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CORPORATE PARTICIPANTS

Gary E. Muenster *ESCO Technologies Inc. - Executive VP, CFO & Director*

Kate Lowrey *ESCO Technologies Inc. - Director of IR*

Victor L. Richey *ESCO Technologies Inc. - Chairman, President & CEO*

CONFERENCE CALL PARTICIPANTS

John Edward Franzreb *Sidoti & Company, LLC - Senior Equity Analyst*

Jonathan E. Tanwanteng *CJS Securities, Inc. - MD*

Robert Paul McCarthy *Stephens Inc., Research Division - MD & Analyst*

PRESENTATION

Operator

Good day and welcome to the Q2 2020 ESCO Technologies Conference Call. Today's call is being recorded.

With us today are Vic Richey, Chairman and CEO; Gary Muenster, Vice President and CFO. And now to present the forward-looking statement, I would like to turn the call over to Kate Lowrey, Director of Investor Relations. Please go ahead.

Kate Lowrey - *ESCO Technologies Inc. - Director of IR*

Thank you. We issued a press release earlier today that will be referenced during the prepared remarks on this call. You can find a copy of our press release and our safe harbor statement regarding forward-looking statements made during this call in the Investors center of ESCO's website at www.escotechnologies.com.

During this call, the company may make forward-looking statements, which are inherently subject to risks and uncertainties, particularly given the unknown impact of the current COVID-19 pandemic and the company's response to these evolving circumstances.

Actual results may differ materially from those projected in the forward-looking statements, and the company does not assume any duty to update forward-looking statements. Please refer to the company's press release for risk factors, which may impact any forward-looking statements and for a reconciliation of any non-GAAP financial measures to their most comparable GAAP measures.

Now I'll turn the call over to Vic.

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Thanks, Kate. Before I hand it over to Gary to discuss the second quarter financials, I'll make a few comments on the current state of the company as well as our outlook for the future in light of the COVID-19 crisis. Given how much the world has changed since our last earnings call 3 months ago, I think it's important to share with you the details of how we're managing the business through this unprecedented time.

As the pandemic spread across the globe during February and March, and its economic impacts started being felt in some of our businesses, we did what we do best. We took decisive action. The actions we've taken have a clear and precise focus, which is to protect our strong financial condition, to secure the financial well-being of the company and to support business continuity. These measures will allow us to weather the storm while continuing to support our long-term strategy for profitable growth.

In the past, we've shown our operational excellence and our ability to effectively manage costs to meet challenging market demands. This challenging time will be no different as we are actively addressing today's business pressures by using all the tools at our disposal. The beauty of these current cost reduction initiatives is they're being done and implemented with minimal cost to achieve, thereby maintaining our flexibility to ramp up quickly should demand increases as customers, communities and countries reopen their economies. Bottom line is we're controlling what is within our control and focusing on the near term, without losing our vision for the future.

I hope our comments today will leave investors with 3 clear messages about ESCO going forward: our diverse portfolio of strong, durable businesses serving a wide range of nondiscretionary end markets provides us with the strength and resilience to continue to support our long-term growth outlook. Number two, our strong balance sheet and significant financial liquidity will allow us to effectively manage through this crisis and maintain the company's financial health and well-being. And finally, our deep and experienced leadership team has managed through and overcome many challenges in our 30-year history, and I'm confident that we will emerge from this extraordinary time as an even stronger company.

Today, we have very clearly defined priorities. First and foremost is the health and safety of our employees and our families, followed by a commitment to meet the needs of our customers and suppliers. Both of these will help support the business today and secure our future during this uncertain time. ESCO will benefit from the fact that we have developed leading positions in various niche markets, with a set of unique and highly technical products and solutions specifically designed to meet our customers' needs, which makes it difficult to be replaced by alternative sources.

Our continued investment in new products across all 3 segments and our staff of highly skilled engineering talent will continue to create new opportunities to provide value to our customers, which will drive our long-term growth. I firmly believe that our future will rise as our customers' communities recover and spending returns to more normal levels.

To close out my comments before I hand it over to Gary, as we face the immediate and ensuing economic fallout of COVID-19, I believe we are well positioned to navigate the short-term challenges in front of us. I'm confident that our fundamental approach to operating our business and our solid liquidity will be the cornerstone of our continued long-term success.

Our employees are our most important asset. And I want to say thank you to our manufacturing employees, leadership teams and staff around the world for their hard work and dedication during this trying time, as you've all demonstrated an extraordinary commitment to the success of ESCO.

Now I'll turn it over to Gary.

Gary E. Muenster - *ESCO Technologies Inc. - Executive VP, CFO & Director*

Thank you, Vic. I'll briefly cover the Q2 and year-to-date operating results, which we've laid out in the press release, then I'll share some comments on the guidance for the balance of the year. And Vic will close out today's call with his current view related to our future and our end markets.

As Vic noted in his comments, our liquidity position is of the utmost importance to us during this challenging time. I'm extremely pleased with where we stand today by having nearly $700 million of dry powder at our disposal between cash on hand and available credit capacity, while carrying a modest leverage ratio of 0.92. I wish I could tell you that we saw this economic crisis coming late in 2019 when we extended our 5-year credit facility out to the year 2024 and we increased our debt capacity by an additional $50 million at lower rates; or when we sold our Technical Packaging business and generated over $190 million of gross proceeds to significantly improve our cash and debt positions. But we didn't see it coming.

We did not anticipate a pandemic as we executed both of these liquidity enhancements as these were part of our normal financial strategy. I'm sure glad we did these things as they have bolstered our current financial position.

I'll touch on a few Q2 highlights from the release. Sales increased 5%, led by our Aerospace & Defense segment growing $16 million or 20% driven by the addition of Globe's submarine businesses, coupled with strong aerospace sales at PTI and Crissair and higher space sales at VACCO. Q2 A&D sales came in approximately $3 million ahead of plan.

Test sales were relatively flat as a result of a 3-week shutdown of our Chinese manufacturing facility in February, coupled with the timing delays as several installation sites where personnel access was restricted due to COVID.

Domestic chamber sales were relatively strong and on plan during the quarter, which nearly offset the installation site issues. USG sales were down due to the timing of various project deliverables as several large utility customers, both domestic and international, realigned their short-term maintenance and spending protocols to focus on uninterrupted power delivery during the global crisis.

Entered orders clearly were a bright spot in both Q2 and year-to-date, where we booked $466 million of new business and ended March with a record backlog of $565 million, which is up 25% from the start of the year. Our DoD business, led by our participation on the Block V contract for additional Virginia Class submarines was the clear winner.

During Q2, we generated $34 million of cash from continuing operations with free cash flow of $23 million, which is 127% free cash flow conversion to net earnings during the quarter. Q2 and year-to-date adjusted EBITDA improved from prior year, with Q2 reflecting a 17.4% margin despite the lower contribution from USG, which is our highest margin segment.

And finally, Q2 adjusted EPS was $0.68 a share, down slightly from the $0.71 a share delivered in Q2 of 2019, which resulted from the noted COVID impact.

To set the table for the balance of 2020, the COVID-19 global pandemic has introduced considerable uncertainty around the extent and duration of today's economic circumstances, which makes it difficult to predict how our future operations will be affected using our normal forecasting methodologies. And as a result of this uncertainty, we're withdrawing our previously issued full year guidance and will not provide guidance for Q3 at this time.

To add some color to Vic's comments on our cost savings actions, we are clearly focused on the right things, and we are pulling on all reasonable cost levers to maintain and optimize our cash flow and liquidity. Our focus is to prudently cut or defer costs in the short term and focus on those costs which do not have a negative outcome, impacting our ability to meet increasing demand or growth in the future.

Now I'll turn it back over to Vic.

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Thanks, Gary. I will offer some qualitative comments about our end markets. But I will emphasize that today's situation is very fluid, and there are many unknowns. So my comments today may change materially in the future.

We recently completed a thorough review of our individual businesses as part of our April planning meetings to better frame our expectations of the impact of COVID-19 across and within our various operating units.

Starting with the Aerospace & Defense segment. We expect to see a slowdown in commercial aerospace deliveries over the balance of the year. And it's too early in the cycle to determine the sales and EBIT impact from the current industry downturn as it relates to future build rates in airline passenger miles. We are working with all of our aerospace customers to get a better picture of their demand requirements over the coming quarters, but the situation continues to evolve daily.

Our defense contract within Aerospace & Defense, both military aerospace and Navy products, is expected to remain strong given its current backlog and the urgency of expected platform deliveries. Our aerospace supply chain partners continue to deliver necessary parts and services to us. And in some cases, where we see some weakness, we are working on bringing some of these products and services back in-house, such as machining and other capabilities we can replicate as a safety net.

We also did see this weakness in the aerospace market as an opportunity for ESCO. So we find suppliers or competitors experiencing financial or operational stress during this crisis. We may be able to provide assistance via partnering or through an acquisition at a reasonable price. Our Test business is expected to remain relatively solid over the balance of the year given the strength of its backlog and the strength of its served markets, including medical shielding and 5G and its related communications technologies.

We expect USG's customer spending softness to continue through the next few months as they come out of their summer testing protocols and return to their more normal buying patterns. Once some of the social distancing guidelines get sorted out and utility service personnel can return to their normal site visit routines, we expect our service business to return to normal as it has been essentially on hold for the past few months.

Utilities have money spend, and I'm certain that spending will return in the near future as maintenance spending cannot be delayed indefinitely without creating significant risk to grid safety, efficiency or regulatory compliance.

The critical need to maintain, repair and improve the utilities' aging infrastructure is not reduced by this pandemic crisis.

On a positive note, I'm really pleased with USG's pipeline of new products and solutions, especially related to cyber security and related asset hardening solutions. We introduced several new solutions at the Doble conference in March, and from customer feedback, both there and after the show, these products are being enthusiastically received.

Moving on to M&A. Prior to COVID, we had a couple of actionable opportunities well down the path to completion, and we'll continue to evaluate several other -- and we're continuing to evaluate several other actionable deals in the pipeline. When the time is right, we will take action on these opportunities to grow our businesses as we have in the past. Our Board is supportive of our M&A strategy and our current balance sheet provides us with plenty of liquidity to allow us to add to our existing portfolio.

In summary, we delivered a strong first half of the year. And for the balance of the year, our plan is to hunker down while dust settles, work hard to control our costs while maintaining our critical workforce, develop contingency plans for multiple scenarios and look for opportunities to leverage our infrastructure. We will survive and prosper.

I'll now be glad to answer any questions you have.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) First question comes from the line of Robert McCarthy with Stephens.

Robert Paul McCarthy - *Stephens Inc., Research Division - MD & Analyst*

So maybe the first thing is to talk about, in the quarter, the strong cash conversion you cited. Could you talk about some of the dynamics of that and how we should be thinking about that going forward?

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Yes. I think, Rob, as we've talked in the past, it's a clear focus of ours to get that percentage up from where it's been historically. So some of the initiatives are taking hold. And it really is kind of across-the-board focus on doing the things that are the easy things to do, which is making sure you're paying your vendors and that sort of thing on the appropriate kind of timescale, and also working on the receivable side and collecting some things. We're also doing some things within inventory, where we're not accepting inventory early and things like that.

So those are the kind of the basic things. But I'd say the other side of it comes from -- on some of the contracting things we're doing across the DoD world. We're -- when we win these contracts, part of our negotiating strategy is ask for larger downpayments upfront to try to keep our investment in those programs to a minimum. And so we're successful with that.

I'm sure you've seen some of the headlines out there where the DoD is increasing their progress payment flexibility in some cases, so we're starting to see some flow in -- coming in from that. And so it's kind of across the board, but we're really pleased with -- I don't think it's -- I don't think it is. I know it's not sustainable at 127%, because on the quarterly volatility, you're going to have swings and roundabouts. But I think you're going to see for the year, depending on how the back half of the year plays out relative to the order book and things like that, you're going to see pretty decent cash conversion in the back half of the year as well, again, not at the 127%.

So what you're starting to see is some traction on the things that we've been working on. As I said, 6 months ago, this is -- we're trying to turn around a battleship here with some of our customers and that sort of thing, and we're seeing some progress. So hopefully, that's helpful.

Robert Paul McCarthy - *Stephens Inc., Research Division - MD & Analyst*

No, it is. And maybe we can talk a little bit about your commercial aerospace exposure as a whole and just amplify your comments around it in terms of sizing the business and the exposure and then just giving us some level of comfort or dynamics. Because, I mean, we can start citing third parties, you get some pretty scary numbers pretty quickly because you're tied, obviously, ultimately to airline travel and movement. So just help us how you're thinking about that, not only in terms of near-term dynamics, but also just how long do you think that -- we could be in this path -- this kind of choppy environment. And what is the implication for you all? Because clearly, you didn't see it in the quarter, which we understand, but it's important.

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Sure. So Rob, overall, it's about 20% of our overall business. So that gives me a lot of comfort in -- that 80% of our business is not associated with that. Commercial aerospace is still going to be a good business longer term. And if you look at what happened after 9/11, you look at what happened after 2008, there certainly was a downturn. But these things don't go to 0. People are still going to fly. People are still going to travel. So these are things -- these businesses are going to be fine over time.

And then if you look at it in pieces, about 18% of our overall businesses is -- 16% to 18% is to OEMs, and then the rest of it is the aftermarket. That's what's really driven by the flight miles. I mean, obviously, the OEMs will be impacted to some level as well. But I don't think it's near-term as dramatically as the aftermarket will.

As far as recovery, I mean, I think we said to kind of look at history and make some assumptions on that. It looks like, and everything I hear, people I talk to, they're thinking it's going to be 3 to maybe 5 years to get back to '19 levels. So this is not something that's going to turn around in the next 18 months. But again, I don't think it's going to go down as far as some people may think. I mean it's not like 95% -- the flight tracks down 95%. We go down 95%. That's just not the way it works.

So what we're doing is looking for opportunities, as I mentioned in my statement, to do some in-sourcing to try to fill some of that void. So it will definitely have an impact in the near term. But I think longer term, those are still good solid businesses.

Robert Paul McCarthy - *Stephens Inc., Research Division - MD & Analyst*

And then finally for me for now, USG. Could you just comment on some of the behavior you talked about with this kind of pushout of some of the deployments in terms of the switching of resources to other to -- on -- for a full power for the utilities? And then I do think there was a comment in the press release about Doble and kind of some of the struggles there, or either in the quarter or expected. Could you just amplify kind of your comments around that?

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Sure. So with utilities, the utility, pretty conservative. And so the most important thing for them to do right now is to keep power flowing, right? And so typically, what we will see in a spring is where you start taking a lot of the substations all flying, they will do the test, they will utilize our equipment, our services that would kind of remind them they need to buy new equipment. And so what they've done is kind of jump past that piece of it and act like it's more a summertime. And so they really have not been taken substations out of service to do some of the work.

Now one thing that happens when they do that, then they take more oil samples. And so our oil labs have been running over time, but not enough to make up the difference in what we were doing from a product and service standpoint.

This is something that's not sustainable. I mean everything we're hearing, and obviously, we're staying very close to the customers. We can't visit them right now, but we're spending a lot of time on the phone with them. And everything they're saying is, hey, this is going to come back. We think we'll start to see some good movement in the fourth quarter and certainly going into next year.

So unlike the airlines, where it's a little more unclear, the utilities are going to have to do this type of maintenance and testing. And so we think it's going to be a much shorter duration dip with the utility business than what we might see in the airline business.

Operator

Next question will be coming from the line of Jon Tanwanteng with CJS Securities.

Jonathan E. Tanwanteng - *CJS Securities, Inc. - MD*

Nice quarter. And also, Gary, to echo your comments, nice job on the sale of packaging, the refi and even the action on the pension that you mentioned in your press release, just all of that very timely stuff ahead of what we're seeing.

My first question, I guess, you mentioned the utilities business servicing not being an option right now. How big was that business on a quarterly run rate? And is that actually going to 0 at this point? Or is there still some minimal level of services going on?

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

With the service business itself, I mean, it's not a huge piece of our business. I don't have the number right in front of me, but it's not going to 0. I mean there's some very critical areas like nuclears that has -- still had to be serviced. But we're talking here, Gary's saying $25 million to $30 million and certainly not going to 0. And as you can see, even with their performance in the last quarter, they were down but not to that kind of level.

So I think people -- you have to be careful when we talk about businesses dipping. I mean they never, I won't say never. They almost never go to 0 unless you're in a retail business or something like that. But with our businesses, they're impacted. And so it's really relative.

So that business, I mean, I would say they're champing at the bit to get people back out to the facilities, but they've been really restrictive about letting people in our property, just like everybody are. I mean we're not letting visitors come into our facilities either. So that service business is certainly taking a dip. It will come back. I think it will be back in the fourth quarter. In fact, we're hearing from some of the testing companies that provide some of the services to the third parties, provides the utilities, that there's a lot of pent-up demand for them as well.

Jonathan E. Tanwanteng - *CJS Securities, Inc. - MD*

Got it. So if you're running at $25 million to $30 million, maybe a year, how much is the run rate in the month of April, for example?

Gary E. Muenster - *ESCO Technologies Inc. - Executive VP, CFO & Director*

Yes. Again, as Vic mentioned, the seasonality of when they're allowing people out, it's not ratable 1/12 across the platform. So it tends to be at this time of the year, if they were in a normal cycle, it'd be a couple -- $4 million -- $3 million to $4 million a month. And then like Vic said, when they go into summer mode, it's a little different profile because that's what we're living in today as they've accelerated that. So if you think of it as kind of in this $2.5 million to $3 million a month right now, that's kind of where we're seeing the softness at that kind of level today.

Jonathan E. Tanwanteng - *CJS Securities, Inc. - MD*

Got it. Okay. That's really helpful. And then maybe just the same question on...

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Jon, mind if I get -- Jon, if I could add one thing, too. I mean we had a call this morning, and one of the things we talked about was kind of the RFP level that we're seeing, and that's really increased over the past 2 weeks. So I think that's indicative of those aren't orders, but those are RFPs, so people know that -- the needs there and they're trying to get us to be ready for a shotgun start, if you will, when things start opening back up.

Jonathan E. Tanwanteng - *CJS Securities, Inc. - MD*

Right, because they can't put off forever. Yes, that makes sense. Okay. And then just a similar question on the aerospace side. What kind of run rates have you been seeing, maybe split between the OEM sales side and the filtration side and through the end of March and into April and maybe the beginning of May? Was there a buffer of inventory at the carriers? Or how should we think of the run rates you're seeing today in those businesses?

Gary E. Muenster - *ESCO Technologies Inc. - Executive VP, CFO & Director*

Yes. One thing we do, Jon, as you know, you've been around us a while, we pay a lot of attention to details as part of our planning process. So one of the things that we keep an eye on is what we call the weekly shipping reports. So when we lay out our plans, there's some obviously volatility, it might ship on a Friday versus the following Monday. But generally, the weekly shipping plans are pretty tight. And so, obviously, we're monitoring that a lot more closely now.

And so what it's looking like on a weekly basis is kind of in the $200,000 to $500,000 shortfall. And again, that's coming off of numbers that are in the multiples of millions. So we had a great first half. We were ahead of plan, as I said, by $2 million or $3 million. And now we're probably behind plan. Sitting here today for 4 weeks in or 5 weeks into Q3, we're about $2.5 million behind where we thought we would be.

So as Vic said, it's not going to go to 0. And the beauty of our stuff is we get orders for finite products. We're not selling widgets and things that they buy off the shelf. And so as of -- we sit here today, the customers are taking the products that they had requested a little bit lighter. There's been some pushouts, but the pushouts are weeks or months, not years.

And so I would say for the first 5 weeks of this period, we're about $2.5 million or so short of what our plan would be. And we're not seeing a dramatic acceleration. So if we look at each of those weeks and we go all the way back to the start of the year, we're not seeing millions and millions of dollars of shortfalls on a weekly basis.

So we're in a beautiful spot because we're 7 months into the year. And so for the next 4 or 5 months, if that trend continues, yes, it's going to be a headwind, but it's not -- as Vic said, it's not going to go to 0 and they're just going to suspend all deliveries. And again, it's validated by the cash flow that we've gotten. So not only are we delivering product, we're getting paid for it. So I think all that kind of helps, if that makes sense to you.

Jonathan E. Tanwanteng - *CJS Securities, Inc. - MD*

Yes, it does. And just to be clear, is that just the aftermarket, or is that the entire aerospace business, say, in terms of us getting the shortfall that's different?

Gary E. Muenster - *ESCO Technologies Inc. - Executive VP, CFO & Director*

On the weekly shipping, the level that I look at is really dollars and customers. We're not -- I'm not getting the split between OEM and aftermarket. But to Vic's comments earlier relative to the relationship, when you look at our contribution of OEM and aftermarket, it's about an 80-20 split, 80 to the OEM side, and so within $1 of sales. And so that helps us because they are still building planes. They're just not going to build as many of them. And so the product and the contracts we have are still being executed at 80% or 90% of the deliverables that were in the plan. That's not going to continue. Obviously, we think build rates are going to slow down. We just don't know to where.

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

And again, I think it's important to remember that the only place we're seeing that type of impact is on the commercial aerospace. And so our defense sales are still strong. Our Navy sales are still strong. And our space is strong. Our space sales have been strong. So it's -- we kind of focused on one area and, obviously, that's where we're going to spend a lot of time to look for ways to bolster that business.

Jonathan E. Tanwanteng - *CJS Securities, Inc. - MD*

Understood. Just one last one, if I may. The Virginia orders you received, the Black V boat, when do those liquidate? What's the schedule and timing for those flowing through to the P&L out of backlog?

Gary E. Muenster - *ESCO Technologies Inc. - Executive VP, CFO & Director*

Yes. I would say the -- it's multiyear. So relative to Block V, there will not be a whole lot of sales this year because, obviously, they're still producing. They're at the front end of Block IV on the calendar build. And so we'll have some long lead material purchases this year, which are part of the contract, so we'll get some revenue. So if you think of it as we booked about $105 million to $110 million of Block V, we'll probably deliver somewhere in the neighborhood of $3 million to $5 million of that over the back half of the year, and the rest of it will carry over.

And so when you look at that backlog number of $565 million and -- 68% to 70% of that backlog will ship over the next 12 months. And so obviously, that equates to about $385 million. So on the Virginia Class, the reason that it's 68%, our historical has been around 80% or 82%, is because the Virginia Class at Globe, in particular, it goes out about 3 years getting back to the whole stability.

When we purchased Globe, as we mentioned back then, one of the most attractive features of being in the Navy business is the long-term visibility and the long-term duration of these contracts, and this is where we're sitting today with it. So it's really a good setup.

Operator

(Operator Instructions) Next question comes from the line of John Franzreb with Sidoti & Company.

John Edward Franzreb - *Sidoti & Company, LLC - Senior Equity Analyst*

I'd like to start with the Test segment. I'm getting different feedback as far as spending in that marketplace, in part because R&D is a discretionary spend. I have some exact...

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

John, we can't hear you. I mean you're really breaking up bad.

John Edward Franzreb - *Sidoti & Company, LLC - Senior Equity Analyst*

Okay. I'll try again. In the Test segment, I'm getting some people that are telling me that it's a discretionary spend and they're not getting great orders. Others that are large jobs actually continuing to go through. You seem to be saying that business is doing well. Can you kind of talk to us why that's the case?

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Okay. I still couldn't quite understand you, but I'm going to -- I think I know what you said. So let me try to ask the question that you asked. Just tell me if I got it right or not. I think what you were saying was some people are telling you that orders are really soft right now in the Test segment. Other people are saying they're pretty strong and kind of what are we seeing. Is that what you said?

John Edward Franzreb - *Sidoti & Company, LLC - Senior Equity Analyst*

That's a good summation, yes.

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Okay, okay. All right. Maybe I can be a translator, but for [starters here, yes.]. So we're really -- our Test business really is pretty solid. And we've seen good orders in our Test business. And it really comes down to -- if you look at our business, there's a lot of different areas. So we have the medical, we've got the components, we've got the absorber, we've got our auditory booths. And so there's a lot of it. It's pretty straightforward and it's very dependable, and it's really not discretionary.

And so then you've got probably 80-plus percent of the business that is pretty rock solid in any given year. So then what you have is another piece that is over and above that. It really depends on if that's discretionary purchase or not. And so many of our customers, these are long-term projects that they have to have done. They've already got the buildings built for. So we just put the test chambers in that. And so we've really not seen that level of variability as of yet.

In fact, as we sit here today, I think we're in really great shape. For this year, we've got a lot of backlog. For next year, we've got good opportunities going into next year. So I think just the diversity of the end markets that we have in our Test business is what has really given us a lot of stability in that area.

Now having said all that, I mean, at the end of the day, some of it is capital equipment, and that is a place where people will look to cut. But -- now if they're not using our equipment, then they're probably going to have to put outside third-party to do this testing, and most of the customers won't have that capability and flexibility to be able to do it themselves.

John Edward Franzreb - *Sidoti & Company, LLC - Senior Equity Analyst*

Okay. Fair enough. And in the commercial aerospace business, how much excess inventory do you think is in the channel for your products?

Gary E. Muenster - *ESCO Technologies Inc. - Executive VP, CFO & Director*

Say that again, John, if you would.

John Edward Franzreb - *Sidoti & Company, LLC - Senior Equity Analyst*

How much excess inventory in commercial aerospace do you have to burn to in the channel?

Gary E. Muenster - *ESCO Technologies Inc. - Executive VP, CFO & Director*

Are you talking on our end or relative to fleets that are parked or things like that

to...

John Edward Franzreb - *Sidoti & Company, LLC - Senior Equity Analyst*

Relative to how much you've delivered that hasn't been built yet.

Gary E. Muenster - *ESCO Technologies Inc. - Executive VP, CFO & Director*

Okay. Yes. Look, our [look] around them is there is such a thing as if we're going to deliver a product, it's usually going to go on an airplane within 90 days. So it's not -- we're not delivering just in time. So it's -- we don't ship things on Monday to Boeing or Airbus and gets put on a plane on Tuesday.

So what we've shipped so far has been utilized. So what we hear from either the distributors that we go through or the direct sales content is that they probably have somewhere between 30 and 45 days of inventory sitting there for planes that haven't been built. And that's where -- like I said earlier, we're starting to see this $2.5 million slowdown here in the last 5 weeks, really is a function of them slowing down their expectations for delivery timing, so until they sort out their build rates. So hopefully, that helps that -- we're not going to see this thing -- and to Vic's earlier point, this isn't going to be a cliff that we drop off of. It's going to be more of a little sliding board kind of thing that goes down over time as opposed to just stop all deliveries for the next 90 days. That's not what we're seeing relative to the backlog we have and expectations. As we said in the prepared remarks, we're talking to our customers every few days, and we're not -- we have not received a formal notice to cease and desist deliveries from anybody.

John Edward Franzreb - *Sidoti & Company, LLC - Senior Equity Analyst*

No. That's perfect, what I was looking for. On the utility service side of the business, is that seasonal spring and fall, kind of like a turnaround season or not?

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Yes. There was a point I was trying to make earlier on, is a lot of times, they will do testing in the spring. But this spring, they're not doing that because they want to keep the power on. So they don't take anything offline. So typically, we would see a little bit more this time of the year. So there certainly is some seasonality to that business. I think that's going to change some this year because they have some delays underway now, which I think they'll try to pick up either in the fourth quarter of this year or the first quarter of next year.

John Edward Franzreb - *Sidoti & Company, LLC - Senior Equity Analyst*

Perfect. And I guess 2 last quick questions, if I may. Is there any change in your capital spending plans for the year based on COVID? And can you just talk a little about the tax rate in the quarter and what we should think about going forward?

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Okay. I'll talk about capital expenditure, and then let Gary talk about the tax rate. Certainly, we are taking a hard look at that. We asked people to go back and rejustify everything. And then we're meeting with each of the CFOs and subsidiary presidents of each of the companies to go through their capital plan. So they're going to have to rejustify that. And they're -- these -- we got a really seasoned management team. So they were already doing that, but we'll be going through the details with them.

But certainly -- I mean, for instance, we were looking to add on to one of our plants starting in the second half of this year, we've put that on hold. There have been some equipments buys that we put on hold. So that is an easy kind of, I won't say painless, but a fairly painless thing that we need to do. And so we're doing everything we can to conserve cash.

Gary E. Muenster - *ESCO Technologies Inc. - Executive VP, CFO & Director*

Yes. And on the tax side, John, what -- if you look at last year, it's kind of the same profile. The second quarter last year had an unusually low rate because of some strategic things that our tax group works on that they basically come to fruition in the second quarter, and we had the same thing this year. So if you look at it on an annual basis, it will be in the kind of 24% range, similar to our expectations were at the start of the year. And again, to get to 24% for the year with this 10% to 12% rate in Q2, again, consistent with last year, we're going to probably have 25% or 26% rates in Q3 or Q4 to get to that blended rate over the average. So the numbers look the same, and it has the same [rate] as last year where [which there] was like benefits of some strategy.

Operator

(Operator Instructions) Next question will be coming from the line of Robert McCarthy with Stephens.

Robert Paul McCarthy - *Stephens Inc., Research Division - MD & Analyst*

Yes. Just a few follow-ups, if I may. I guess, first, I mean, just looking at your overall exposure, and I understand and respect, obviously, given the dynamic situation at COVID, it's very hard to forecast these things. However, we do not have that luxury.

So I guess the first question I would have is, obviously, a lot of your businesses are fairly cyclically resistant, that's been talked kind of ad infinitum, ad nauseam, and you can talk about, obviously, the Navy businesses, space, defense, to a certain extent. And then obviously, aerospace has more of a cyclical patina, and the utilities is fairly defensible. But maybe talk about testing. I mean testing really tied to kind of CapEx among the corporations that are using them. How cyclical could we expect there? Could we see some pretty dramatic cuts there? Just any kind of color that you can provide so we can kind of ring-fence where we would see a little more volatility in kind of the end market in your view.

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Yes, I would say that today, and we spent a lot of time looking at this, and I would say, today, that business is very solid. I really think it gets to the end markets we're serving. And some of the primary end markets there, again, are medical, both on auditory testing and in MRI shielding, industrial shielding. And then you get into the 5G piece of it. So I'd say that those are very dependable. Also, there's -- and I think people lose sight, there's a good bit of, say, recurring kind of business there and that we have all types of instruments that we provide, and those are going to be sold pretty ratable since every approach every year. And so people are buying antennas and they're buying turn tables, they're buying amplifiers, they're buying those types of things.

So really, where I think you would see the volatility would be in large projects. And fortunately, we don't need a lot of large projects today to make the numbers that we have out there for this year and what we're looking for, for next year. I think those provide more protection and upside than anything else. So you're right. It absolutely is capital equipment. But it's a different type. I mean it's not like somebody is buying a machine from us, they're buying a testing chamber. And again, for companies that are required to this type of testing, and again, anything that there's electronic content or electronic products have to do this type of testing, they only have 2 options. One is to do it in-house, the other is to send it outside to a test house. And most people want to have control over that. And so that's the reason we sell a lot of the chambers to the end customers.

And again, if you look at what some of those electronic manufacturers are doing, they're moving forward. I mean they're developing products to sell in the holiday season at the end of the year. And they're certainly moving forward with that, because if they don't do that now, they're not going to be in a position to meet the demand they have later in the year.

Gary E. Muenster - *ESCO Technologies Inc. - Executive VP, CFO & Director*

And Rob, I'll add a number around what Vic's comments is that's going to support kind of how we think about that. One of the other metrics we track is what's called shippable new orders or snow, which says, okay, here's the backlog position you have today at March 31. You know how that backlog runs out. The construction gets done to meet your second half sales commitment, what do you have to book and ship in the same period. And so that's a metric we track that, I would say this year, despite COVID being what it is, we only have to book about $18 million to $19 million and ship it this year relative to the commitments, relative to your model and our model, that sort of thing. And so what that means in English is we basically have 83% of the stuff we need to meet our commitments this year already in our hands. And so to take that to Vic's point of, we sell antennas and things like that, that are the more routine kind of deliveries. When you break that down into, let's call it, $3 million to $3.5 million a month, that's kind of what our normal run rate is for antennas and some of the off-the-shelf products and services and things like that.

And back to the installation delays, again, on these calls that we have every other day with all the group leaders, the customers -- those countries open up. We have a couple of projects in Europe, Italy, in particular, that have been shut down for 2 months. And it's one of those things you can't be on site. Then also when the site opens up, they say, where the hell are you, you guys are late, let's get on it. And so what's great is we're going to see acceleration there. And again, that's already in backlog. So having a book-to-bill ratio that we have today in a shippable new order base of only 17% or something like that, $20 million is really comforting, knowing that, that's what we have to do to meet our Test business commitments.

Robert Paul McCarthy - *Stephens Inc., Research Division - MD & Analyst*

Okay. And then just, I guess, as a follow-up then -- go ahead.

Gary E. Muenster - *ESCO Technologies Inc. - Executive VP, CFO & Director*

No, I was finished.

Robert Paul McCarthy - *Stephens Inc., Research Division - MD & Analyst*

Yes. I guess as a follow-up then, in terms of the M&A opportunity set, I mean, clearly, you have -- with the favorable outcome of the divestiture and the strength of the balance sheet and the cash you received, you're in a very good position for capital deployment. Maybe just level set what your expectations are for kind of a bounded size or outer bound for doing deals? I understand that niche and bolt-ons are kind of the [coinage] of the realm, and you're not going to do a crazy big deal, particularly in this environment, I would think.

But talk a little bit about the bid-ask out there. Obviously, presumably, the consensus would suggest that this is a very difficult time for M&A just given the buyer and seller expectations and an overall inward focus on operations as opposed to deals transacting. But I have heard episodically, like, for instance, coming out of middle market private equity or other places, where folks have assets that they want to deploy and return capital, and they might have other businesses that might be tougher workouts or problem children, that there might be some of these properties unlocking because people know they can get some certain, and then focus on that part of the portfolio that might be more troublesome and then get some capital returned to their limited. So I didn't know if any phenomenon like that was going on that would lead you to believe that perhaps this could be counterintuitively a decent M&A environment.

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

I think you think about it the right way. I mean we think there are going to be really great opportunities coming out of this. I mean I think some people are going to be in a position where they need to sell their business. Some people are going to be in a position where they just wanted -- they don't have the risk of going through this again. So we've told all of our management teams that they need to identify what's -- where they think the best opportunities are. They need to be having those conversations with people now. They need to be close to them, so that when we start coming out of this and people decide they want to do something, maybe they call us first and we have a discussion and we move forward because you got those relationships. That's just a lot easier to do.

I think the multiple that can -- have to come down as a result of this, I'd certainly say that we will -- we've always been very diligent in our due diligence. But I think the toughest thing on the other side of this, and something we will have to spend a lot of time on, is just verifying forecasts because that's what it's really about. Every industry is going to be a little bit different. But I think we are experts in areas where we participate. Some things you can't really understand, I mean, build rates on a commercial aircraft are going to be murky for a while. I think we'll have a lot better sense in 60 days and 90 days and every month after that. But that's the area where we have to make sure that we don't buy into somebody's forecast. It's just based on bad assumptions. So we'll spend a lot of time doing that as a result.

But one comment you made that's absolutely right. We're not going to go make a big acquisition. This is the wrong time to do that. I think we'll be looking for acquisitions of the size that we've done over the past couple of years because we can do that without putting ourselves in a position from a liquidity perspective that we don't want to be in. I mean one reason we're really happy with what we're at is we do have a good strong balance sheet. We want to maintain that. But I think you also can't say on your hands when there are good opportunities out there. So we're just going to have to be very diligent about identifying those, diligent with them hard and then move forward when it makes sense.

Operator

On the line is John Tanwanteng with CJS Securities.

Jonathan E. Tanwanteng - *CJS Securities, Inc. - MD*

Can you hear me now? I'm sorry about that.

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Yes. We can hear you now. Okay.

Gary E. Muenster - *ESCO Technologies Inc. - Executive VP, CFO & Director*

Okay.

Jonathan E. Tanwanteng - *CJS Securities, Inc. - MD*

Sorry. I guess the first one for my follow-up, so I was wondering, can you quantify the kind of cost reductions that you're looking at, maybe in the aerospace business? I don't know if you mentioned the actual amount. And kind of what you're saving year-over-year there?

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

We've not quantified that entirely yet. I mean we're still -- there are some things we just put a stop to, like travel and some compensation things. We have not had to -- have force cut reductions yet. And our hope is that we can find ways to work around that. But obviously, we're in to make decisions we have to make. But I don't think we've got a firm number on what the cost reductions are to date.

Jonathan E. Tanwanteng - *CJS Securities, Inc. - MD*

Okay. Got it. And then second, this may be a little bit out there, but I know you guys are involved in the cabin air filtration space. And I'm wondering if there may be some increased demand for that or new products just as it relates to hygiene and filtering air purifiers as part of that kind of stuff, when these plans go back into business?

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

That's really -- we've been asking the same question internally. And the real issue is I don't think the filtration of the air on the airplanes is really as much of an issue as kind of the seat you sit in and the 4 or 5 people around you. So already, you talk about these COVID -- or the -- what are those masks?

Gary E. Muenster - *ESCO Technologies Inc. - Executive VP, CFO & Director*

N95.

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

N95 masks. So that means they stopped 95% of the particles with a certain size. And already the HEPA filters that are on airplanes are well above 99%. So that's not where the issue is. It's really going to be on proximity of people. I think they're going to -- they may switch them out more frequently. We have developed some things with some anti-bacterial on the material itself. But I don't think that's -- that was one of the first things we asked because we thought, well for -- maybe there's a great opportunity for us here. But the real issue is the person setting on each side of you.

Gary E. Muenster - *ESCO Technologies Inc. - Executive VP, CFO & Director*

Jon, if you'd notice, some of the press communications or even I saw it on the TV commercial last night, that the airlines are touting that. They're saying they're increasing their HEPA filtration elements, and they're doing this in that. And it's really just the marketing there is to give comfort into a travelers' mindset to be able to get them back on the plane. But the airlines are thinking the same way. And if they want to be overly cautious and replace those more than they need to, we're all for it.

Jonathan E. Tanwanteng - *CJS Securities, Inc. - MD*

Got it. Okay. And then just last, I know you're not quite as in a rush to close M&A. But I know before you were going into this with, I think, 2 acquisitions that were within line of sight of closing and maybe 10 more. Can you just update on those specific opportunities and if closing maybe any time in the near future?

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Well, one of those, we decided to put a close down on, stop it because of the market was in and really not being able to get a clear forecast on it. There's another one that we're still working, but we're working at a little slower to make sure we don't miss anything. Because I don't think this is the time to take a big risk. And so we're going to make sure that -- no acquisition is risk-free. But I'd say in this environment, you want to have a lower risk tolerance than you typically might.

Operator

(Operator Instructions) We don't have any further questions. Presenters, please continue.

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Okay. Well, I appreciate everybody's interest today. And hopefully, we'll have a less eventful next 90 days before we talk to you again. So thank you very much.

Gary E. Muenster - *ESCO Technologies Inc. - Executive VP, CFO & Director*

Thanks.

Operator

And this concludes today's conference call. Thank you, everyone, for your participation. You may now disconnect.
