Operator: Greetings, and welcome to the Columbus McKinnon Corporation Third Quarter Fiscal Year 2019 Financial Results Conference Call. At this time, all participants are in a listen-only mode. [Operator's instructions]

I would now like to turn the conference over to your host, Deborah Pawlowski, Investor Relations for Columbus McKinnon.

Deborah Pawlowski: Thanks, Brenda, and good morning, everyone. We certainly appreciate your time today and your interest in Columbus McKinnon. On the call with me today are Mark Morelli, our President and CEO; and Greg Rustowicz, our Chief Financial Officer. You should have a copy of the third quarter fiscal 2019 financial results, which were released earlier this morning. If not, you can access those as well as the slides that will accompany our conversation today at our website, cmworks.com.

If you'll turn to slide 2 on the deck, I will first review the Safe Harbor statement. As you are aware, we may make some forward-looking statements during the formal discussions, as well as during the Q&A session. These statements apply to future events that are subject to risks and uncertainties, as well as other factors that could cause actual results to differ materially from what is stated here today. These risks and uncertainties and other factors are provided in the earnings release, as well as with other documents filed with the Securities and Exchange Commission. These documents can be found on our website or at sec.gov.

During today's call, we will also discuss some non-GAAP financial measures. We believe these will be useful in evaluating our performance. You should not consider the presentation of this additional information in isolation or as a substitute for results prepared in accordance with GAAP. We have provided reconciliations of non-GAAP measures to comparable GAAP measures in the tables that accompany today's release and the slides for your information.

So with that, please turn to slide 3 and I will turn it over to Mark to begin. Mark?

Mark Morelli: Thanks, Deb, and good morning, everyone.

We delivered another quarter of solid results and remain optimistic about our future. We're demonstrating excellent execution of our Blueprint for Growth strategy, as we're improving the earnings power of Columbus McKinnon.

For the quarter, we had strong organic sales growth of 6%, adjusting for the impact of FX, as we gain share by improving availability and shortening our lead times for quotes. Helping the strong sales growth was a $3.5 million rail project we delivered in Saudi Arabia in the quarter as well.

For the seventh consecutive quarter, gross margin expanded year-over-year. Gross margin was 33.8%, expanding 90 basis points. On a GAAP basis, we had a diluted loss per share of $0.03 in the quarter that was driven by a noncash charge associated with the remaining businesses held for sale. However, on an adjusted basis, diluted earnings per share improved

39% to $0.61. Further, adjusted EBITDA margin expanded 130 basis points to 14.2%, and stands at 15.1% year-to-date.

Through our self-help strategy, we're deploying our operating system that includes our 80/20 process which is helping to drive significant bottom line growth. In fact, we realized $5.5 million in savings in the quarter from our strategic initiatives. There's a long runway ahead of us with a lot of opportunities to further drive improvements.

We continue to generate strong cash flow. We paid down $50 million of debt year-to-date. Our net leverage ratio has crossed an important milestone as it's now below 2 times net debt to adjusted EBITDA, once again, ahead of target. We will continue to prioritize our cash to reduce debt and improve our net leverage ratio. Another important metric for us is ROIC. With the strength of our financial performance, adjusted ROIC was 10.5%, an improvement of 190 basis points year-over-year.

Please turn to page 4 and let me update you on our progress with our Blueprint strategy. We are currently in Phase II of our Blueprint for Growth strategy, and it has three focal points: simplify the business, improve productivity, and ramp the growth engine. We've employed our 80/20 process across about half of the company thus far. On previous calls, we've discussed elements of our process as part of our earnings power acceleration operating system.

We also spoke about product line simplification and the launch of our new wire rope hoist platform. We now expect to have our legacy model wire rope hoist line completely converted to the new platform during the first half of fiscal 2020. The conversion lowers our costs and significantly reduces our SKUs while enhancing our product offering. The new hoists are more compact, offer more features, and run smooth and quiet due to their superior engineering. Our expanded product range allows us to compete in the high end of the market with the STAHL brand and leverage the Yale brand in the mid-market for a very competitive offering.

Our execution of the 80/20 process is clearly demonstrating results, and we're confident we're on the right path and we can deliver more. Of the approximately $7 million of savings we've identified in fiscal 2019, $4.1 million has been captured year-to-date. Through the simplification lens, we identified the three divestitures disclosed previously. The Tire Shredder business was sold on December 28, 2018. We signed the stock purchase agreement yesterday for the sale of CES, which is expected to close at the end of February. We're making progress on the sale of the remaining business which is the German forging operation.

The second focal point of Phase II is improving productivity. Our success here is demonstrated in several areas. First, our operational excellence initiatives are improving efficiencies at our factories and generating considerable savings. Of the nearly $8 million saved through productivity improvements, $3.5 million is directly attributable to operational excellence. Our focus on eliminating waste and reducing the amount of indirect labor is paying off. In fact, we're improving productivity by reducing indirect labor support levels. Other actions include improving material productivity and streamlining scheduling processes. We are investing as well in upgrades like paint systems, and intensified training for operators to improve throughput and quality.

Second, with the combination of operational excellence and product line simplification, we're able to consolidate factories in Ohio and eliminate about 50,000 square feet. This consolidation should be completed early in fiscal 2020 from which we expect approximately $2 million in savings. Ramping the growth engine is the third point of Phase II. Here, we focus on enhancing our professional grade position by improving our product offerings and delivering solutions that offer greater productivity and safety. We believe this will position us in higher growth applications and lead to market share gains.

Our variable speed drive hoists are gaining traction with customers. We're launching our Lodestar VS now in a full range of 1/8 tons to 3 tons capacity. This product line features CM HI-Tech™, which stands for Hoist Interface Technology, a unique, easy-to-use computer interface. This gives operators the ability to quickly adjust hoist speed and performance parameters to deliver the precision load control their applications demand.

We also see one of our core values "be easy to do business with," as a means of growing sales. This is another area in which our team is making major strides. Our digital tools, specifically our cloud-based configuration tool, Compass™, is a great example. Compass™ is an enhanced tool on our digital platform that improves customer productivity. Our customers complete their design work online more efficiently, and we continue to increase the number of products offered on the platform while quoting activity continues to grow.

We expect further enhancements to continue to outpace the competition and are aligning resources to improve new product development. In April, we're opening our center of excellence in Charlotte, North Carolina. By centralizing key talent, we believe we can more efficiently drive product development, new line of customer tools, and operational efficiencies. This focuses our human capital rather than spreading people and investments too far and too thin.

With that, let me turn the call over to Greg to cover the financials. Greg?

Greg Rustowicz: Thank you, Mark. Good morning, everyone.

On slide 5, consolidated sales in the third quarter of $217.4 million were up approximately 4% from the prior year. Without the impact of FX, we saw organic sales growth of $12.7 million, or 6.1%. This was slightly better than the top-end of the outlook provided last quarter of 4% to 5% sales growth, excluding adjustments due to foreign currency translation.

Sales volume was up $9.9 million, or approximately 5%, and pricing was higher than the previous year by $2.8 million, or 130 basis points. Year-over-year pricing improved about 30 basis points from Q2 levels, largely due to our 80/20 pricing initiatives. As you know, we typically raise prices for the majority of our businesses in fiscal Q4 and those plans are underway. While the markets are competitive, we have demonstrated our ability to capture pricing annually.

Foreign currency translation remained a headwind in the quarter of approximately 2%, and we expect the headwind to get worse in the fiscal fourth quarter. At today's foreign exchange rates, the headwind will be in a range of 3% to 4%.

We saw solid growth in the U.S., and non-U.S. sales results were positive despite the impact of FX. For the quarter, U.S. sales were up $7.9 million, or 7.3%. Sales outside of the U.S. were up $800,000, or 0.8%. Excluding the effects of foreign currency translation, we saw organic growth of 4.8% outside the U.S.

It's important to note that our non-U.S. growth included a large rail project that Mark mentioned, which was valued at approximately $3.5 million, delivered to the Middle East. We feel good about the sales performance this quarter, which is historically our weakest quarter from a seasonality perspective. We believe we are growing share in key markets and executing well.

On slide 6, we recorded a strong gross margin of 33.8% in the quarter. This is a 90-basis point expansion in gross margin from a year ago, and is our seventh consecutive quarter of year-over-year margin expansion. As you know, Phase II of our strategy is focused on simplification and operational excellence. We are seeing good traction with driving margin expansion as a result of these initiatives.

Let's now review the quarter's gross profit bridge. Third quarter gross profit of $73.4 million increased by $4.7 million, or 6.9%, compared to the prior year. The three largest contributors to gross profit expansion were higher sales volume, productivity, and pricing net of material cost inflation. Sales volume contributed $2 million of gross profit, while productivity and pricing net of material cost inflation each contributed $1.6 million.

Year-to-date we have achieved a record level of productivity of $7.9 million as our strategy takes hold. The impact of higher pricing continues to offset raw material inflation and tariffs. We expect tariffs to have up to a $1 million negative impact in the fourth quarter. In fiscal 2020, with the current tariff schedule and no mitigation efforts, tariffs will have about a $3 million negative impact on gross profit. We are actively working to mitigate this headwind. Foreign currency translation reduced gross profit by $1 million this quarter.

As shown on slide 7, RSG&A costs were $47.5 million in the quarter, or 21.9% of sales. This is an improvement of 260 basis points from the previous year. As a reminder, the prior-year third quarter included pro-forma costs totaling $4 million, and the current quarter has pro-forma costs of $500,000. In addition, FX was a benefit in the current year of approximately $800,000, or 160 basis points.

Selling costs decreased by 6.3% and G&A costs decreased by 8.7%. Selling costs decreased due to FX and some structural cost changes. The decrease in G&A costs is due to FX and $3.4

million of pro-forma costs that occurred in the prior year for STAHL acquisition costs, and a net reduction in insurance recovery litigation costs compared to the prior year.

Excluding these pro-forma costs and the impact of FX, G&A costs were up 9.5%. This was primarily due to higher annual incentive comp and stock comp compared to the prior year as a result of the company's strong financial performance this year. Our fourth quarter forecasted RSG&A run rate has been lowered as a result of the Tire Shredder divestiture, and is expected to be in a range of $47.5 million to $48.5 million.

Turning to slide 8, adjusted income from operations grew 29% to $22.9 million, or 10.5% of sales, a 200-basis-point improvement over the prior year. Our adjusted operating leverage in the quarter was 59%, which is a strong leverage ratio. Overall, our operating performance is driving earnings power. As Mark noted, in this quarter, we achieved savings of $5.5 million related to our Blueprint for Growth strategy.

We had a noncash charge this quarter related to an additional impairment on our businesses held for sale. The total charge of $16.7 million was a result of our updated estimate of fair market value for the remaining businesses to be sold. This was partially offset by a $1.1 million gain on the sale of the Tire Shredder business. While the impact to GAAP operating income was $15.6 million, these are small, noncore businesses and are not reflective of the earnings power of our core business.

As you can see on slide 9, GAAP earnings per diluted share was a loss of $0.03 that reflects the non-cash charge I just discussed. Adjusted earnings per diluted share was $0.61 compared with $0.44 in the previous year, an increase of $0.17 per share, or 39%. On a GAAP basis, our effective tax rate in the current quarter was 134%. This was impacted by the impairment on the remaining businesses held for sale, which is nondeductible, partially offset by the reversal of the transition tax related to the Tax Cuts and Jobs Act. We have finalized the accounting for this and do not believe that a transition tax is required. While we expect the full year tax rate to be in a range of 27% to 29%, we believe our normalized tax rate is 22% and this is the rate used to calculate non-GAAP adjusted EPS.

On slide 10, we continue to expand our adjusted EBITDA margins. On a year-to-date basis, our adjusted EBITDA margin was 15.1%, an increase of 140 basis points over last year. We also continue to make progress on driving our ROIC higher and are now at 10.5%. As a reminder, our Blueprint for Growth strategy goal is to achieve 19% adjusted EBITDA margins in fiscal year 2022, and achieve an adjusted ROIC in the mid-teens.

Turning to slide 11, our working capital as a percent of sales was 17.9%, an improvement of 180 basis points over the trailing quarter. This is due to a three-day improvement in DSO performance for the company overall. Last year's fiscal third quarter was 50 basis points lower due to the impact of the STAHL acquisition. Inventory turns were 3.8 turns, an improvement over the trailing quarter. We think there is opportunity to further improve inventory turns going forward.

On slide 12, net cash from operating activities for the quarter was $26.2 million which was higher than the prior year amount of $16.5 million. Year-to-date we have generated approximately $47 million of operating free cash flow. We expect strong cash flow generation and free cash flow conversion in the fiscal fourth quarter. Our guidance for capital expenditures for fiscal 2019 has been lowered to approximately $10 million to $12 million for the year.

Turning to slide 13, our total debt was approximately $315 million, and our net debt was approximately $257 million as of December 31, 2018. Our net debt to net total capitalization is now below 38%. We repaid $25 million of debt in the third quarter and have reduced our term loan debt by nearly $120 million since acquiring STAHL two years ago today. We made excellent progress de-levering, and have achieved a net debt to adjusted EBITDA ratio of 1.99 times, which is now below our targeted net leverage ratio of 2 times. From a capital allocation perspective, our plan is to use our free cash flow to continue to de-lever our balance sheet. We expect to exceed our debt repayment target of $60 million in fiscal 2019.

Please turn to slide 14 and I will turn it back over to Mark.

Mark Morelli: Thank you, Greg.

Let me give you some color on our markets. Globally, entertainment remains a sweet spot for us where our new black load chain offering has been well-received. There are more applications for automation in the entertainment segment that plays into our brand positioning and offerings. On the industrial automation front, our DDC Series 2 new drive platform for the conversion of old DC power cranes in factories, such as steel mills, is a leading choice for these engineer to order projects.

The relative strength of the oil and gas industry is driving mid and downstream activity, and is an area of growth for us. Globally, our oil and gas, petrochemical, and power generation customers look for the precise and safe lifting and positioning of heavy equipment. In many cases, these markets require explosion-proof hoists, which is a core competency for us.

In the construction industry where backlog is quite high, confidence remains strong in the distribution channels for construction equipment and contractors. In the utility market, power grid modifications are expected to drive demand for our new strap hoist launching in March.

While lumpy, our rail project pipeline is stronger than it ever has been. Customers are upgrading infrastructure and electrifying rail systems as they expand new routes and replace diesel trains. I’d say a soft spot might be automotive; however, we’re still seeing model changes. The advance of new models of SUVs, trucks, and electric vehicles is a plus for us. Geographically, demand in North America remains strong and Europe continues to grow. There was some slowness in the Middle East, which was related to project timing. China is less than 2% of our total sales and doesn’t have a significant impact on our results.

As we’ve discussed, we’re making excellent progress with our Blueprint for Growth strategy. We’re advancing through Phase II with many successes that are visible in our results. I’d like to point out that globally the Columbus McKinnon team is doing a great job. The team is rising to the challenge, embracing the Blueprint for Growth strategy, and further transforming into a performance culture. Our new mission, vision, and core values resonates with employees and helps us identify with our new collective work culture. Our new organization structure is more streamlined and focused on adding value to customers and drives the key tenets of our strategy. I'm very proud of this dedication, commitment, and drive to achieve results for customers and shareholders.

Given the continued strength of order and backlog growth during the quarter and the solid outlook from customers, we expect organic revenue growth in the fourth quarter of fiscal 2019 to be approximately 4% to 5%. Last year's fourth quarter comparator revenue should be reduced by approximately $3.3 million related to the Tire Shredder divestiture and $1.5 million related to the expected timing of the CES divestiture. There's also about $600,000 in related operating income. Our outlook is not adjusted for foreign currency exchange headwind, which we estimate could reduce revenue by approximately 3% to 4%.

We are on track to achieve our long-term goals over the next three years to measurably strengthen our earnings power, reaching 19% in adjusted EBITDA margins and ROIC in the mid-teens. Allow me to reiterate that our strategy is to improve the earnings power of Columbus McKinnon with a better business model focused on industrial technology. We are confident that the changes we're making create a more resilient business. Our strategy is working, our team has gained traction, and we believe the changes we are making are sustainable.

Brenda, we're now ready to open the call for questions.

Operator: Okay. Thank you. [Operator Instructions] Our first question comes from the line of Greg Palm with Craig-Hallum.

Greg Palm: Good morning. Thanks for taking the questions. Hopefully, you guys are surviving the cold and snow out there okay.

Mark Morelli: It's an impressive winter.

Greg Palm: Anyways, Mark, thanks for the commentary on the end market exposure. Was curious if you saw any change or inconsistency with the cadence of sales as the quarter trended on from a month-by-month basis, and curious what you're hearing or seeing so far in January.

Mark Morelli: So, the project-related businesses saw very strong demand, and our order growth was well-received. We're very encouraged by that. Folks are really progressing well on projects related to steel, aerospace; as I said in my remarks, power generation is very good, as well as utility markets. So, I think the demand we're seeing on the project businesses is very, very good.

We do have a seasonal downturn related to the industrial-type products, and this happens every year at this time, as folks that follow the business know. This is where people try to manage some of their budgets and their inventories for the end of the year, and we saw that normal drop off. So that was very normal, and I think we probably are seeing an outsized growth in projects, which, like I said, we're very happy about.

Greg Palm: Okay. Great. As it relates to smart hoist, didn't hear a whole lot on the call, but you've had some more time to digest the initial launch. So, just kind of curious what you're hearing from customers. I mean, does it make you more confident, less confident in the opportunity going forward?

Mark Morelli: It makes us more confident. In fact, we're just now expanding the range, and we are planning a press release that announces that we're expanding to a 1/8 ton to 3 ton capacity range. The feedback we're getting is very well-received particularly because of the ease-of-use interface. This is very intuitive for folks on how you set parameters for the hoist and control it. I think it's a very good offering with a really easy to use interface, and we're getting some very positive feedback with that.

Greg Palm: And in terms of overall acceptance in it, I mean, this is a new product set – new application for a lot of your customers, so how are they thinking about overall adoption and time line in doing that?

Mark Morelli: This product right now is positioned at the premium end of the market. So it's customers that want to enhance productivity, and they see the benefits of the technology. We believe that it's a very good offering, and we feel good about it. As we continue to expand, we'll be pushing more into the middle part of the market. We're also excited because, with the launch of the expanded capacities, we're actually getting preorders for that -- which is not normal for us to get preorders ahead of a launch. I think that's also an encouraging sign.

Greg Palm: That's great. Last one for me. You've done, really, a fantastic job at de-levering here over the past year. I'm just wondering have your capital allocation priorities changed at all? I've always thought that additional M&A would maybe be further down the road, but you've got an industrial environment that is softening a bit; I'm assuming valuations are coming in. So, curious if that changes your thinking around acquisitions at all.

Mark Morelli: Well, as you know, our Phase III does involve M&A; however, we're really comfortable with our current posture of generating strong cash flow and continuing to pay down debt. We haven't fully engaged on Phase III yet for doing the M&A work, so I don't suspect anything in the near term, and I think the capital allocation strategy we have is great, particularly with the current outlooks for the market. So we will continue to pay down debt, below the 2 times net leverage target that we've had.

Greg, do you want to make any comment on that at all?

Greg Rustowicz: I think that's clearly the focus. One of the hallmarks of the company is our ability to generate cash. And at least for the immediate time, we will continue to de-lever the balance sheet. We do expect to exceed our target of $60 million of debt repayment for the year.

We've already paid down $50 million, and we expect at least for the first couple of quarters next year until we're more fully into our Phase III, we'll continue to de-lever the balance sheet.

Greg Palm: I guess, if I could just sneak in one more quick one. It looks like free cash flow – it might have been an all-time record in the quarter – it was a record for as far as I go back in my model. But have you changed the expectations or estimates for free cash flow this year?

Greg Rustowicz: I would say, you're right. It's fantastic performance on the free cash flow generation; really, the hallmark of our company. Typically, the fourth quarter is a really strong free cash flow quarter for us. The other thing I would point out is we have lowered our CapEx guidance for the year from approximately $15 million down to $10 million to $12 million. So, obviously that will increase the operating free cash flow that we generate. Our expectation is that with the new EBITDA margin target of 19% in fiscal 2022 that we would expect more cash flow generation going forward. For example, at least, in the $70 million to $75 million range next year; probably $60 million to $65 million this year, $70 million to $75 million next year.

Greg Palm: Awesome. All right. I'll cede the floor. Thanks so much.

Operator: Our next question is from the line of Matt Koranda with ROTH Capital.

Matt Koranda: Hey, guys. Good morning. Just want to start out with a clarification on the Q4 guide. So, if I net the FX headwind against the organic guidance, I come up with something about 1% overall growth combined, and then we need to take out the additional headwind from the divestiture of Tire Shredder, and then another $1.5 million related to the Crane Equipment & Service business. So, all together, I think it spits out something like $211 million in total for Q4, is that roughly directionally correct?

Greg Rustowicz: Matt, it's Greg. Yes, you're thinking about it absolutely right. It's going to be in the neighborhood of $210 million to $212 million, which is our best estimate at this point.

Matt Koranda: Okay, got it. And then, the underlying organic growth is still pretty healthy. Just wondering if you could talk about the key drivers of that growth in the coming quarters. Typically, the way I think about some of the macro data that comes out that are kind of a good leading indicators for Columbus McKinnon, if I look at PMI or capacity utilization figures globally, there are puts and takes around the world, but I would say in general, the direction is either in decline or, in the U.S. it's obviously still expanding, but just at a lower rate.

What are the key drivers to sustain that low single-digit to mid-single digit growth rate in the out quarters? I know you guys mentioned share take, something that seems critical to the quarter in your organic growth there and the outperformance. But wondered if you could talk a little bit more about share take, your expectations for unit growth, and then also pricing as we move into fiscal 2019, and then I guess, fiscal 2020 for you guys.

Mark Morelli: We've got some really good initiatives that are really driven by the 80/20 process, because it gives us the clarity of what we should focus on. We talk a lot about how we shed bleeders as part of that, but there's also parts of the business that you want to emphasize and we deploy more around that. I think an excellent example of that is this project we talk about, this wire rope hoist platform consolidation. It's not really a cost reduction for us; it is really a repositioning of that product line, and it helps us to expand into different market segments, as well as added capacity. That's a great example of how we get better coverage with a better product and translates into share.

The second point that I'd like to make is that some of these digital tools, particularly in an environment where supply chains are stretched, customers are actually stretched as resources, it might be hard for them to get labor, to be able to focus on these kind of things. If you can improve their productivity, you're going to be a lot easier to do business with, and that actually leads to share gain because folks need to get their work done. If you can get it done quicker and easier and, by the way, reduce lead times and lead times on quote and on products, then you're going to gain share. I think that's exactly what we're beginning to see.

I don't think we're going to see huge outside growth if the markets go down, but I think we feel really good about a low growth environment which is very healthy for us and our strategy is perfect for that. So, I think we see good markets, as you said. If there is slow growth, we're very happy to enjoy that slow growth with our strategy.

Matt Koranda: Okay. I heard a lot of commentary about share takes in there which is positive. Anything else on the pricing environment as we head into a critical time period for you guys where you typically make price increases?

Greg Rustowicz: Yes. So, we did see our year-over-year pricing increase from about 1% the last couple of quarters to 1.3% and that would have been largely due to some of our 80/20 initiatives. But as we go forward, you're right, we have a number of our businesses that raise price in this fiscal fourth quarter. Our U.S. business being the largest has an early March effective date. So right now, we've gone out with what we expect, and it's a competitive market, and you unfortunately don't get all that you ask for, but we'll continue to press on that.

We've had good pricing leverage in Europe. Their prices went into effect in January, and some of our other businesses have price increases effective in April. But all in all, I'd say we're cautiously optimistic. We'll continue to drive pricing forward and continue to offset some of the headwinds we see with tariffs and raw material cost.

Matt Koranda: That's helpful. And then last one is, since you mentioned 80/20, wanted to attack it from the savings front. It looks like you're expecting an incremental roughly $3 million in savings in the fourth quarter for you guys from 80/20. So, maybe you could talk a little bit about the buckets that's coming from. I think Mark mentioned some of the simplification of the wire rope hoist product, but any more color on that? And then for fiscal 2020, I think you guys had said that 80/20 savings should be higher than the $7 million that you're doing in 2019. So, any way to dimension that or directionally provide a little commentary on where that should be, that'd be helpful.

Greg Rustowicz: So, your math is right, Matt, on that. We are targeting $7 million of savings. We've achieved $4.1 million through December, so that implies about another $2.9 million in Q4, and it comes from a number of areas. There's customer list simplification, product list simplification. We're also looking to service our bigger, more important customers better, and we call that our raving fans program. As a result of that and a refocus on where we're making money and perhaps where we're not making money, we kind of redeploy resources and, in some cases, we've taken some indirect costs out of our facilities as we simplified our manufacturing processes.

So, it comes from all those areas and it's typically a gross margin story. There is some incremental pricing that we saw in this past quarter. About half of the company is into the 80/20 process now; the other half is going to get going with it this calendar year. So, we're excited about that. One of our businesses is further along than others -- in the U.S. in our Industrial Products business -- and we're seeing a lot of good savings coming out of that business.

Matt Koranda: Okay. And then for fiscal 2020, anything more directional in terms of the magnitude of the savings? I think you guys have said it's going to be more than fiscal 2019, but is that – we'll leave it out at this time or any additional color.

Greg Rustowicz: I think at this point, we're not ready to go out with another target. What we do know is that we got started around the March timeframe this past year. It takes a bit to get trained, to analyze the data, to make decisions, to implement decisions. So, we'll see the full year run rate next year. Then for the businesses that haven't started the process yet, we've got to run the analytics. So, it's too premature to talk about what we might see there.

Matt Koranda: Okay. Fair enough, guys. I'll jump back in queue. Thanks.

Operator: Our next question is from line of Joe Mondillo with Sidoti & Company.

Joe Mondillo: Hi, guys. Good morning.

Greg Rustowicz: Good morning, Joe.

Mark Morelli: Good morning, Joe.

Joe Mondillo: Just to follow up on that, I guess. Looking at the other 50% that you have to tackle on 80/20, what kind of timeframe – you just mentioned that there's some analytics that you have to look at before starting to implement. But I think you initially started with North America or you're maybe easier low-hanging fruit ways to implement. I'm just wondering what kind of timeframe are you guys thinking about overall level in terms of that other half of 80/20? Is this going to be within the next four or five months things are going to be starting to implement; or is there going to be a pause between what you've done so far and tackling the rest of things?

Mark Morelli: So, this is a phase activity, as you can imagine. You can't do it all at once. As you said, we tried to start with areas that we thought might be some low-hanging fruit. But we are starting now with our Engineered Products lines of products, and we'll be moving that forward next. Then, we obviously have our STAHL business that we're also teeing up for later in this calendar year. So, I think we do have a good pipeline of activity here. Folks are really engaged. People are really excited about it because they see the benefits of it. We are pretty methodically moving through the company here at a pretty good clip. So, we'll update you more as we go through it, but we're going forward, for sure.

Joe Mondillo: Great. And then in terms of productivity improvements and maybe potential efficiency improvements with square footage, whether it's consolidation or anything else that you can take advantage of, how should we think about what you've done with that and how much room for improvement you have with that?

Mark Morelli: So, great question, because it gives me an opportunity to highlight that we've really added a lot of new talent here in our operations team. As you know, Bert Brant came in, as head of Operations. We're also bringing in new folks in terms of supply chain operations, and also on our safety side. So, the team is really getting their legs under them and really digging in. It's a very database approach where we look at some of the facts on how we can tackle the problems in a logical order, where we can get some of the biggest benefits, and it's encouraging because it really shows how much opportunity there is in this business and what a tremendous runway of opportunities we have. So it's a fairly new team.

We've done a lot of top grading to the organization, and bringing in folks that really have seen some best-in-class examples out there. I think for a company like Columbus McKinnon who's been on the lean journey, it really ramps up our approach significantly. So, we're very encouraged not only what we're beginning to see we can deliver, but what more we can deliver.

Joe Mondillo: Okay. And then just looking at the core business taking out the restructuring benefits and everything that you're getting from that, in terms of your incremental margins, could you update us on how you think about just normalized core incremental margins?

Greg Rustowicz: I think you're referring to the operating leverage, Joe.

Joe Mondillo: Yes. That's correct.

Greg Rustowicz: So, historically, the company has always had really strong operating leverage, and historically we would have said it's somewhere between 30% and 40%. I would say that we are expecting that to actually go higher because of our strategy, as you know – it is a self-help strategy where we're driving our performance, driving cost out of our products. This quarter, for instance, our operating leverage was almost 60%; I think last quarter it was over 100%. So, as we're able to move our initiatives forward with the strategy, we should continue to see very strong operating leverage. So, our strategy isn't dependent on high revenue growth; it's a low revenue growth assumption but, we still think we can drive roughly 400 basis points of EBITDA margin improvement.

Joe Mondillo: Okay. And just to clarify, when you say should be higher, are you accounting for all the benefits that you're going to see from savings of less personnel here, less inventory in the process over here, it's more efficient so we're seeing savings there? In terms of the incremental savings, I'm trying to take that out and just think about the incremental margins ex-future cost savings relative to restructuring. Is that still the case in terms of your comments relative to higher than the 30% to 40%?

Greg Rustowicz: If I understand your question, I would say that once we've made more progress with our strategy, we would expect to have higher gross margins than the 35% level we have today. So, probably on a normalized basis down the road, it's probably in the 40% to 45% leverage. So, higher than the historical 30% to 40%.

Joe Mondillo: Okay. Perfect. Thanks. And then, I also wanted to ask just in terms of your geographical exposure and what you're seeing. It seems like the common theme around the industrial sector is Asia and China are the worst and it's bled a little bit into Europe, and they're seeing a little bit of softness but not as much as China, and U.S. is holding up seemingly the best. Your non-U.S. sales, if you exclude that rail shipment, it looks like maybe down a little bit low single-digits and it was flattish even including that rail shipment. Could you talk about your non-U.S. exposure, what you're seeing, what you're hearing, and what the trend is going into this quarter and beyond, that you're seeing?

Mark Morelli: So I would concur with some of your statements that China or Asia-Pacific might be a bit slower. It's not a large part of our business. I think net-net we have more opportunity to gain share. In Europe, we are seeing a slower growth environment, but our business continues to be strong. As we said in our remarks and on the other Q&A here that we like a slow growth environment because it works really well for us. So we don't have any concerns there. We do see continued demand going forward. We're very comfortable with where that business sets, but it certainly has slowed a bit compared to last year this time.

In the U.S. things continue to be quite strong. As I gave some color as well, we see some real, strong project demand. Actually that demand is continuing into this year, this calendar year. So, our outlook from our visibility is good. We don't have reason to be really overly concerned. Obviously, you read a lot on the macro trends, but right now, things look pretty good to us.

Joe Mondillo: That's perfect. Thanks for taking my questions.

Operator: Thank you. Our next question comes from the line of Walter Liptak with Seaport Global.

Walt Liptak: Hi. Thanks. Good morning. Thanks for taking my question.

Greg Rustowicz: Hi, Walt.

Mark Morelli: Hi, Walt.

Deb Pawlowski: Hi, Walt.

Walt Liptak: Hey. I want to ask a follow-on to the last one with the revenue growth for next quarter, the 4% to 5%. Are you expecting that across the board? Is the U.S. stronger; some international, weaker? I guess, a little bit of guidance on a regional basis, please.

Mark Morelli: Sure. Well, we continue to see strength in the U.S. markets. I would say the North American markets, because Canada is also strong. Once again, I think Europe is seeing some slow growth. I can give you a little more color on that compared to the Middle East. We did see the Middle East fall off a little bit, but we believe that's due to project timing issues. We have a lot of oil and gas projects into the Middle East, and there's a normal ebb and flow of that based on project timing. So we're not really concerned about the Middle East, but we did see some weakness due to project timing. But Europe continues to grow and I think net-net we have more opportunities to expand in China and Asia just because we have such low share. But we're not exposed there as other companies may be, so we're not really feeling as much impact from that.

Walt Liptak: Okay. Let me ask another one, just on the EU. And you commented that project-based business is where you have the best visibility. Is the EU a heavier project region of the world or is it more distribution book and ship business?

Mark Morelli: It's about equal mix. STAHL has a great historical project business there, but we also have an Industrial Products space that's more historical at Columbus McKinnon. So, we see both sides of that.

Walt Liptak: Okay. And if I could ask a pricing one. Do you guys do an annual price increase? And if you did, I wonder about when it was implemented and how much can we expect at the top line over the next 12 months from that?

Greg Rustowicz: Walt, it's Greg. We typically raise prices annually, and the timing is different depending on the region of the world. So, in the U.S., that is underway right now and that has been announced to our customers, with an early March effective date. In our Industrial Products business in Europe, that has already been enacted, effective January 1st. In Asia-Pacific and Latin America, that is an April 1st timing. STAHL, as well, would also be an April 1st timing.

So, in terms of where we're going to end up, it's probably too early to tell. We'll have, I think, a better sense a little bit further down the road. It is a competitive environment, but once again, the company has always proved its ability to get price; and we've always have had price exceed raw material inflation at least over the last seven, eight years.

Walt Liptak: Okay.

Mark Morelli: I'll add some color on that, too, because the 80/20 process, which is different for Columbus McKinnon, is a lot more insightful on where you actually raise price. So, I think instead of just going out to the markets and raising, generally speaking, which I think we've demonstrated good traction, we're a lot more insightful at actually where we should be raising price more. So, we're also seeing the benefits of that. I don't think there's any reason for us to be less pessimistic about price; I think we're more optimistic about price.

Walt Liptak: Okay. That sounds great. And I'd like to ask one more question about some of the profit growth and gross margin. I guess, first, just to comment that, congratulations on the profit growth, 29% year-over-year, and some of the other metrics that you called out. But I wanted to ask one about gross margin, on page 6 and some of those buckets. I wondered if you were surprised by anything during the quarter that was different versus your expectations to get that little bit of a lower gross margin?

Mark Morelli: I'm going to have Greg answer that too but I want to jump in. Thank you for asking that question, Walt. We were not surprised at all. This is a seasonally down quarter for us. Every Q3, we have less working days, it's typically a lower margin period for us. So, we saw exactly what we would have expected and we also saw the year-over-year growth that we would've expected. Greg, do you want to give us more color on that?

Greg Rustowicz: Yes. On a reported basis, the gross margin year-over-year expanded 90 basis points. We're beginning to see some of the costs roll in from the Ohio plant closure. If you took that out, we had 100-basis-point improvement versus a year ago. I think when you look at it sequentially, to Mark's point, the third quarter is typically our seasonally slowest quarter; we have three less working days, we're absorbing less of our fixed costs in our manufacturing facilities.

Then, the only other factor this year which impacted us was the rail projects; we had record rail sales this quarter, and those tend to carry a lower gross margin than our typical business. Although the operating margins are quite strong, it's a business that just doesn't have a lot of SG&A associated with it. So, not surprised at all. From our perspective, it's our seventh quarter in a row of year-over-year gross margin improvement, and expectations would be that we'll continue to drive margin improvement going forward with the operational excellence initiatives, as well as 80/20.

Walt Liptak: Okay. All right. That sounds great. And if I can ask about – I can see the seasonal change third quarter to fourth quarter, so are we expecting in the fourth quarter a similar improvement in gross margin as you had last year? I guess, what kind of range should we think about for gross margin?

Greg Rustowicz: Well, we don't really give guidance on gross margins, Walt. I think if you look at the track record you can see how it typically rolls out. It would not be a stretch to say that Q4 gross margin is going to be better than Q3, for sure, just because there's more shipping days, it's typically our strongest quarter of the year from a revenue perspective. So, it's hard for us to pinpoint exactly where we think it's going to end up. There's a lot of moving pieces to it.

The one thing I would say is, there is a lot of upside, but there are some headwinds that were offsetting, like tariffs. Raw material inflation has been a bit of a headwind this year, although that appears to be moderating somewhat.

Walt Liptak: Okay. All right. Great. Well, thank you very much, guys.

Mark Morelli: Thanks, Walt.

Greg Rustowicz: Thanks.

Operator: Thank you. [Operator Instructions] Our next question comes from the line of Jon Tanwanteng with CJS Securities.

Jon Tanwanteng: Good morning, gentlemen. Thanks for taking my question and nice job in the quarter.

Mark Morelli: Thanks, Jon.

Greg Rustowicz: Thanks, Jon.

Jon Tanwanteng: Yeah. Greg, can you talk about the profitability of the tire shredder and crane businesses, so we can better model the earnings impact as they are divested?

Greg Rustowicz: So, we wanted to make it a little easier for the folks who are modeling this, so we've included a slide – I'm not sure if you've seen it – slide 17, in our deck, in the appendix section, which basically provides the sales and the operating income for the three businesses together so far this year. Year-to-date, we've had about $30 million of revenue, $29 million and change, and about $3.1 million of income from operations. You can see on that page that the income from operations is around $700,000 in the first quarter and it's grown to about a $1.5 million in Q2 and then about $1 million in Q3.

One thing I would point out is beginning in Q2, there was about $600,000 of depreciation which was no longer being taken, which is a result of the held for sale accounting requirements. The reality of it is the Q2 and Q3 earnings numbers are really more an EBITDA number. EBITDA is exactly the same as operating income in those two quarters. So, that's part of the change there.

Jon Tanwanteng: Got it. That's very helpful. Thanks. And then, Mark, just going back on a previous question that you talked about share gain. It's great that you're seeing that now, but what are your competitors doing? Are they noticing at all, are they standing still, and how much runway for share gain is there really?

Mark Morelli: So, it's hard for us to really comment on what actions the competition is taking. Historically, we've been in a competitive market. I'd like to be in competitive markets, it keeps you on your toes. But the key is that we are gaining share and I think we have a lot of headroom in that area. If you look at some of our share over long periods of time, I think Columbus McKinnon had taken their eye off the ball and I think we've lost some share. I think with this real focus and sense of purpose around what really is going to drive value for our customers and a solid deployment around that, I think we have some very concrete ways to be able to do that.

I think one other area that has not really come in to the fold yet is in the area of new product development. This is the third part of our strategy that we're working on that is part of Phase II; how do we ramp our growth engine. We're just getting started on that. You see some of our variable speed offerings coming out, and we have a lot of great ideas that the folks have been working on. We think there's a lot related to the automation space, where we see very solid growth and demand at higher margins and that are growing higher than the market rates.

So, we should think of this strategy, it's very much about simplification, rationalization, as being in the early innings, but as we get into later innings, it's much more about growth; and I think there's tremendous headroom here.

Jon Tanwanteng: Got it. That's helpful. And then, finally, it's a long way to 2022 where you have your targets out there. If there is a downturn in that timeframe, where can we reasonably expect margins to trough? Sales are down 10% or 20%, and also given all the things that you're still trying to do to improve the margins operations 'til then?

Mark Morelli: I'll answer generally, and I'll see if Greg can answer a little with more color. Look, I think the business is not recession proof. If there is a recession, obviously, the business will go down. However, I think what we fully expect in a low growth environment that we're going to make excellent progress and we're going to make a lot more progress on the bottom line due to our initiatives here. When you model it, I think the business is going to perform a lot better than it did in the last downturns of equal magnitudes. Greg, do you want to comment?

Greg Rustowicz: Yes. So, Jon, I think if I understand your question, if sales were to drop, say, 10%, that's roughly a $90 million dollar drop, everything else being equal, we'd expect to lose 35% to 40% of that. So, it'd be about $36 million. Then, from there there'd be a lot of tactical items we would do to reduce that gap, which would partially offset this reduction. I know in the last recession in 2008, I wasn't here, but there was a substantial reduction in SG&A costs.

Clearly, the company would tighten its belt on expenses, professional services; we'd re-adjust the head count in the factories; and reduce travel expenses. So all of those tactical things would offset some of that margin decline. You can look at our historical performance, in 2008 to see how much progress we made there. But, the key point that I would say is that we're going to be starting from a much higher level. So if there's a recession two years from now and we're at a 16% or 17% EBITDA margin level by then, yes, there will be a reduction, but we're coming from a much higher level. From that perspective, we'd be better than we have been in the past recessions.

Jon Tanwanteng: Great. Thanks a lot, guys.

Operator: Our next questions are from the line of Joe Mondillo, Sidoti & Company.

Joe Mondillo: Hi, guys. Just a quick follow-up question. Just wondering, as we look towards fiscal 2020 and relative to your free cash flow guidance, wondering what your thoughts are on working capital needs, as well as CapEx.

Greg Rustowicz: So we haven't actually given CapEx guidance yet. We're just in the early innings of our budgeting process. So, let me hold off on answering that one. We do see room on the inventory side, but as we expect sales to increase, there would be more receivables; more payables as well, but certainly more receivables. So, one thing, I guess, you might want to think about – and I'm not sure if you factored it in – is pension contributions of roughly $12 million a year as a use of cash. The other item at least in the short-term is, the company's having a really strong year, and so there will be bonuses paid out to the management team in probably the June timeframe.

Joe Mondillo: Okay. And so, just to follow up on the inventory part of it. I mean, if you're seeing – just hypothetically let's say low single-digits revenue growth, could you keep your inventory flattish, is that the kind of ballpark thinking?

Greg Rustowicz: Without actually running the math, the other way I would look at it is from an inventory turns perspective. We're at 3.8 turns today; we expect to be close to 4 turns by the end of the fiscal year, and we'd like to see some more improvement on that next year.

Joe Mondillo: Okay. Great.

Operator: Okay, thank you. That concludes our question-and-answer session. I'd like to turn the floor back to Mark Morelli for closing comments.

Mark Morelli: Thanks, Brenda. Thanks for your interest in Columbus McKinnon.

Just for your information, we plan on hosting an Investor and Analyst Day on Thursday June 13th in New York. We plan to update you further on our progress, and our plans for our Blueprint for Growth strategy.

Thanks a lot. Have a good day. Bye now.

Operator: Thank you. This concludes today's teleconference. You may disconnect your lines at this time, and thank you for your participation.