well as reconciliations between GAAP and non-GAAP financial measures.

Non-GAAP financial measures are presented during this call with the intent of providing greater transparency to supplemental financial information used by management and the Board of Directors in their financial analysis and operational decision-making.

With those cautions, I will hand the call over to Mike.

Mike Tokich

Thank you, Julie and good morning everyone. It is once again my pleasure to be with you this morning to review the highlights of our performance. As you saw in the press release, we finished the year strong with total revenue growth of 10% in the fourth quarter and constant currency organic revenue growth of 6%.

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Adjusted earnings per diluted share for the fourth quarter were $2.58. For the full year, we exceeded expectations with 12% total revenue growth and constant currency organic revenue growth of 9%. Adjusted earnings per diluted share totaled $8.83 exceeding our outlook.

With the announcement of the divestiture of the Dental segment, we are required to report results from continuing operations starting now. As a result, the rest of our comments today will be focused on results from continuing operations.

Contained within the numerous press release tables, you will find an eight-quarter recast -- results from continuing and discontinued operations to help with year-over-year comparisons.

Turning to continuing operations, fourth quarter constant currency organic revenue grew 7%, driven by volume as well as 240 basis points of price. This is impressive when compared to the strong fourth quarter last year.

Once again, our Healthcare segment exceeded expectations. During the quarter, Healthcare shipped a record $332 million in capital equipment. Gross margin for the quarter declined 80 basis points with the prior -- compared to the prior year to 42.6%. Positive price and productivity were more than offset by negative segment mix and increased materials and labor costs.

EBIT margin decreased 30 basis points to 23.7% of revenue compared with the fourth quarter last year. The operating income mix shift between Healthcare and AST once again impacted our margins.

The adjusted effective tax rate in the quarter was 21.4%, lower than we anticipated due to several favorable discrete item adjustments. Net income from continuing operations in the quarter was $240.5 million and adjusted earnings per share from continuing operations were $2.41.

Capital expenditures for fiscal 2024 totaled $360 million, while depreciation and amortization totaled $565 million. Total debt sits at $3.2 billion and our total debt-to-EBITDA at quarter end was approximately 2.1 times gross leverage.

Free cash flow for fiscal 2024 was $620 million as we benefited from higher generation from cash from operations, including less use of cash for working capital requirements.

With that, I will turn the call over to Dan for his remarks.

Dan Carestio

Thanks Mike and good morning everyone. Thank you for making the time to join us today. Mike already covered the fourth quarter, so I will focus on our fiscal 2024 segment performance and our outlook for fiscal 2025 for continuing operations.

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Fiscal 2024 turned out to be a strong year for STERIS. As you've heard from us previously, Healthcare has consistently outperformed all year ending fiscal 2024 with 13% constant currency organic revenue growth, the third consecutive year of double-digit growth for this segment. The single biggest driver was the work done by our operations teams to reduce lead times, and as a result, return our backlog back-to-normal levels.

I am pleased to report that as of the fourth quarter, our lead-times are back to pre-pandemic levels for the first time in two years. As a result, Healthcare backlog is also now hovering around what we believe to be the new normal at just over $350 million.

Service and consumables each had strong organic revenue growth for the fiscal year as we continue to benefit from the breadth of our offering and the size and quality of our service teams.

AST grew 3% constant currency organic for the year, which is unusually light, but ended up with improving service revenue growth, for example, in the fourth quarter, service revenue grew 7%, which is a mixture of double-digit revenue growth in the U.S. and low single-digit revenue growth in EMEA.

While it is early days, bioprocessing demand seems to have stabilized and did not unfavorably impact our performance in the quarter. This is a positive step forward. We do not expect to return to meaningful bioprocessing growth until the second half of fiscal 2025, aligned with the comments that you have been hearing from our public company customers.

Life Sciences ended fiscal 2024 in line with our long-term expectations at 6% constant currency organic revenue growth. The path may have swerved a bit more than we're used to, but a solid year for the segment overall.

In particular, double-digit revenue growth in service for the year is an impressive achievement as we continue to win new contracts and see improved parts sales. Considering some of the macro challenging facing the pharma sector, we are pleased with the Life Sciences segment results.

Turning to our updated outlook. Fiscal 2025 will be another strong year for STERIS. As-reported revenue from continuing operations is expected to increase 6.5% to 7.5% for fiscal 2025. This includes the additional four months of the BD acquisition, a full year impact from the divestiture of our Controlled Environmental Services business within the Life Sciences segment, and neutral foreign currency.

Constant currency organic revenue growth from continuing operations is expected to be 6% to 7%. For your modeling, our expectation that the segment level for constant currency organic revenue growth is that AST grows high single-digits for the year with growth accelerating in the second half. Healthcare is anticipated to grow mid-single-digits and Life Sciences expected to grow low single-digits.

As a reminder, our first quarter of fiscal 2024 was particularly strong with high teens growth in Healthcare. EBIT margins are expected to improve for the year as some headwinds from fiscal 2024 abate.

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As a result, adjusted earnings per diluted share coming from continuing operations are anticipated to increase 10% to 13% at a range of $9.05 to $9.25. This outlook assumes that the divestiture of the Dental segment closes in the first quarter, and the proceeds are primarily used to repay variable rate debt. Our earnings split for revenue is anticipated to be 45% in the first half and 55% in the second half.

Before we conclude, I do want to make a few remarks on the strategic plan we have been executing during fiscal 2024. After significant review, we decided we needed to improve focus on our core customers in healthcare, pharma, and MedTech as well as areas where we can achieve sustainable and profitable growth. As a result, we made a decision to divest two businesses during the year, most notably the Dental segment.

In addition, today, we announced a targeted restructuring plan, which includes restructuring of the Healthcare Surgical Capital business in Europe as well as other actions, including impairment of an internally developed high-capacity X-ray accelerator, product rationalizations, and facility consolidations.

Combined, these actions allow us to focus on our core business and deliver on the long-term commitments we have made to our investors. We are confident that with these changes, we have the right portfolio, sales channels, and network of facilities to deliver to our customers over the years to come.

That concludes our prepared remarks for the call. Julie, will you please give the instructions, so we can begin the Q&A.

Julie Winter

Thank you, Mike and Dan, for your comments. Chuck, if you'll give the instructions, we can open for Q&A.

Question-and-Answer Session

Operator

Yes ma'am. We will now begin the question-and-answer session. [Operator Instructions]

And the first question will come from Patrick Wood with Morgan Stanley. Please go ahead.

Patrick Wood

Fantastic. Thank you. Just a couple from me. Maybe to start with a dull guidance one. On the Healthcare side of things, mid-single-digit growth makes sense. Obviously, you've got a very tough comp on the capital equipment side. And I'm just curious how you're thinking about that. Obviously, Q1 is very tough, but the interplay between the order books and that coming through.

Is the assumption that you can keep that capital equipment business in growth? Or is the guidance assuming it's kind of flat? I'm just trying to get a sense for how much of that mid-single-digit in Healthcare is contingent on the capital equipment side within Healthcare?

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Dan Carestio

Hey Patrick, thanks. This is Dan. Yes, our expectation is that we can have very low single-digit growth on the capital side of the business in Healthcare. If you look at the last five months or the last four quarters, rather, I'm sorry, I misspoke there, we kind of shipped an extra quarter of capital during the fiscal 2024 because in 2023, we had the challenges with supply chain, which pushed out delivery. So, we had a huge Q1, which is abnormal for us. And then we finish strong as we typically do in Q4.

So, there was a bit of a timing issue there that's affecting the comps going into next year. But nonetheless, we do expect that we can maintain the level and grow it a bit. We've had -- we've consistently had strong order books.

And then the remaining growth is really the expectation on the momentum we've built in the services and then the consumables organizations for healthcare. And as we place more and more equipment, it drives more consumption of both sides of that business. And obviously, as we've seen some consistent recovery in procedural rates, those business are largely procedurally driven.

Patrick Wood

Got that. Thank you. And then just second, maybe a bit bigger picture. For the industry overall, there's been quite a lot of changes. We had the FDA sterilization town hall and then the EO regulatory side.

I guess what are you seeing from the competitive environment? And how are you thinking the industry could change going forward vis-à-vis stuff like in-sourcing versus outsourcing? Just an update on the competitive environment and the, I guess, the challenges facing your customers, and where they decide to go with you or keep things in-house.

Dan Carestio

Well, I mean, Patrick, it's hard to say. What I would say is that STERIS is incredibly well-positioned as a technology-neutral and location-neutral company in terms of how we help our customers.

And whether that means that we sell them accelerators for their own in-house deployment or VHP for their own in-house deployment for terminal sterilization or whether they use us in a large-scale contract situation where we've consistently continued our expansion efforts as we expect the growth in the industry to continue long-term.

So, I believe from our perspective, we have done everything possibly to support our customers from a capacity, from in-house perspective and also from a regulatory perspective in terms of how we operate, but also working with the regulatory agencies on things like master files and changing classifications for alternative methods like vapor hydrogen peroxide to lower those barriers in terms of regulatory.

Patrick Wood

Always a lot going on. Thanks so much for taking the questions.

Mike Tokich

Sure. Thanks.

Operator

Next question will come from Brett Fishbin with KeyBanc. Please go ahead.

Brett Fishbin

Hey guys. Thanks so much for taking the questions. I'm going to ask just one more on AST. I think it was really encouraging to see a little bit of progress in terms of growth in the service line this quarter.

So, just curious if you could provide a little bit more color on where we stand in regards to the inventory overhang, specifically in Europe, given that was the reason that seemed to be lagging the most from an inventory standpoint?

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Dan Carestio

Yes. Sure, Brett, this is Dan. I can speak to that, and thanks for the question. We really saw things turn in the U.S. market strongly in the second half of the year. And in terms of medical devices in that segment, if you put aside the bioprocessing overhang, we were growing at double-digits for most of the second half for those type of products. So, we've seen a full recovery here in the U.S. in terms of the inventory burn down.

Europe has taken a little more time and at this point, I'm not so sure if it's just inventory, I think it's more procedure-driven, and there's still a slower recovery over there in terms of procedural backlog that needs to play out.

Eventually, that's got to sort of sell through, right? And we believe with a high degree of confidence that in the second half of the year that we should see a robust turnaround in the European market in terms of overall consumption.

Brett Fishbin

All right. Super helpful. And then just one quick follow-up on the EPS guidance. Just curious if there was any impact to how you're thinking about either margins or EPS as a result of the incremental divestiture in Life Sciences? And if there's any financing considerations that we should be aware of for that deal?

Mike Tokich

No, that was a very small deal, but we wanted to point it out because it does have a negative impact on Life Sciences growth rates. But all-in-all, it was very small for us. So, no impact bottom-line.

Brett Fishbin

All right. Thank you

Operator

The next question will come from Mike Matson with Needham & Company. Please go ahead.

Mike Matson

Yes, thanks for taking my questions. Just a couple on the guidance. So first, can you remind us how much pricing you got for the full year for fiscal 2024? And then what have you assumed in the fiscal 2025 guidance for pricing?

Mike Tokich

Yes. So, for the full year of 2024, our total consolidated, total company price was 270 basis points favorable. And what we are assuming in our FY 2025 guidance is around 200 basis points of favorable price.

Mike Matson

Okay, got it. And then just in terms of M&A, with the dental divestiture, reducing your debt to some degree, should we expect near-term deals just given that additional capacity you're going to have?

Dan Carestio

Yes, Mike, this is Dan. What I would say is we have the capacity both financially and internally from a people perspective. As you know, we've been in the acquisition business for a number of years. We're good at it. We're good at integrating companies, but those opportunities have to present themselves and when they do, and when it's imminent, we'll be sure to talk about it.

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Mike Matson

Okay, got it. Thanks.

Operator

Your next question will come from Jacob Johnson with Stephens. Please go ahead.

Unidentified Analyst

This is Matt [ph] on for Jacob. I just want to follow-up on the guidance question asked earlier. Do you mind clarifying your first half, second half remarks, it seems like you may be guiding to like roughly 2% organic growth for the first half and maybe 10% plus for the second half, is that correct?

Julie Winter

The earnings split we provided was earnings, not revenue. And certainly based on that, we would expect growth to ramp up in the second half of the year. We don't -- to clarify, we don't guide to revenue split.

Unidentified Analyst

I appreciate that. And then on gamma radiation, I know you caught up on some gamma loading last quarter, but in the medium term, I believe a few years ago, there was some concern in the bioprocessing industry about the shortage of capacity. Do you have any thoughts on the current state of gamma supply versus demand as bioprocessing demand comes back? And what could this mean for your X-ray capacity as well?

Dan Carestio

Well, that's the basis of our X-ray expansion, and we have a number of sites that have come online and will come online over the next year -- two years, actually, in particular. So, we think we're well positioned to take advantage of the gap that does exist and will grow in terms of short-term supply of isotope versus the demand that they have for radiation processing.

Unidentified Analyst

Great. Thank you for taking my questions.

Dan Carestio

Yes, thank you.

Operator

[Operator Instructions]

Our next question will come from Jason Bednar with Piper Sandler. Please go ahead.

Jason Bednar

Hey good morning. Congrats on a nice finish to fiscal 2024, guys. I'll take maybe a little bit of a different swing here on the revenue pacing. I think you said AST acceleration over the course of the year. But is it right to think the -- for kind of company-wide level, first half of the year, maybe a tick or two below the full year organic guide second half, a little bit above, I think we're all just trying to dial in and make sure we're not too back-end loaded with your -- with our models based on what you're guiding to today?

Mike Tokich

Yes, our comparisons are tough in both Q1 and obviously now with the strong finish in Q4, but I would agree that the first half would be a little bit lighter, both from a revenue standpoint and from a margin standpoint.

Jason Bednar

All right. Perfect, thanks Mike. And I'll ask a question here to follow up on Patrick's question earlier. So, if you could help us out, if backlog is back to normal levels, I guess, why wouldn't healthcare equipment revenue moderate unless you're expecting meaningful order growth to compensate for what was an above-normal level of backlog reductions last year? I'm just really trying to reconcile those points.

Dan Carestio

Yes. At a high level, I would say, although we pushed out a lot of product last year because we had built up a huge backlog. The demand for our products remains high. And if you look at what our annual order intake looks like today versus four years ago, it's significantly higher.

I think we had a bit of an anomaly last year, but we don't expect our general order rates to really slow down. We believe that we're well positioned with our portfolio. We're winning more than our share I believe, in terms of capital projects, in particular, on the IPT side of the business, and we would expect that to continue.

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Jason Bednar

All right. But I guess, Dan, just as a quick follow-up there, sorry to monopolize here, but if your lead times are back to pre-normal levels, I mean, unless you're turning that backlog quicker doesn't that necessarily imply that you're not going to be growing healthcare equipment at the same pace? I'm just -- something is still missing, maybe we can follow-up offline, I'm still having a hard time piecing that together.

Julie Winter

Jason, just to clarify, clearly, we're not saying we're going to grow at the same pace, but we are expecting to grow, right? So, down from the double-digit growth we've been doing to low single-digit growth is our expectation.

Jason Bednar

Okay. All right. Thanks Julie.

Operator

And this concludes our question-and-answer session. I would like to turn the conference back over to Ms. Julie Winter for any closing remarks.

Julie Winter

Thank you, everyone for taking the time to join us this morning. I look forward to speaking with many of you in the coming days.

Operator

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

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