Parker-Hannifin Corporation's (PH) CEO Tom Williams on Q1 2020 Results - Earnings Call Transcript

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Press Release SEC *10-Q* *Slides*

EPS of $2.76 beats by $0.10 | Revenue of $3.33B (-4.16% Y/Y) beats by $4.24M

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Parker-Hannifin Corporation (NYSE:PH) Q1 2020 Results Earnings Conference Call
October 31, 2019 11:00 AM ET

Company Participants

Cathy Suever - Chief Financial Officer

Tom Williams - Chairman and CEO

Lee Banks - President and COO

Conference Call Participants

Nathan Jones - Stifel

Ann Duignan - JPMorgan

Joel Tiss - BMO Capital Markets

Jamie Cook - Credit Suisse

David Raso - Evercore ISI

Andrew Obin - Bank of America

Andy Casey - Wells Fargo Securities

Jeff Sprague - Vertical Research Partners

Operator

Ladies and gentlemen, thank you for standing by. And welcome to the Parker-Hannifin Corporation First Quarter 2020 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speaker presentation, there will be a question-and-answer session. [Operator Instructions] Please be advise that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference to your speaker today, Cathy Suever, Chief Financial Officer. Please go ahead, madam.

Cathy Suever

Thank you, Joule. Good morning, everyone. Welcome to Parker-Hannifin's first quarter fiscal year 2020 earnings release teleconference. Joining me today are Chairman and Chief Executive Officer, Tom Williams; and President and Chief Operating Officer, Lee Banks.

Today's presentation slides, together with the audio webcast replay, will be accessible on the company's investor information website at phstock.com for one year following today's call.

On slide number two, you will find the company's Safe Harbor disclosure statement, addressing forward-looking statements, as well as non-GAAP financial measures. Reconciliations for any reference to non-GAAP financial measures are included in this morning's materials and are also posted on Parker's website at phstock.com.

Today' agenda appears on slide number three. We will begin with our Chairman and Chief Executive Officer, Tom Williams, providing highlights from the first quarter. Following Tom's comments, I will provide a review of the company's first quarter performance, together with the revised guidance for the full year fiscal 2020. Tom will then provide a few summary comments and we will open the call for a question-and-answer session.

Please refer now to slide number four and Tom will get us started.

Tom Williams

Thank you, Cathy, and good morning, everybody, and welcome to the call. We appreciate your interest in Parker. So let me start with the first quarter highlights and I am going to start like I normally do on safety.

We had 25% reduction in recordable safety incidents year-over-year, which is a great start to the year. When you look at it from a safety incident rate, so for those who aren't familiar with this, this is the number of safety incidents per 100 people. We came in at 0.46, which is the top quartile number, top quartile happens to be 0.5. So this is the first time in history of our company that we came in on the top quartile for incident rates. So we are very proud of that.

Safety for us is a core value and zero accidents is not an aspirational goal. It's really an expectation that we are going to operate the business and lead the business in such a way that we are going drive a zero accident culture.

And if you have seen, there's a linkage between safety and business performance, and you can see that if you look at our numbers over the last several years and plot its safety and our financial improvement, you will see they went hand in hand.

So switching to financial results, Q1 was a strong quarter on margins and on cash against a challenging macro environment on sales. Sales declined 4% and that composition was a minus 3 organic, minus 1.5 on currency and a plus 0.5 on acquisitions.

Total segment operating margin remained level at 17.0% reported. Adjusted segment operating margins increased 10 basis points to 17.3 basis points. On a reported basis, EBITDA margin increased to 70 basis points to 18.4 basis points, and adjusted EBITDA margin increased 110 basis points and reached 19.1%. So really when you look at it operating margin or EBITDA margin, really excellent performance at this part of the cycle. EPS reported was $2.60 and on an adjusted basis it was $2.76.

We had a very strong quarter on cash flow. Cash flow from operations came in at 13.5% of sales. We had a record as far as cash flow from operations in terms of dollars at $449 million and free cash flow was 12.0%, and when you look at free cash flow conversion that was 118%. So, really, really strong quarter on cash.

We had a number of exciting announcements in the quarter. We launched Win Strategy 3.0. So that's the third revision of the Win Strategy. This follows the second revision we did in 2015 and we launched a new purpose statement for the company and we closed the LORD and Exotic acquisitions. So we have been busy in the quarter.

And we are excited to welcome the LORD and Exotic team members to the Parker team. The joint integration teams have been working hard in preparation for the closings and they are hitting the ground running as we speak.

And you heard me talk about the acquisitions are transformational to Parker's portfolio, really strengthening engineered materials and aerospace with high growth, high margin businesses that will definitely be more resilient over the business cycle. Our global Parker teams are very energized by all these announcements between the Win Strategy, purpose and these acquisitions so we are excited about the future.

Now switching to the outlook, we advised guidance for FY '20, we have seen a market shift within the last 90 days as reflected in weekend order entry, primarily driven by macro conditions and trade certainties.

So when you look at total sales for Parker in FY '20 are expected to be flat year-over-year at the midpoint. With guidance now, these midpoint numbers at minus 6 organic, minus 1 for currency and plus 7 on acquisitions. Segment operating margin guidance is now at 15.2% as reported at the midpoint and the adjusted midpoint is now 16.3%.

I would just call your attention there's two important impacts on there, when you look at it from a partial year as the amortization of the two deals from a partial year standpoint for FY 2020, that impacts us by 70 basis points, when you look at it on a full 12 months, there's 100 basis points of deal amortization as a headwind on margins.

Business realignment expenses are expected to increase to $40 million. This is reflective of the current macro conditions. This was $20 million in the prior guide, and, of course, our guidance now includes LORD and Exotic Metals forming for the balance of the year. And we will go through discussing markets and the guidance assumptions in more detail during the Q&A.

So let's switch to cash flow and margin resilience. So, hopefully, you saw on the cash numbers in my comments just a moment ago, cash flow was very strong, record numbers. And then when you look at the operating and EBITDA margin performance and I am going to compare it to 2015 and 2016, so the last downturn we experienced and we will look at this legacy Parker without acquisitions. So it allows us to do an apples-to-apples comparison.

So FY '16, which would have been the worst year in that downturn on an adjusted operating margin was 14.8% and then FY '20 guidance is 16.6% the midpoint. So when you look at that delta, that's an improvement of 180 basis points.

On adjusted EBITDA FY '16 it was 14.7%. Our current guide at the midpoint is 18.2%. So that's a 350 basis point improvement. So, clearly, raising the floor on margins when you compare the 15%, 16% downturn to what we are experiencing now.

We fully anticipate to do double-digit cash flow from operations for the full fiscal year like we have been doing for the last 18 years and really this performance is driven by a combination of factors. The new Win Strategy, which we introduced in 2015 is propelling our performance. All the previous restructuring activities we have done, which has positioned us to be a more agile and lean operating company.

So let's move to slide five and talk about the future. We are very positive about the future and I think we are absolutely poised to generate nice earnings growth after we clear these near-term macro conditions.

A couple things influencing our confidence on the earnings potential, Win Strategy 3.0 and the purpose statement represents some important changes for the company, plus we have added two great businesses via these acquisitions. And actually in my view the timing of these acquisitions couldn't be any better during the soft part of the cycle there's clear advantages here.

We have the capacity to digest these much easier than when we were digesting CLARCOR we were trying to ramp-up the base business, as well as digest CLARCOR. And when you look at the timing, when you look at the integration teams hitting their stride, it's about the same time the markets will start to turn for us in approximately nine months and both of those factors will drive earnings growth as we look into the future.

We are going to be hosting an Investor Day March 12, 2020 in New York City and during that Investor Day we are going to showcase Win Strategy 3.0 and the purpose statement. So we will give you a lot more color on the key strategic changes for the future.

We are going to highlight all six operating groups and in the past we have highlighted one group and last time we highlighted three groups. So for the first ever we are going to give you insights to all six groups. You will see the entire company and we will go through the three last acquisitions, CLARCOR, LORD and Exotic.

So just a quick reminder, which is on this page as you see the winning format for Parker, our competitive differentiators the Win Strategy now 3.0, the third revision of that, which is our business system, you couple that with our decentralized divisional structure.

In my view, that's the best of both worlds. You got a certainly led business system that's deployed locally with that closeness to the P&L. The breadth of our portfolio and technology is very interconnected, strong intellectual property, long product life cycles, very balanced between OEM and aftermarket with the best distribution channel in the motion control space, low CapEx requirements to actually generate growth and productivity.

And all this equate -- ends up culminating in being able to generate a lot of cash and being able to deploy on the best we can for shareholders. So, we have a lot of confidence on our ability to achieve the FY '20 financial targets. I just want to thank all the global teams listening in for their hard work, their continued and dedicated effort.

And I will hand it back to Cathy for more details on the quarter and the guidance.

Cathy Suever

Thanks, Tom. I'd like you to now refer to slide number six. This slide presents as reported and adjusted earnings per share for the first quarter. Adjusted earnings per share for the quarter were $2.76, compared to $2.84 for the same quarter a year ago.

Adjustments from the fiscal year 2020 as reported results totaled $0.16, including before tax amounts of business realignment charges of $0.04, acquisition costs to achieve of $0.04 and acquisition transaction related expenses of $0.14, offset by the tax effective these adjustments of $0.06. Prior year first quarter earnings per share had been adjusted by $0.05. The details of which are included in the reconciliation tables for non-GAAP financial measures.

On slide seven, you will find the significant components of the walk from adjusted earnings per share of $2.84 for the first quarter of fiscal '19 to $2.76 for the first quarter of this year. We have benefited $0.02 per share in operating income from Exotic Metals Forming Company since closing on that acquisition September 16th. For Legacy Parker, a $166-million decline in sales contributed to a $0.15 reduction in operating income. The teams did a great job of controlling costs with lower volume by sustaining a 15% decremental margin for the quarter.

Incremental interest expense on the debt borrowed for the two acquisitions resulted in a $0.15 decline in the current earnings per share. Interest income from the pre-acquisition investments of that cash benefited the current quarter $0.09.

Lower other expense of $0.13 came from several one-time gains in the current year and by not repeating several one-time losses from last year. Lower corporate G&A contributed $0.01, while fewer favorable discreet tax benefits in current quarter resulted in a higher tax rate causing $0.12 of incremental tax expense. Finally, our lower share count benefited the quarter $0.09.

Slide eight shows total Parker sales and segment operating margin for the first quarter. Organic sales decreased year-over-year by negative 3.3%. Currency had a negative impact of minus 1.5%. These declines were partially offset by a positive impact of 0.6% from the September acquisition of Exotic.

Despite declining sales, total adjusted segment operating margin improved to 17.3% versus 17.2% last year. This 10-basis-point improvement reflects the operating costs improvements teams have been working hard on, combined with additional positive impacts from our Win Strategy initiatives.

On slide nine, we are showing the small benefit Exotic had on the first quarter FY ‘20 results post-close on September 16th. You can see they contributed $21 million in sales and $3 million in operating income on an adjusted basis during this brief stub period. Exotic results are included in the Aerospace Systems segment.

Moving to slide 10, I will discuss the business segments, starting with Diversified Industrial North America. For the first quarter, North American organic sales were down 3.2%. Currency had a small impact on sales of negative 0.2%.

Even with lower sales, operating margin for the first quarter on an adjusted basis was an impressive 17.3% of sales versus 16.6% in the prior year. North America continued to deliver improved margins, which reflects the hard work dedicated to productivity improvements, as well as synergies from CLARCOR and the impact of our Win Strategy initiatives.

Moving to Diversified Industrial International segment on slide 11, organic sales for the first quarter in the Industrial International segment decreased by 8.7%, currency had a negative impact of minus 3.9%. Operating income for the first quarter on an adjusted basis was 15.9% of sales versus 17.0% in the prior year, a decremental margin of 25%. The teams continue to work on controlling costs during the more difficult drops in volume by utilizing tools of our Win Strategy initiatives.

I will now move to slide 12 to review the Aerospace Systems segment. Organic revenues increased 8.2% for the first quarter as a result of growth in all of the platforms, with the strongest growth in Military OEM and the Commercial Aftermarket. In addition, the

Aerospace segment sales increased $21 million or 3.7% from the addition of the Exotic acquisition.

Operating margin for the first quarter was 20% of sales versus 19.5% in the prior year, reflecting the impact of higher volume in all the platforms, lowered development costs and good progress on the Win Strategy initiatives.

On slide 13, we report cash flow from operating activities. Cash flow from operating activities was a first quarter record of $449 million or 13.5% of sales. This compares to 10.3% of sales for the same period last year after last year's number is adjusted for a $200 million discretionary pension contribution. That's a year-over-year increase of 25%. Free cash flow for the current quarter was 12% of sales and the conversion rate to net income was 118%.

Moving to slide 14, we show the details of order rates by segment. As a reminder, these orders results exclude acquisitions, divestitures and currency. The Diversified Industrial segments report on a three-month rolling average, while Aerospace Systems are based on a 12-month rolling average.

Continued declines in the industrial markets drove total orders to drop 2% for the quarter-end. This year-over-year decline is made up of a 6% decline from Diversified Industrial North America, 10% decline from Diversified Industrial International orders, offset by a very positive 22% increase from Aerospace Systems orders.

The full year earnings guidance for fiscal year 2020 is outlined on slide number 15. This guidance has been revised to align to current macro conditions, and now includes the impact of the LORD and Exotic acquisitions. Guidance is being provided on both an as-reported and an adjusted basis.

Total sales for the year with the help from acquisitions are now expected to remain flat compared to prior year. Anticipated full year organic change at the midpoint is a decline of 6%. Currency is expected to have a negative 1.1% impact on sales and acquisitions will add 7.4% to the current year.

We have calculated the impact of currency to spot rates as of the quarter ended September 30, and we have held those rates steady as we estimate the resulting year-over-year impact for the remaining quarters of this fiscal year.

For Total Parker, as reported, segment operating margins are forecasted to be between 15.0% and 15.5%, while adjusted segment operating margins are forecasted to be between 16.0% and 16.25%. We have not adjusted for the incremental amortization of approximately $100 million, which we will incur for the remainder of this year as a result of the two acquisitions.

The full year effective tax rate is projected to be 23%. The first quarter tax rate was favorably impacted by discrete items which we don't forecast. We are anticipating a tax rate from continuing operations of 23.3% for quarters two through four.

For the full year, the guidance range for earnings per share on an as-reported basis is now $8.53 to $9.33 or $8.93 at the midpoint. On an adjusted earnings per share basis, the guidance range is now $10.10 to $10.90 or $10.50 at the midpoint.

The adjustments to the as-reported forecast made in this guidance include business realignment expenses of approximately $40 million for the full year fiscal 2020, with the associated savings projected to be $15 million.

Synergy savings from CLARCOR are still estimated to achieve a run rate of $160 million by the end of fiscal 2020, which represents an incremental $35 million of year end savings. In addition, guidance on an adjusted basis excludes $27 million of integrated costs to achieve for LORD and Exotic and $200 million of onetime acquisition-related expenses. LORD and Exotic are expected to achieve synergy savings of $15 million this fiscal year. A reconciliation and further details of these adjustments can be found in the Appendix to this morning's slides.

Savings from all business realignment and acquisition costs to achieve are fully reflected in both the as reported and the adjusted operating margin guidance ranges. We ask that you continue to publish your estimates using adjusted guidance for purposes of representing a more consistent year-over-year comparison.

Some additional key assumptions for full year 2020 guidance at the midpoint are a split first half, second half of 47%, 53% for all sales, adjusted segment operating income and adjusted EPS. All three we expect to be split 47%, 53%.

Second quarter fiscal 2020 adjusted earnings per share is projected to be $2.22 per share at the midpoint. This excludes $15 million of projected business realignment expenses and $167 million of acquisition related expenses and costs to achieve for both LORD and Exotic.

On slide 16, you will find a reconciliation of the major components of revised fiscal year ‘20 adjusted EPS guidance of $10.50 per share at the midpoint, compared to the prior guidance of $11.90 per share.

Starting with just the legacy business, a $0.10 per share beat in the first quarter is quickly going to be offset by the challenging macro conditions facing the rest of the fiscal year. A drop of nearly $800 million in forecasted sales at the midpoint is driving a decline of $1.44 in operating income for the rest of the year.

Interest expense in our previous guide included the interest on $2.3 billion of bonds we were holding for the acquisitions. Since then, we have borrowed additional term loans and commercial paper to complete those acquisitions. Now that both acquisitions are closed, we have allocated $0.72 of interest expense to the acquisitions, which includes the interest on the bonds, the term loans and the new commercial paper, causing a relief of $0.29 of interest expense within the Legacy business.

Also, in our previous guide, we had an assumption of earning $0.35 from interest income on the cash from the bonds. That cash has now been used for the acquisition so the other expense line, which includes interest income has been reduced going forward.

And finally, within the Legacy business, we are anticipating a slightly higher tax rate for the rest of the year, which will drop earnings per share $0.03, resulting in revised Legacy Parker adjusted guidance of $10.50.

Exotic is estimated to contribute $0.28 and LORD $0.44 to operating income for the year, inclusive of the additional combined $100 million amortization expense we will be incurring. Offsetting this will be the $0.72 of interest expense related to the debt for these acquisitions. All in, this leaves $10.50 consolidated adjusted earnings per share at the midpoint for our guide for fiscal 2020.

On slide 17, we show the impact the acquisitions will have on both an as reported and adjusted basis. On an adjusted basis, the acquisitions' lower operating margin to 16.3% for total Parker from 16.6% for Legacy Parker, impacted by $100 million of amortization expense.

For adjusted EBITDA margins, the acquisitions provide 50 basis points of improvement, moving from 18.2% for Legacy Parker to 18.7% for Total Parker. For those of you building forecast models, we have included more details regarding the LORD and Exotic impact on the total year guidance in the appendix.

You will now go to slide number 18. I will turn it back to Tom for summary comments.

Tom Williams

Thank you, Cathy. So we are very pleased with our progress. We are going to perform well with this downturn, as demonstrated by our cash flow performance and raising the floor on operating margins. And we are well on our way to being that top-quartile company we want to achieve and being best-in-class.

As just a reminder, where we are trying to drive to, we want to transform the company to achieve targets we have set out in FY '23 of growing organically 150 basis points greater than global industrial production growth, segment operating margins of 19%, EBITDA margins of 20%, free cash flow conversion greater than 100% and EPS CAGR over that time period of 10% plus. So again thanks to everybody all the global team members around the world for your hard work.

And with that, I will hand it over to Joule to start the Q&A portion of the call.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] Our first question comes from Nathan Jones with Stifel. Your line is now open.

Nathan Jones

Good morning, everyone.

Cathy Suever

Good morning, Nathan.

Nathan Jones

Tom, it seems like you guys have taken maybe a bit more negative outlook going forward over the next three quarters here than some of your peers have. I think you mentioned you were planning on three more quarters of downturn here. Can you just maybe talk a little bit about what's going on in the end markets and your expectations around why you are thinking this downturn is as long as you guys have seemed to built into guidance here?

Tom Williams

Yeah. Nathan, it's Tom. And I am sure this is question top of mind for everybody. So let me -- I will start by going through kind of what was behind the guide, then I will finish with a summary of end markets.

So it starts first with our Q1 orders and you have seen that minus 2 total company, but in particular, minus 6 North America and minus 10 internationally. And then you got to look at other external indicators that are typically flow-through in our orders, three months to six months out.

Those things like the ISMs and the PMIs. So the U.S. ISM had 47.8 for September, that was a 10-year low as everybody knows. Europe's PMI of 45.7 for September, and of course, Germany, our third largest country at 41.7, obviously, feeling the impact of the trade related uncertainties. Asia PMIs are weak.

And so what we look, part of what influenced our forecast was the trend of orders through the quarter. So August and September were about the same, but they were weaker than July. And then as you look at October, while October's not done yet, we look at October on a daily basis, we saw further softening from that August and September rate. So put those factors into also our bottoms up latest look from the divisions and our view yielded a more challenging macro environment.

So I will give you -- I will peel back the organic piece a little bit more, and I will give you some of my thoughts as to why we did what we did. So you have seen organic at the midpoint at minus 6. So that composition is North America at minus 6, International at minus 11.5 and Aerospace at plus 4.5.

So the first half, second half organic is both minus 6, so minus 6 for first half, minus 6 for the next half. And so given that organic growth was minus 3 in Q1, that implies that our low point or the bottoming out of Parker is somewhere between Q2 and Q3 in this guidance.

And we also looked -- and you remember I talked about the pressure curves last time and we had baked about a 15-month duration. This now looks like it's an 18-month duration, a whole fiscal year, that's a difference versus the prior guide.

When we look at the four phases of growth that we have talked about in the past. We have got -- the markets are definitely moving through those phases. The largest phase is now in Phase 4, decelerating growth at 48%. That last quarter, that was at minus 10. So that's encouraging that you are starting to move through that. When we look at Phase 3, which is accelerating decline, that used to be 67% last quarter. Now it's 28%. So that's also an important point.

So that's -- all these things are signaling some kind of a bottoming for us about the midpoint of our FY '20, so maybe now just to kind of walk on the prior guide to the new guide. So the prior guide was minus 1.5 at the midpoint, again, I am talking about organic and the new guide's minus 6, so that's up 450-basis-point step down. Our order step down 200 basis points, again, I am focused on the industrial piece, where North America and international step down 200 basis points.

And then we had to try to project out those ISMs and PMIs I just described that are pretty negative and they are going to flow through on orders anywhere over the next couple of months to maybe a maximum of six months. And then, also, looking at the October orders that weekend from what you see in September.

So, that kind of made up the balance that you got 200 that's already declined with orders. The balance of 250 made up of that projecting those PMIs and ISMs into our future orders and what we saw in October. So that kind of gives you a walk down.

So maybe if I give you comments on the end markets for Q1. I will start with the positives. Aerospace continues to be very strong, lawn and turf, forestry and marine, and pretty much all the others are negative. So probably the best way for me to summarize the others is to take them into major buckets.

So distribution I recognize is not a market but it's an important channel for us. Distribution actually got a little bit better. I am talking about going from Q4 to Q1 year-over-year. It came in Q1 at about a minus 2. And in Q4, it was minus 2.5.

That composition, North America got better, Europe stayed about the same and Asia-Pacific got worse. The industrial end markets stayed relatively the same both were minus 9, minus 9 in Q4 and minus 9 in Q1.

And the mobile market is where we saw the step down. Mobile markets went from a minus 3 in Q4 to a minus 6. In particular, what stepped down in mobile was ag, construction, heavy-duty truck and material handling. So, that's a quick run through -- that's at the global level what I was describing as far as the end markets and what caused us to move the guidance like we did.

Nathan Jones

I appreciate the transparency and the color there. Just moving away from things that are happening in the short-term here, I am sure there will be plenty of questions for that on you. Maybe you could just talk a little bit about what's changed in the Win Strategy 3.0 from Win Strategy 2.0?

Tom Williams

Yeah. And I'd be happy to do that, because that's going be very exciting for the company. And obviously, when we have you all together, we will go through this in a lot more detail, but if I would just paraphrase the key points, so underneath engagement, going to continue to expand the whole ownership concept with the idea that the more people we have thinking and acting like an owner the better the company's going to perform.

But a big change on people is Kaizen and we will take you through all the things we are doing on Kaizen as far as our approach to it, who we are working with and the results we are seeing. Under customer experiences, a lot more emphasis on digital leadership, and we will expand what we mean by that ad a new metric, which is not too dissimilar to what we had before, but we have a new metric called composite likelihood recommend, which is going to be a mixture of on-time delivery and feedback from customers and distributors.

Earnings and profitable growth, we have this new strategic initiative called strategic positioning, which we will give you more color on. New product blueprinting underneath innovation and two new metrics for innovation, product vitality and mix and gross margin for the product vitality and we will explain more about that when we are in person.

And then underneath simplification, a very new powerful concept called simplified design, where we focus on simplifying the design of our products to reduce the building material complexity, the inventory and planning and scheduling complexity, and the ability to produce it, recognizing about 70% of our product costs are tied up in how we design it.

So we will talk a lot more about that when we have you all there. We will be somewhat careful on simple by design, because I don't want to teach my competitors how to do that, but we will give you enough color since you all know that it's real and there's some big enhancements to the company both on a growth and a margin standpoint.

Nathan Jones

I appreciate all the color and all the transparency there. I will pass it on. Thanks very much.

Cathy Suever

Thanks, Nathan.

Operator

Thank you. Our next question comes from Ann Duignan with JPMorgan. Your line is now open.

Ann Duignan

Hi. Good morning. I am not sure if there were any questions left after all of that color. You gave us global end markets, industrial versus mobile, would you mind breaking those up by region, please, or any notable differences across the major markets that have decline ag, construction, heavy duty, material and handling?

Tom Williams

Yeah. Ann, this is Tom. So I will give you the high points by region. So North America was about 3% organic decline, on the positive side was machine tools, heavy duty truck, forestry and lawn and turf, flat was distribution on automotive. And then on the negative side, we had low single digits was mining, telecom and life sciences, mid single-digit decline, these are all declines, refrigeration, mills and foundries and tires.

And then switching to the mobile markets, mid single-digit declines was construction and marine and mid-teen declines was ag, material handling and rail. So, again, I had mentioned that distribution fared better North America than any of the other regions as far as how it performed.

Then in Europe came in about a minus 7 for the quarter. On the positive side was refrigeration, power, semicon, life science and oil and gas. And then on the negative side, starting with the industrial end markets we had a couple that were greater than 20%, mills and foundries, machine tools, obviously, Europe being more export sensitive feeling the impact of trade uncertainties. Those are very trade-centric type of end markets.

Mid-teen declines was mining, tire and rubber, distribution came in around minus 4.5 about the same as it was versus prior period. And mobile, we had low single digit declines in construction and ag and about 10% in heavy duty truck and auto. So, actually mobile fared okay in Europe and the industrial markets suffered worse in Europe.

And then in Asia on the positive side, Asia came in a 12% decline for Q1 and on the positive side were oil and gas, mining and marine, although, declines distribution was down about 5.5 and on the industrial space, we had about mid-teen declines out of mills, refrigeration, machine tools greater than 20 on some of those big secular end markets like powergen, semicon and, of course, telecom being somewhat impacted by the Huawei challenges.

And then on the mobile side is where we saw some of the steepest declines greater than 20 in construction, ag, material handling and rail. So you can see that mobile feeling the worst in Asia-Pacific. So that's quick spin to the regions.

Ann Duignan

Okay. And then just as a follow up, I think you have already answered this, but are you seeing any signs of, I hate to use the word we use every time coming up, but any green shoots anywhere?

Tom Williams

Well, what has been nice is that distribution got a little bit better. So we like that the fact that that went into Phase 4 and we had a number of other things moving into Phase 4, automotive and life sciences and oil and gas. So and actually powergen and semicon, even though they are down mid-teens for us, the fact they went into Phase 4, I always like when things move into Phase 4 because guess what the next phase is, accelerating growth. So that's encouraging.

And we still had the ones that were strong and continue to be strong like aerospace, lawn and turf, we are seeing some seasonal help there and forestry with all the paper related goods tied to e-commerce has continued to be strong.

So those are what I would say as indicators. Again, for us it's -- what we are signaling with this guidance is a bottom forming for us. I can't call it bottom for anybody else but a bottom for us is somewhere in the middle of our fiscal year.

Ann Duignan

Okay. I will leave it there in the interest of time. I will get back in queue. Thank you. Appreciate it.

Cathy Suever

Thanks, Ann.

Operator

Thank you. Our next question comes from Joel Tiss of BMO Capital Markets. Your line is now open.

Joel Tiss

Hi. How’s it going?

Cathy Suever

Hi Joel.

Joel Tiss

I just wonder on the last discussion and super duper color there. Can you just give us any sense of how you take -- it feels like things are a little worse now or maybe in the next couple of months’ future, because of inventory reductions. How do you take the amplification of that in the near-term out of your forward guidance, I am just curious how to think about that.

Tom Williams

Yeah. Joel, it’s Tom again. So the destocking it’s always a tough question. But the one area where we do have good data on is North America distribution and you have heard both Lee and I talk about this in the past that it’s been the destocking has been improving by about 100 bps and that’s actually what happened again. So to refresh people’s memory in Q3 of 2019 it was down 300 bps of destocking, Q4 was 200 bps and now Q1 was 100 bps.

So we had guided to that we felt distribution was going to at least North America was going to get into somewhat of equilibrium at the end of the calendar year, so the end of Q2. But we clearly are seeing destocking at the OEMs, especially the mobile OEM's destocking and how long that takes to play it through is very difficult, because we don't have the kind of visibility into that that we have with the U.S. distribution. But what we are guiding is very hard to split end-market demand versus destocking, what we gave you is kind of our view all-in of this impact.

Joel Tiss

And then just like a strategic question and not so much thinking about a forecast, just thinking about how do we think about Parker's earnings resiliency going forward, like beyond the obvious, okay? Aerospace is a bigger part of the company, but like some of the ways that you guys think about it, if that could help us? Thank you.

Tom Williams

Yeah. Joel, Tom. That's a good question and I am actually glad that you asked it. Because we have been working very hard at this, as you might imagine and there's a number of factors. First, it would start with some of the portfolio moves that we have made over the last number of years. CLARCOR, LORD and Exotics, so let me give you some for instances.

So when we look at our order entry without getting into things that I don't want to disclose publicly, our filtration platform is holding up much better than the rest of the industrial platform and that was by design, with CLARCOR, with the density in aftermarket. So that is -- it's living up to its billing and what we had hoped for.

LORD is coming in that -- with about a 4% organic growth and that compares to what we just told you or guiding to a minus 6 for Parker. And Exotics's growth is coming in around 11% and so that's better than Parker and better than Parker Aerospace. So you have got some portfolio things that are -- that we are doing that drives resilience and enhance organic growth.

And then you have heard us talk about what we have been doing on distribution, growing international distribution in particular and we have changed that mix from one, we started with Win Strategy 2.0. We were at 35% international mix and distribution and now it's 40%. So that doesn't seem like a lot. But moving that number, 100 bps a year, is meaningful, that enhances margins and it provides more resilience, again, because our channel there is servicing primarily aftermarket.

We are doing a lot of things on innovation, which will give you a lot more color with 3.0 when we see it all in March. But the new product blueprinting, product vitality and mix, our gross margin that we are tracking on these products are all designed, because if you look at our innovation growth, it is growing faster than the base business. So it's going to hold up better in a downturn.

The things we are trying to do to drive customer experience are really important because you can't really grow with a customer if you don't give them a good experience. And then all the things we have been doing operating-wise, simplification, lien, supply chain, et cetera and now Kaizen to make the company more agile and just a better operating company. So those would be the things that I would say on the topline and then just from operating standpoint, how we are going to get to those FY '23 targets.

Joel Tiss

Great. Thank you very much.

Cathy Suever

Thanks, Joel.

Operator

Thank you. Our next question comes from Jamie Cook with Credit Suisse. Your line is now open

Jamie Cook

Hi. Good morning. I guess just a couple questions. I guess the first one, just understanding the guide. The international -- or the implied international adjusted margins I guess fall off a little more than I would have expected in the remaining nine months of the year. Understanding there's a lot of moving parts. But is there any way you can sort of help me -- help us with what the puts and takes are there besides increasing amort? And then, just obviously the cash flow in the quarter was very strong and as we are in sort of a slowdown here, leverage becomes more topical. So just, Tom, how we should think about cash flow for 2020, whether there's any structural improvements we should be looking for. Thank you.

Tom Williams

So, Jamie, let me start. I will have Cathy add on as far as debt and maybe comment on cash flow. One thing I want to try to make sure everybody understands. This new guide has got still some really good decremental margins in it and we have always -- if you benchmark companies, which I know you all do this, a minus 30 decremental is still best-in-class decremental. So I am just going to read to you total decrementals for the company, Q2 through the rest of the year.

So Q2 -- and these are approximate, these are at the midpoint, there's going be a range around these numbers, 27% decremental, Q3 a 28% decremental, Q4 a 23% decremental. So we end up with a full year of about a 25% decremental. So, those are really, I think, very excellent performance given that if you look at industrial, it's going to be down minus 6 North America and minus 11.5 on international.

That's why international's is a little bit worse. On its decrementals, North America is coming in around 24 and internationals at 29. And it's because it's about a 2x difference on volume and so that's creating a lot more challenges.

And then, in addition to the volume side, international has currency, which we have always struggled to identify currency impact on financials and we have -- we basically decided not to try to figure -- to try to communicate that because you can't get a consistent number with it. But we do all know that when currency becomes a headwind to us, it becomes a pressure point on margins. So that's another factor for international.

On cash flow, I will hand it over to Cathy. I would just - I would have shareholders rest assured that that 18 years of 10% plus CFOA is going to turn into 19 years, because we have got a proven track record of being able to work with working capital.

And these operating margins, like you heard me talk about in the opening comments are 180 basis points better than our last downturn. So we have better operating margins and we will work the working capital like we normally do. Cathy, have you got anything to add on.

Cathy Suever

Yeah. Jamie, we finished quarter end at a leveraged gross debt-to-EBITDA of 3.6. We did bring in a small amount of additional debt in the form of term loan when we -- to be ready to -- to close LORD this past week and so it’s going to go up slightly. But if you look historically, we do have a great track record of managing the working capital very well during a down cycle.

So, we are pretty confident. In addition to that, both LORD and Exotic have a history of very strong cash flow stronger than Parker, so they will be great contributors to it. And we are confident we would be at a level that we have - that we were with CLARCOR when we closed that deal and we brought that down very quickly and we feel that we can do the same, even though we are seeing things slowdown Also keep in mind, we do carry about $1 billion of international cash, so our net debt-to-EBITDA was actually 2.1 at the end of the quarter.

Jamie Cook

Okay. Thank you. I appreciate the color.

Cathy Suever

Thank you.

Operator

Thank you. Our next question comes from David Raso with Evercore ISI. Your line is now open.

David Raso

Hi. Thank you. Just looking at the organic growth first half, second half, obviously, the second half, a big change from used to be up 1 to negative 6 now. Can you take us through your thoughts on how you see orders playing out underneath that decline? I mean, it seems like the second quarter, you are expecting the biggest organic decline, but the second half is still pretty healthy at down 6. I mean, healthy meaning a large decline. So, I am just trying to get a sense of how you are viewing the order patterns underneath that negative 6 in fiscal second half?

Tom Williams

Yeah. David, it's Tom. And that's where the forecast gets far more challenging the he further that you go out. But really we are trying to project some of those macro indicators that I mentioned in my comments. U.S. ISM, Germany's number, Asia's PMI, rest of Europe PMI's, et cetera, recognizing as we plotted those historically, they tend to lag and impact our orders three to six months out.

So we know what we saw weakening in October, which that's going to influence Q2 and then, these other macro indicators three to six months out, starts to impact the second half and so that was the thought process behind that.

But it does become more challenging as we try to figure that out, because our backlog doesn't carry us outside of Aerospace. It doesn't carry us out that far, so we had to kind of look at historical trends and lagging periods between these macro indicators of what we do.

David Raso

Yeah. I am just trying to think how you thought about managing your own inventory through the end of the year and that interplay between, okay, the second half's a lot weaker than what we thought, but we do see some bottoming process and that's how we are managing, be it not even just inventory but how you are thinking about pricing. That usually gets announced January 1st and so forth. I mean, is it fair to say at this stage you are not thinking of the orders improving much in the back half fiscally and just the comps get a lot easier. So, I think for a lot of people seeing the cut through the organic is obviously not pleasant. But if you felt the orders were improving in the back half to some degree, you can call it temporary. So what you are speaking to the businesses is it's kind of a temporary macro environment. I know it's hard to call. I was curious if you had some sense of where you are headed and how you are managing the company for that fiscal second half. It doesn't sound like you are planning for orders to be say, up in the latter part of the year, is that a fair assessment in how you are trying to manage?

Tom Williams

Yes. David, I think that's fair. We would project that orders would continue to be weak because our orders, organic growth in orders are typically within a month or two of each other when you plot it historically.

So for us on inventory, inventory is never good. It's always it's a waste when you are running a lean operation. So we are continuously whether we have volume going up or volume going down we are looking to optimize inventory period all the time and the kinds of efforts that we are doing in unity with our Parker lean process we will continue to look work at managing inventories down.

Now obviously when orders go down, you need to update all your planning tools. You plan for every part, which is part of our lean system, so we are doing that. And then on pricing, I will let Lee comment on pricing with what we are doing with that.

Lee Banks

Well, David, maybe I will put price and costs together. I would say costs inputs, it's a mixed bag, there's some going down, some going up. But from a price cost standpoint, as always, we just try to stay margin neutral and that's what we are planning going forward.

David Raso

Okay. And just to make sure just to wrap up here, the first quarter organic was in line with your expectations maybe 20 bps even better. I actually thought the orders weren't even that bad in the first quarter relative to some of the fears out there. But then, obviously, you took a big chunk out of the rest of the year on organic sales and even your thoughts on orders. So the surprise I guess must have really been this last month that you really thought to see at least some beginning of bottoming process. So is that fair, it's really been the last month that really drove the change in the guide.

Tom Williams

David, it's Tom again. So there's two things, you are right, October, but then also the sequencing we saw within the quarter. The fact that August and September got worse from July. So we were starting to see a weakening through the quarter then another step down in October. That's why we have changed the guide.

David Raso

All right. That's helpful. I appreciate it. Thank you.

Cathy Suever

Yeah. Thanks, David.

Operator

Thank you. Our next question comes from Andrew Obin with Bank of America. Your line is now open.

Andrew Obin

Yeah. Hi. Good morning.

Cathy Suever

Good morning, Andrew.

Andrew Obin

Just a question on cash flow and it's not more a question but a lot of companies that do deals have shifted to reporting sort of cash earnings, given a massive discrepancy between your cash flow generation and reported earnings. Have you guys considered moving to reporting cash numbers and what has the feedback been from your investors?

Tom Williams

Yeah. Andrew, it's Tom. It's good question. We have thought about it and we have reached out to shareholders and it's been pretty uniform from shareholder feedback saying don't make that change. I continue to obviously we will adjust for a onetime cost and the things that we would normally be doing but other than that, continue to report on a GAAP basis.

And if you think about it, just it creates a more, a bigger hurdle that business needs to absorb to generate returns on behalf of the shareholders and I think that was the feedback I heard from shareholders is we want you to incorporate that bigger challenge into how you run the place. But it's a good comment, I know there have been good companies that have made that change, at this point we have elected to stay with what we have been doing.

Andrew Obin

Thank you. And then just a question, as your numbers have decelerated, what has the feedback been from LORD and Exotic, what have they experienced relative to expectations when you announced the deals?

Tom Williams

Yeah. So, Andrew, it's Tom again. So actually they have held up really nicely. LORD and the outlook that we have just given you is coming in at about a 4% organic growth and we had in our model, about 5.5%. That's what I was verbally said during the announcement that was kind of our five-year CAGR.

So if you think of everything that's going on that's changed from when we made that announcement to today, that's pretty good. And again, that 4% positive compares to minus 6% for Parker. That's why we like LORD so much. It's why we bought them. It's accretive from a growth standpoint.

And then when you look at Exotic, Exotic's coming in at a little over 11.5. we -- in our model that we built for the DCF, we had about a 7.5% CAGR, so that's held up nicely. I would say two things, A, little better F-35 sales and we modeled a more conservative 737

Max. We have modeled Exotic going down to 42, but Boeing has not done that yet with Exotic and probably won't because Exotic with its long lead time for materials.

When you look at what Boeing's done with their management supply chain, the rest of Parker Aerospace, for the most part, at 42, but as they have managed long lead time type of suppliers, Exotic being one of those, they have kept them at 52 because of obvious reasons. You can't ramp back up with that kind of long lead time. So that's part of why they have overproduced on the revenue.

So in a nutshell, both acquisitions holding up on revenue, both acquisitions coming in at the EBITDA level that we expected to actually LORD slightly better on EBITDA, margins because we have pulled in the $15 million that Cathy referred to in her comments as the synergies for LORD, we are able to pull them a little bit earlier than we thought.

Andrew Obin

And if I may squeeze just one in, auto exposure with LORD, you did comment that auto is bottoming, was that referring to sort of the old Parker exposure or was that referring to LORD's exposure as well, and that will be it for me. Thank you.

Tom Williams

That was total Parker. We haven't -- that was based on Q1 so we didn't have LORD in Q1. But their auto has held up better than our auto has, so pretty comparable.

Andrew Obin

Thank you.

Cathy Suever

Thanks, Andrew.

Operator

Thank you. Our next question comes from Andy Casey with Wells Fargo Securities. Your line is now open.

Andy Casey

Thanks a lot. I just wanted to go back to the decrementals that you talked about, Tom. Were those all in including the acquisitions over those Parker Legacy?

Tom Williams

Parker legacy without the acquisitions and they are trying to do it with the acquisitions as apples and oranges, acquisitions are not in the prior period. We have got the $100 million of intangible amortization. So the MROS is when you look at it all-in versus prior basically nonsensical, you can't really read anything into it, which is why I gave you the ones without it.

Andy Casey

Okay. Okay. Appreciate that. And then, basically over the long-term, you had talked about 30% incrementals. The decrementals you gave were lower than that, which is good. When you embed the two new acquisitions that seem to be a little bit similar to CLARCOR, a little bit more resilient, would the downside over the long-term relative to the mid to high 20% decremental that you gave kind of even shrink further?

Tom Williams

Well, I think, there is definitely that potential, because to your point they will be more resilient. Their higher margins as well. So they should help us with that. And we are going to work to make them even better than they are today. The whole goal of these is to take the best of what we do and the best and of course, we is not all of us and the best of what the acquisitions had and to make it even better.

So I still think, again, for purposes of bottling, I don't want to get too far over my skis, I would just encourage you to continue to use the plus or minus 30 as still best-in-class, and of course, our goal is we try to do better than that.

Andy Casey

Okay. Thank you very much.

Cathy Suever

Okay. Thanks, Andy. Joule , I think we have time for one more question.

Operator

Thank you. Our final question comes from Jeff Sprague with Vertical Research Partners. Your line is now open.

Jeff Sprague

Thank you. Good morning. Hey. Just two from me, if you don't mind, just first back on the acquisitions. At the time they were announced, I thought LORD's run rate sales were about $1.1 billion and Exotic was about $450 million. And when I look at what you laid out here, it looks like they are both actually kind of on an annualized basis tracking flattish, is there something in timing or do I have this basis wrong?

Tom Williams

Jeff, it's Tom. I think the main thing would have -- when we gave it, it was based on calendar year over calendar year. Now these numbers are FY in Parker's fiscal year, so the prior periods are not comparable.

Jeff Sprague

Those growth rates you gave us though, Tom, were for the year in your plan or just in the quarter, those organic…

Tom Williams

Yeah. The growth rates I gave, Jeff, are for our FY '20. So it would be comparing the period of time they are in part of Parker in our FY '20 and then using the same Parker fiscal year at FY '19 for them to go back and kind of reconstitute that, the two acquisitions.

Jeff Sprague

Then just one other question on incrementals, if you don't mind, and perhaps, it goes to the FX point you were making, Tom, but the decline in the 6% organic growth sales decline is about $650 million in sales, I think, Cathy said $800 million, if I think about it on a core basis, and $1.44 of EPS would gross-up to about $230 million. So that's a 35% decremental on the core business, if I think about it relative to the walk that you gave us where you showed Legacy Parker versus deals, am I missing something there, or is it FX?

Cathy Suever

Yeah. Jeff, it's the FX differential, so the number I quoted was top-line total drop that we had in our guidance for the second, third and fourth quarters. And when you are quoting organic, you are probably correct that it's closer to $600 million.

Jeff Sprague

Okay. Great. Thank you for that color.

Cathy Suever

Okay. Thank you. All right. This concludes our Q&A and our earnings call. Thanks everyone -- thank you to everyone for joining us today. Robin and Jeff will be available throughout the day to take your calls should you have any further questions. Everyone have a great day. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.