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Q3 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, everyone, and welcome to the STERIS Plc Third Quarter FY 2021 Conference Call. All participants will be in a listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please also note, today's event is being recorded.

And at this time, I'd like to turn the conference call over to Julie Winter, Investor Relations. Ma'am, please go ahead.

Julie Winter
Vice President, Investor Relations & Corporate Communications, STERIS Plc (Ireland)

Thank you, Jamie, and good morning, everyone. As usual on today's call, we have Walt Rosebrough, our President and CEO; Mike Tokich, our Senior Vice President and CFO; and Dan Carestio, our Chief Operating Officer. I do have a few words of caution before we open for comments from management.

This webcast contains time-sensitive information that is accurate only as of today. Any redistribution, retransmission or rebroadcast of this call without the expressed written consent of STERIS is strictly prohibited. Some of the statements made during this review are or may be considered forward-looking statements. Many important factors could cause actual results to differ materially from those in the forward-looking statements including, without limitation, those risk factors described in STERIS's securities filings. The company does not undertake to update or revise any forward-looking statements as a result of new information or future events or developments. STERIS's SEC filings are available through the company and on our website.

In addition, on today's call, non-GAAP financial measures, including adjusted earnings per diluted share, adjusted operating income, constant currency organic revenue growth and free cash flow will be used. Additional information regarding these measures including definition is available on today's release, as well as reconciliations between GAAP and non-GAAP financial measures. Non-GAAP financial measures are presented during this call with the intent of providing greater transparency to supplemental financial information used by management and the board of directors in their financial analysis and operational decision-making.

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

Michael Joseph Tokich

Chief Financial Officer, Senior Vice President & Treasurer, STERIS Plc (Ireland)

Thank you, Julie, and good morning, everyone. It is once again my pleasure to be with you this morning to review the highlights of our third quarter performance. For the quarter, constant currency organic revenue increased 1.4%, driven by 130 basis points of favorable price and 10 basis points of organic volume growth. Gross margin for the quarter was up 110 basis points to 44.2% and benefited from productivity, price and acquisitions. EBIT margin for the quarter was 23.6% of revenue, an increase of 250 basis points from the third quarter last year, due primarily to higher gross margin attainment and lower operating expenses for travel, sales and marketing, and compensation due in part from the business disruption from COVID-19.

Our adjusted effective tax rate in the quarter was 18.4%, somewhat lower than anticipated due to favorable discrete items. Net income in the quarter grew 20% to $149.2 million and earnings increased to $1.73 per diluted share as compared to $1.45 per diluted share in the prior year. Our balance sheet is a continued source of strength for the company. Our leverage ratio at the end of the third quarter is once again below 2 times as we continue to pay down debt post the Key Surgical acquisition. Considering our cash position of $253 million, access to available credit lines and a low leverage ratio, we are well positioned from a liquidity standpoint. During the third quarter, capital expenditures totaled $53.8 million while depreciation and amortization was $56.8 million. Free cash flow for the first nine months was strong at $337.7 million, an increase of almost $100 million over the same period last year, primarily due to improvements in net income and working capital, somewhat offset by higher capital expenditures.

With that, I'll now turn the call over to Walt for his remarks.

Walter M. Rosebrough, Jr.

President, Chief Executive Officer & Director, STERIS Plc (Ireland)

Thanks, Mike, and good morning, everyone. It's a pleasure to be with you to discuss our third quarter results, which once again demonstrate the resilience of our business and the great work of our associates to serve the needs of our customers. Once again, we want to acknowledge the caregivers around the globe who are on the front-lines of this pandemic and doing such a tremendous job.

Looking back at the first three quarters of this fiscal year, the sequential improvement of our business is impressive. While we continue to experience the challenges of a global pandemic, the worst impact on our business appears to be in the rearview mirror. Despite significant numbers of new COVID-19 cases and some hospitals around the globe close to or at capacity, procedures continue to occur.

Our most significant concern, Healthcare capital equipment, achieved a critical milestone, showing three straight quarters of sequential improvement and ending the third quarter with an all-time record order month. This resulted in near record backlog which is greater than that before the pandemic at the end of Q3 last year. Even with pockets of slowdowns in procedures due to COVID-19 uptick, we're quite pleased with our position at this point of our fiscal year. Constant currency organic revenue grew 1% in our third quarter, driven by double-digit growth in AST, which was offset by flat to slightly down revenue in Life Sciences and Healthcare on a constant currency organic basis.

Our strong growth in AST continues to be favorably impacted by demand for COVID-related single-use products such as PPE and COVID testing materials, as well as components used in vaccine manufacturing and packaging. The business has also seen steady demand from its core medical device customers.

Life Sciences revenue was flat in the quarter, with mid-single digit growth in consumables and services, offset by a decline in capital equipment shipments. On the consumable side, we have been anticipating a return to more normalized growth for some time. It appears our customers are destocking the excess inventory that was built up over the last three quarters. With COVID vaccines now in production, we expect to see sustained high demand for our consumables offering, but not at the extraordinary growth rate of recent quarters when our pharma customers built inventory due to [ph] sterility of (00:07:12) supply concern for vaccine production.

And as we have commented frequently over the years, capital equipment shipments in Life Sciences can be lumpy. The decline in Q3 was strictly a matter of timing as capital equipment orders were strong in the quarter, reflected in our Life Sciences record capital equipment order backlog. Healthcare benefited from the addition of Key Surgical during the quarter, which added about $15 million to Healthcare consumable revenue. While it's still early days, we are quite pleased with our integration efforts and what we're seeing so far in that business. We continue to have high expectations for Key Surgical going forward.

As I mentioned earlier, while the shipments for Healthcare capital equipment declined year-over-year for the quarter, we did see sequential improvement from Q2 to Q3 and backlog ended above last year's levels. We are cautiously optimistic about our fourth quarter and start of our new fiscal year regarding Healthcare capital equipment as the risks appear to have declined throughout this fiscal year.

Our profit overall has exceeded our expectations as we continue to see the benefit of continued efficiency gains along with lower operating expenses. The operating expense reduction is largely due to travel disruptions from the pandemic. As we've said all year, we do expect some of those expenses to phase back in as travel resumes, returning our operating expenses to more normal levels. We are committed, however, to evaluating opportunities to permanently reduce expenses as we have learned that some things can be accomplished virtually.

Adjusted earnings for the quarter, as Mike mentioned, were $1.73 per diluted share, or growth of 19%, as we benefited from higher gross margins, reduced operating expenses and a slightly lower than anticipated tax rate. With just two months remaining in our fiscal year, we like where we stand today and the long term positioning of our global portfolio.

Our thoughts on the full fiscal year have not changed materially from what we discussed last quarter. Constant currency organic revenue excluding acquisitions should be about flat for the fiscal year. That's impressive performance in this environment, but it is safe to say that we all look forward to getting back to normal and delivering the revenue growth we know we are capable of in the longer term.

Once again, I would like to thank STERIS people for their commitment to our customers, those healthcare professionals who continue to do a simply miraculous job on the frontlines of this pandemic. We also welcome the people of Key Surgical to our team, and we're working through the process to complete the acquisition of Cantel Medical and look forward to welcoming the Cantel people to the STERIS family as well.

Now, before we open to Q&A, I want to comment on our announcement that I will be stepping down as CEO at the end of July. The board and I have been working on my succession for years. And while we have other capable candidates, Dan Carestio, our current Chief Operating Officer, is our unanimous choice. Dan, the board, and I have been working to prepare him for this transition. And as the announcement said, I will be available through July of 2023 as an advisor to management and the board.

As you all know, I hold a significant amount of STERIS stock and options and continue to be highly vested in our long-term success both personally and financially. When I came to STERIS a little over 13 years ago, the preponderance of investors and analysts advised me to exit the Life Sciences and AST businesses due to their moribund performance. I worked with the executives of those groups to determine whether or not that was the way to go. The answer is now abundantly clear, and we have Dan and his teams to thank for the improvements in those segments.

Dan's early executive leadership role was running sales and marketing for the AST group. He developed and implemented a strategy to improve that business. A few years later, I asked him to take on Life Sciences as general manager while maintaining the sales and marketing leadership for AST. He worked with that team and led the improvement in Life Sciences while continuing the success at AST. He then successfully integrated Synergy Health AST business as general manager of AST and Life Sciences.

Dan took on the leadership of our Healthcare IPT business several years ago, making him responsible then for all sterilization and disinfection products across the STERIS portfolio. And finally, he became responsible for all of our operations as Chief Operating Officer in 2018. STERIS' performance the past 13 years, for which I have happily been able to take credit, are significantly the result of the work done by Dan and his management teams. I am extremely confident that he is the right person to lead STERIS into the future.

To add to that confidence, I could relate a similar story about many additional members of our senior management team, especially including our CFO, our General Counsel and the leaders of the commercial operations and business units of STERIS. Almost all of those leaders have been with us or companies we've acquired for over 15 years and have stepped up and made significant improvements in their operations, while taking on increasing responsibility as we have grown.

They've done great work that has individually and collectively added to the success of our company. The median tenure of our 27 members of our senior management team is over 15 years, longer than I've been with the company. The median age is 53. The most should be here for a good long time. That talented senior management team along with the 13,000 people of STERIS are the bedrock of our past success and why STERIS' future is bright, and Dan and I both know it.

I'm looking forward to having more time to spend with my family beginning this fall. I am blessed with a wife of over 40 years. I meant to say a wonderful wife of over 40 years and have two fantastic adult children and their spouses who have given us nine young grandchildren. But I'm not stepping down until the end of July and will be fully engaged as CEO until that time. After that, I will be available to our management team and the board of directors for an additional two years. We believe STERIS is stronger and better positioned than ever. The STERIS team stands ready to capture additional opportunities and we continue to be confident that the future of STERIS is bright.

With that, I will turn the call over to Julie for Q&A.

Julie Winter
Vice President, Investor Relations & Corporate Communications, STERIS Plc (Ireland)

Thank you, Mike and Walt, for your comments. Jamie, if you would please give the instructions and we can get started on Q&A.

QUESTION AND ANSWER SECTION

Operator: Ladies and gentlemen, at this time, we'll begin the question and answer session. [Operator Instructions] Our first question today comes from Dave Turkaly from JMP Securities. Please go ahead with your question.

David Turkaly
Analyst, JMP Securities LLC

Q

Great. Thanks. So Walt, I just want to get this timeline straight here. So you do a bunch of big strategic and accretive deals, but put a feather in your cap and then you stepped down and leave it to Mike and Dan to make it all work. I understand your explanation, but I'd love to just say [ph] what gives – (00:15:26) how do you do that?

Walter M. Rosebrough, Jr.
President, Chief Executive Officer & Director, STERIS Plc (Ireland)

A

Yeah. A great question. In my experience, there's always something going on and usually something big going on in life with companies, whether it's an opportunity, an acquisition, a problem, a crisis. There's always something going on. So the question really is what's the perfect time for a transition. And the perfect time in my opinion for a transition is just before a successful CEO is ready to go and just after the incumbent CEO is ready to take over. That's the perfect time for a change and that's where we are right now.

David Turkaly
Analyst, JMP Securities LLC

Q

Thank you for that. We're certainly going to – I know [indiscernible] (00:16:15) will certainly miss you being as actively engaged. I guess just as a quick follow-up, you mentioned Key Surgical, I think you said $15 million. I was just curious if you had any color on where that stood maybe versus what you thought if there's any positive or negative surprises so far. Thanks a lot.

Walter M. Rosebrough, Jr.
President, Chief Executive Officer & Director, STERIS Plc (Ireland)

A

Yeah, we're generally on track with what we thought with Key Surgical. The time we did the transaction, we're happy to get it done in November, but that's right before the Thanksgiving holidays and the Christmas holiday. So actually, we – I think we've said to do about $15 million and we beat it by a bit. So we're pretty pleased there.

David Turkaly
Analyst, JMP Securities LLC

Q

Thank you.

Operator: Our next question comes from Larry Keusch from Raymond James. Please go ahead with your question.

Lawrence Keusch
Analyst, Raymond James & Associates, Inc.
Q

Thanks. Good morning, everyone, and Walt, congratulations here on what has obviously been a very successful career in building a lot of shareholder value for investors at STERIS and certainly wish you well, but I know we'll get a chance to speak again here before the time is out. I guess I wanted to just pick up on a couple of points on this succession and then add a couple of quick sort of maintenance questions. But first, Walt, you've sort of talked about what you want to do with your time, but why is now the right time for you to be leaving and in particular because you indicated that you'd be in a sort of consulting role here for – until July of 2023? And then, the second part of that question I'd really love to hear from Dan, because I think one of the big investor questions will be, gee, this is all happening in front of the acquisition of Cantel. And so, I'd really love to hear from Dan sort of just his thoughts around how he sees approaching integration and specific thoughts around Key and Cantel specifically.

Walter M. Rosebrough, Jr.
President, Chief Executive Officer & Director, STERIS Plc (Ireland)
A

Sure, Larry. I think I sort of answered the first part of your question already. I do think again there's always a significant risk opportunities, whatever, in the life of a company. That's the beauty of it, by the way. It's why CEOs work 50-70 hours a week is because there's always something going on. There's too much to do all the time. So there's no perfect time in my view as it relates to that. Having said that, the right time is again while I'm still very active, very engaged, love what I'm doing, but see the end, and when Dan is ready and he's little more than ready, he's probably little anxious to get my ass out of here. But the short answer is that I think is the key is the timing of the person leaving and the successor.

Now, having said that, if anyone who knows me knows it, I'm not going to retire today. I'll be in there 60 hours a week until July 29. And they'll be lucky if they can get me out of here in less than 50 hours a week for the several months after that. I love what I do, love the business. For the last two or three years, for all intents and purposes, I've been giving advice, not driving the business anyway. The people this – senior management team of this business is extraordinary and they don't need a whole lot of help [ph] and truth (00:20:00). And people like Dan and Mike and the people who work with them are more than capable of doing this work.

I mean truth of the matter is I've hardly been involved in Key because Dan has pretty much taken that on. I've been more involved in Cantel for some obvious reasons and I had historic relationships there. But in terms of implementing the work, I haven't been an implementor for quite a while. So these guys are perfectly capable – these guys in the both sexes term. By the way, a third of that senior management team is female. So I'm serious about using it in the sex-neutral term if you will, but these people know what they're doing and they will do a great job with or without me. Dan, I'll turn the second half to you.

Daniel A. Carestio
Chief Operating Officer, STERIS Plc (Ireland)
A

Yeah. Thanks, Walt. What I would say is, Larry, since we started the process with Cantel, Mike Tokich and I have led virtually all the diligence efforts in terms of research and working with the leadership of Cantel to get to the synergies we derived and I know that we're very confident in our leadership team and their involvement in that diligence process as well. And we're ready to execute once we get through the proper regulatory processes on that deal.

In terms of the [ph] timing as it relates to (00:21:22) Key, the opportunity here for STERIS is to look at the broader integration of Key and STERIS and Cantel. There's some real synergies between the three businesses that we believe will play out in the future and we're well down the path already in terms of integration as it relates to Key

Surgical and we're confident with where we are and it performs the business. And our management teams have done roughly 50 deals over the last six, seven, eight years, right? This is a – I don't want to say it's another day in the office. It's the big deal. There's no doubt. But we did a pretty nice job with these exact teams working on Synergy on the integration of that fairly large deal five or six years ago. So we're confident in our senior leadership's ability to execute on this deal and continue to be successful for STERIS.

Lawrence Keusch
Analyst, Raymond James & Associates, Inc.

Q

Okay. Terrific. And then just two quick questions here. Just on the AST margins again obviously very impressive and certainly, as I look back over time, I'm not sure that we've hit this sort of margin level in the past. So two questions there, kind of how much of the performance is being driven by opportunities around COVID and how should we think about the sustainability or durability of that type of margin within the business? In other words, were there any one-timers in the quarter to think about? And then the second question, perhaps for Mike, is the cash flow improvement again is notable. You called out working capital is certainly one of the drivers there. Again, what's the right way to sort of think about room to improve working capital going forward and also how does that sort of think about CapEx in a broad sense? Thank you.

Daniel A. Carestio
Chief Operating Officer, STERIS Plc (Ireland)

A

Hi, this is Dan. I can tackle the AST question first if that's okay. So we are getting some benefit right now in terms [ph] of the COVID-related products (00:23:23) like testing kits and swabs and things of that nature clearly are in high demand. And, frankly, everybody with a 3D printer these days is making swabs for test kits right now and those need to be sterile. In addition, we're seeing an increased demand from vial manufacturers, syringe manufacturers and folks involved in supplying components into the manufacturing process for vaccine, as well as significant growth in what we would categorize as bioprocess sterile disposables. They're used in pharmaceutical manufacturing. Those have been on a strong growth uptick for number of years but has been accelerated by the demand in vaccine production.

Now, having said that, we're still seeing less than normal demand from our core medical device customers, especially those that operate in the realm of more elective type procedures, things like orthopedics and spine and things of that nature. So much of the core business has still been a bit suppressed in terms of normal growth rate or normalcy. And we believe those – a return to normalcy, if you will, that will more than offset the short-term impact of some of the COVID-related benefit. Now, having said that, vaccines aren't going away. I don't anticipate seeing any slowdown in either the bioprocess disposable business or any of the packaging or materials going to vaccines in the future. So we think that will sustain at a pretty high level.

Lawrence Keusch
Analyst, Raymond James & Associates, Inc.

Q

And the margins?

Daniel A. Carestio
Chief Operating Officer, STERIS Plc (Ireland)

A

Well, the margins are a function of really utilization and scale of our global footprint. And as the plants right now are pretty full, we're dropping through it pretty strongly pretty strongly on the revenue that we have. We've got a number of expansions coming in line. But those are metered out over time where I don't foresee that having any significant impact on the overall margin rate of AST.

Michael Joseph Tokich
Chief Financial Officer, Senior Vice President & Treasurer, STERIS Plc (Ireland)

A

And then, Larry, I'll take the free cash flow. So obviously, a very strong free cash flow for the first nine months of the fiscal year and, as I stated earlier, the combination of increases in net income and working capital improvements, specifically when I'm talking working capital improvements, we've seen fantastic efforts across our business in the collections of our outstanding AR, our balances and actually our DSO has once again been down about two days for the third quarter and we've continued to see improvements in those collection efforts throughout the whole year and that's on top of elevated inventory levels which we continue to maintain surety of supply and level load. So if I look longer-term, obviously, I don't know if the levels of AR collections will be this good sitting here next year, but obviously, the opportunity for us is to reduce the inventory. So, hopefully over time, we continue and should continue to improve our free cash flow position.

As far as our capital expenditures, year-to-date we're up $11 million compared to where we were at this point last year. We anticipate to continue to spend at elevated levels, not only for the rest of this year, but also as we look out for the next couple of years, specifically around our continued expansions into our AST segment. we spent roughly $100 million a year over the last couple of years on those expansions, and sitting here today, I would guess that we would continue to spend a couple hundred million dollars at least annually for the next couple of years going forward.

Lawrence Keusch
Analyst, Raymond James & Associates, Inc.

Q

Okay. Very good. Thank you very much. Appreciate it.

Michael Joseph Tokich
Chief Financial Officer, Senior Vice President & Treasurer, STERIS Plc (Ireland)

A

You're welcome.

Operator: Our next question comes from Chris Cooley from Stephens. Please go ahead with your question.

Chris Cooley
Analyst, Stephens, Inc.

Q

Good morning. And Walt, I just want to say congratulations on your upcoming retirement. It's been a true pleasure to work with you this last decade. And I just want to also call out what a gentleman you are. You're acknowledging this morning what's always been extremely strong and hard-working bench, I don't think has been appreciated as much by the Street. But also I want to acknowledge that you've always had a very astute, steady hand at the keel throughout the entire time and you're going to be missed, but look forward to working with Dan.

Maybe just two quick ones for me here this morning. First, when we think about what you're seeing more so on the Healthcare side with capital and the build, just trying to get a better understanding of what types of projects you're seeing there that drove that new record backlog in that segment. And then secondly, I would like to follow on to Larry's comment regarding the cash flow, which was extremely strong in the quarter, especially in light of what's transpiring. Just want to think or maybe this is for Mike or for Dan, if we should start to step up our expectations for free cash flow generation when you look at the yield versus the sales line historically, you're trending up and clearly AST seems to be supporting that with higher margin. So just want to think about how we should think about cash flow on a longer-term basis as well. Thank you so much.

Walter M. Rosebrough, Jr.
President, Chief Executive Officer & Director, STERIS Plc (Ireland)

A

Yeah. Chris, on the Healthcare capital side, we've talked about it a bit, probably less than we could have or should have, is the number of new products we have in the space right now is very, very strong. Virtually everything in our surgical line has been refreshed in the last 12 to 18 months, room, lights, tables, ORI, and we have several new products that are in the infrastructure space. They're all doing nicely. So surgical is clearly the operating room, what we call surgical is. The operating room is very strong right now relative to last year. And IPT continues to be just an extraordinary piece of business on the capital side, so between the two.

And I would say although we had and still have a little trepidation about capital spending, when things – when hospitals tend to pull back a little bit in capital, one of the last places they tend to pull back is with the surgeons who generate the income for the hospitals. So we have traditionally not pulled back as hard as some other areas when things go bad. That means we don't jump up as much when things go a little bit better. But I think it's a combination of – there was a little gap when there wasn't so many orders. I think there – they seemed to be back to "normal" at least in our space, on the surgical and IPT space. So, I would say, at a high level, that's it. [ph] I'm going to let (00:30:23) the other guys talk about the cash flow question you asked.

Michael Joseph Tokich
Chief Financial Officer, Senior Vice President & Treasurer, STERIS Plc (Ireland)

A

Yeah. So Chris, this is Mike. Obviously, we are very proud of what we've accomplished this year from, not only an earnings perspective, but also from a free cash flow standpoint, although, again, as we are not giving guidance the rest of this year, We hope to give guidance I would think in the May timeframe for the new fiscal year. But one of the other things that you've got to be cautious about is as we do adjusted earnings on the P&L standpoint, We do not do adjusted free cash flow. So as we continue with acquisitions, especially the integrations and the cost of those integrations, especially around Cantel, we're going to be spending a significant amount of cash to get those cost synergies. So I'd be just cautious. If you were to back out and start doing an adjusted free cash flow, I would agree with you that it may be time to look at our step, what has changed. But since we do not report that way, I would just be cautious of how you look at it.

Chris Cooley
Analyst, Stephens, Inc.

Q

Thank you.

Operator: And our next question comes from Matthew Mishan from KeyBanc. Please go ahead with your question.

Matthew Mishan
Analyst, KeyBanc Capital Markets Inc.

Q

Hey, good morning, everyone. And Walt, I know you're leaving, but it's been a real pleasure seeing the evolution of STERIS overall over the last 5, 10 years, and congratulations. So in honor of you leaving, I'm going to ask some tough questions for Dan and...

Walter M. Rosebrough, Jr.
President, Chief Executive Officer & Director, STERIS Plc (Ireland)

A

[ph] He's a good man (00:31:57).

Matthew Mishan
Analyst, KeyBanc Capital Markets Inc.
Q

...like an – as an initiation. So Dan, if you average out the last three quarters for Life Sciences consumables, it's about 25% growth off a pretty good base, which is good. But I guess it's just hard to believe that new vaccine demand is only up 25%. Can you give us a sense of like the mix of Life Sciences consumables tied to vaccines? And then also when and where are your Life Sciences consumables typically used in production in comparison to – and I know it's always been a tough comparison to get because it never really works out, but to the BetaBags to clarify for folks trying to make a connection with their 70% order increase.

Daniel A. Carestio
Chief Operating Officer, STERIS Plc (Ireland)
A

Okay. Thanks, Matt, and thanks for the challenge. So, what I would say is I think we've talked about and you stated as well, on a year-to-date basis, our Life Sciences consumable business is up roughly 25% give or take. And what we're seeing now is a little bit of pullback in terms of as our customers burn off some of the inventory they built early on in the early phase of the pandemic when there's a lot of concerns about [ph] sterility of the (00:33:18) supply. And we've made it a point at STERIS to serve our existing customers in pharma and never deviate from that and sell outside of market to make sure those folks knew that we would have those validated chemistries as demand continue to rise as they got into vaccine.

In terms of an actual percentage of how much is going to vaccine, it is impossible for me to say. And the reason why is that many of the vaccine manufacturers are also – have been long-term large customers of STERIS that use our product [Technical Difficulty] (00:33:45) bioprocess cleaning perspective in their normal day-to-day production of pharmaceuticals and biopharma. So it's not as if we're tracking down to the shopfloor level as to every application or products go into. What we know though is that we are getting some uptick from vaccine as our customers sort of refocus in that area, especially around COVID, and we believe that will be a trend that continues.

In terms of the BetaBag product, that's a sterile transfer product that has [ph] been integrated with an isolator (00:34:20). It's not something we do. We are in the space of sterility maintenance and sterility assurance as it relates to bioprocess no doubt with our Barrier Products Solutions Group of products and those have continued to do very well since the beginning of the pandemic. They've done well since the time of acquisition actually, but they've done very well since the pandemic really started and those products [Technical Difficulty] (00:34:47) and has stayed fairly consistent in terms of their growth as opposed to slowing down as we've seen in the chemistries space.

Specifically on the chemistries, we've mainly two offerings there. One is what we call critical environment products, and those are disinfectants and sterilants that are largely used in either aseptic manufacturing process or highly regulated clean rooms for pharma manufacturing. Now, not a lot has changed in terms of their application with COVID. There's just more application as it relates to increase vaccine production. And then the other large portion of our consumable business is what we would call bioprocess cleaners, and those are chemistry used for cleaning out the actual biopharma equipment used in the manufacturing process. So in between production runs, they assure they have the highest level of purity in terms of how they treat their machines [Technical Difficulty] (00:35:49) the process.

Matthew Mishan
Analyst, KeyBanc Capital Markets Inc.
Q

Okay. Excellent. And I appreciate that answer. Well done, Dan, to start. Just going back to capital equipment, what was the impact on the backlog from the accounting change you made earlier in the year. Is it masking a higher year-over-year number? And then to continue with that multiple question, how should we think about orders versus shipments, especially as hospitals transition from the COVID surge to non-COVID surge through the course of the calendar year?

Michael Joseph Tokich
Chief Financial Officer, Senior Vice President & Treasurer, STERIS Plc (Ireland)

A

Matt, I'll take that first question about the impact of – so when we made the adjustment in the first quarter for the ORI deferral, we are starting to recognize that revenue as it is shipped rather than on install, it was about a $15 million uptick in revenue in the first quarter. And throughout this year, we really – we've gotten rid of the backlog if you will. But last year, it is still reflected in the backlog. And if you look year-over-year, there's about $12 million in last year's backlog. So if you need to adjust last year's backlog, if you want a true apples-to-apples comparison, if you do that, obviously, we would be at a all-time record, but that's why we're near our record backlog because of that impact.

Walter M. Rosebrough, Jr.
President, Chief Executive Officer & Director, STERIS Plc (Ireland)

A

Yeah. It would be $12 million to $15 million over the last year and $12 million or $13 million over the best year we ever had, the best spot we ever had. And then, the second question. Sorry.

Matthew Mishan
Analyst, KeyBanc Capital Markets Inc.

Q

Yeah. How should we think about orders versus shipments? I mean obviously, our hospitals are obviously still dealing with the COVID surge. And are they placing longer term orders or are these orders in which they're like let's just build now and replacement?

Walter M. Rosebrough, Jr.
President, Chief Executive Officer & Director, STERIS Plc (Ireland)

A

Yeah. As you know, our typical pattern is kind of 60%-40%. We have been a little stronger, heavier, whatever the right term you want to say in terms of the big projects recently. But in order for us to have record order months and record backlogs, they both have to be chugging along. So, it is running much more like normal than it was for example six months ago.

Matthew Mishan
Analyst, KeyBanc Capital Markets Inc.

Q

Okay. And then, last piece for me would be just how should we think about the operating margin level as compared to where we're at today as sales growth return, your mix begins to normalize and you integrate two large acquisitions?

Walter M. Rosebrough, Jr.
President, Chief Executive Officer & Director, STERIS Plc (Ireland)

A

That's a lot of moving parts. And so that has a lot of moving parts. Obviously, the areas that have been very strong have tended to be toward our higher margin products. So there has been a bit of a mix effect. And as we ship more of the capital and as we do more of that, there will be some I'll call it mix effect. But as you know, we don't plan on keeping our cost the same level ever. And so we are working to reduce costs, some of which we pass on through lack of price increase to our customers, some of which we take to the bottom line. So that's one set of mixes.

And then, as we bring the other businesses onboard, it depends on which parts of those businesses are coming in. There is a natural mix effect, but on the other hand, given the level of synergies that we see, we think we will be offsetting that. So we think that if you were to look at it in a pro forma basis, if you will, how those businesses all look today and add them together, the margins are going to go up because we're going to take more than $100 million out of the businesses that are coming onboard. So we feel very good about that.

And you know from our long association that I only care about growing profit dollars, and as long as we can grow profit dollars double digits, that's what the team's mandate is. And if we happen to – the margin happens to go up 10 basis points or down 10 basis points, [indiscernible] (00:40:18) over it. But in the end, it's pretty hard to grow revenue at high-single digits and margins, and then profits at double digits unless we grow margins and that's our mandate.

Matthew Mishan
Analyst, KeyBanc Capital Markets Inc.

Q

Okay. Excellent. Thank you very much.

Operator: And our next question comes from Mike Matson from Needham & Company. Please go ahead with your question.

Mike Matson
Analyst, Needham & Co. LLC

Q

Yeah, thanks. So just want to go back to the capital orders in the Healthcare business. Do you think any of the strength you're seeing there is because of pent-up demand, sort of things that were deferred in 2020 because of the pandemic? And do you think that if that's the case, I mean, is that something that could be sustainable for some period of time?

Daniel A. Carestio
Chief Operating Officer, STERIS Plc (Ireland)

A

Yeah, Mike, this is Dan. I do think that we are experiencing some of that effect, and specifically I mean we had a really tough time with the sales reps getting access for three to four months give or take. And just that – don't ever underestimate the ability of the sales organizations' ability to sell and being present is very important. So I think there's some catch up in those numbers. But generally speaking, when we talk to customers and hospital systems, there is a concern about the surge after the surge, and that is what's going to happen with all of these backlog surgeries that are elective or semi-elective once we get back to a normal steady state in terms of COVID in operating site. I think that's also helping us in terms of the sustainability of the capital backlog and the orders we're seeing.

Mike Matson
Analyst, Needham & Co. LLC

Q

Okay. Thanks. And then just more of a housekeeping question, I was wondering about the – you're excluding some COVID-19 incremental costs from your adjusted EPS. This isn't the first quarter obviously that you've done that, but I just wanted to ask about if you could clarify what those costs are and kind of how you determine how much falls into that line item. Thanks.

Michael Joseph Tokich
Chief Financial Officer, Senior Vice President & Treasurer, STERIS Plc (Ireland)

A

Yeah, certainly, Mike. And we've been, I'll call it, consistent if you will all year surrounding this. And the makeup of that is as we have put employees on furlough, and when I mean furlough, they're not doing anything for the company, so they're just off completely. So we've taken the opportunity to capture those costs. Also we've been able to get some government reimbursement for those folks at the same time. So we're netting that cost into the adjustments.

In addition to that, we've had to put in some training tools. We've done some enhanced cleanings, some different protocols that we've also done in our facilities across the globe. We've made some modifications to our buildings. Obviously, traffic patterns have changed, signage has changed. So all of those costs surrounding that is what we're capturing and we're identifying separately as the COVID incremental costs as we're adjusting those out. To date, we're about just over $20 million for the first nine months and that has significantly dropped from the first quarter levels and we anticipate it will continue to drop as most if not all of our employees are back to work. And recall, we were also very proud that we did not have to lay off anybody. This was our intention of keeping our folks whole, and when our customers were ready to come back to work, we were there right alongside with them.

Walter M. Rosebrough, Jr.
President, Chief Executive Officer & Director, STERIS Plc (Ireland)

A

Yeah. I think Mike pretty much described it. Just to be clear, those furloughed employees are all paid 100% of their base pay. And so the governments of the world, depending on which part of the world they're in, make up some portion of that, but never all of it. And so that's been the cost and that's really the most significant cost that we've captured. And in most cases, where there is – and certainly when there's a government subsidy, it's absolutely clear that they cannot do anything while we're – while they're on furlough if you will and we have taken that approach on anyone who we have captured in this, is that they are absolutely not working and absolutely being paid 100% of their pay.

Mike Matson
Analyst, Needham & Co. LLC

Q

Okay. Got it. Thank you.

Operator: [Operator Instructions] And our next question comes from Michael Polark from Baird. Please go ahead with your question.

Michael K. Polark
Analyst, Robert W. Baird & Co., Inc.

Q

Hi good morning. A question on the leadership transition, two-parter. Number one, would you expect to backfill for Dan's COO role, elevate somebody else in your organization? That's part one. And then, part two for Dan. Dan, how many direct reports do you have today? And once you get up and running in the new seat, how many direct reports would you expect to have at that point?

Daniel A. Carestio
Chief Operating Officer, STERIS Plc (Ireland)

A

Yeah. Sure, Michael. Thanks. So in terms of backfill, I would say, no, not in the existing role. I would not expect us to operate going forward with a COO. And in terms of my direct reports, currently I have eight or nine give or take right now. And what I would say is it's likely with the acquisitions coming in and some changing roles within the organization that the number of direct reports I have on the commercial side of the business will consolidate to some extent under leadership that we have in place. So I would expect [Technical Difficulty] (00:46:09) direct reports whether that's 8 to 11 or 8 to 12 or something like that. But I think over time, we'll sort of transition to something that looks more like that.

Michael K. Polark
Analyst, Robert W. Baird & Co., Inc.

Q

And then my second – yeah, yeah.

Walter M. Rosebrough, Jr.
President, Chief Executive Officer & Director, STERIS Plc (Ireland)

A

If I comment on that, that 8 to 12 was kind of what we think senior executives should have. And it's a heck of a lot easier to save money if we all have 8 to 12 and we don't have four extra chiefs running around. And so, that's been a hallmark of one of the ways that we operate efficiently is virtually everyone on my staff, virtually all the time, except by the way for me right now. I'm almost on vacation. I think I have briefly left. But everybody else is 8 to 12, and that's just kind of the way we operate.

Michael K. Polark
Analyst, Robert W. Baird & Co., Inc.

Q

I appreciate that color. The second question was on the Cantel transaction. It sounds like there is no news in terms of the timeline. I would just be curious for a brief update there, the discussions with regulators, how are those progressing. And then, has there been a date set yet for the Cantel shareholder vote?

Walter M. Rosebrough, Jr.
President, Chief Executive Officer & Director, STERIS Plc (Ireland)

A

Yeah, it's still too early for any real news there. We're going through the process of determining the various countries we do or don't need to file in and then getting those files in. So it's way too early to comment at this point.

Operator: And ladies and gentlemen, in having no additional questions, I'd like to turn the conference call back over to management for any closing remarks.

Julie Winter
Vice President, Investor Relations & Corporate Communications, STERIS Plc (Ireland)

Thanks everybody for taking the time [Technical Difficulty] (00:48:07-00:48:50).

Operator: And ladies and gentlemen, that will conclude today's conference call. We do you thank you for joining. You may now disconnect your lines.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This communication contains forward-looking statements within the meaning of the federal securities laws about STERIS, Cantel and the proposed transaction. Forward-looking statements speak only as to the date the statement is made and may be identified by the use of forward-looking terms such as “may,” “will,” “expects,” “believes,” “anticipates,” “plans,” “estimates,” “projects,” “targets,” “forecasts,” “outlook,” “impact,” “potential,” “confidence,” “improve,” “optimistic,” “deliver,” “orders,” “backlog,” “comfortable,” “trend”, and “seeks,” or the negative of such terms or other variations on such terms or comparable terminology. These forward-looking statements are based on our respective management’s current expectations, estimates or forecasts about our businesses, the industries in which we operate and current beliefs and assumptions of management and are subject to uncertainty and changes in circumstances. Readers of this communication should understand that these statements are not guarantees of performance or results. Many important factors could affect actual financial results and cause them to vary materially from the expectations contained in the forward-looking statements, including those set forth in this communication. No assurances can be provided as to any result or the timing of any outcome regarding matters described in STERIS’s or Cantel’s securities filings or otherwise with respect to any regulatory action, administrative proceedings, government investigations, litigation, warning letters, cost reductions, business strategies, earnings or revenue trends or future financial results. Unless legally required, STERIS and Cantel do not undertake to update or revise any forward-looking statements even if events make clear that any projected results, express or implied, will not be realized. These risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements include, without limitation:

- the failure to obtain Cantel stockholder approval of the proposed transaction;
- the possibility that the closing conditions to the proposed transaction may not be satisfied or waived, including that a governmental entity may prohibit, delay or refuse to grant a necessary regulatory approval and any conditions imposed on the combined entity in connection with consummation of the proposed transaction;
- delay in closing the proposed transaction or the possibility of non-consummation of the proposed transaction;
- the risk that the cost savings and any other synergies from the proposed transaction may not be fully realized or may take longer to realize than expected, including that the proposed transaction may not be accretive within the expected timeframe or to the extent anticipated;
- the occurrence of any event that could give rise to termination of the merger agreement;
- the risk that shareholder/stockholder litigation in connection with the proposed transaction may affect the timing or occurrence of the proposed transactions or result in significant costs of defense, indemnification and liability;
- risks related to the disruption of the proposed transaction to STERIS, Cantel and our respective managements;
- risks relating to the value of the STERIS shares to be issued in the transaction;
- the effect of announcement of the proposed transaction on our ability to retain and hire key personnel and maintain relationships with customers, suppliers and other third parties;

- the impact of the COVID-19 pandemic on STERIS's or Cantel's operations, performance, results, prospects, or value;
- STERIS's ability to achieve the expected benefits regarding the accounting and tax treatments of the redomiciliation to Ireland ("Redomiciliation");
- operating costs, Customer loss and business disruption (including, without limitation, difficulties in maintaining relationships with employees, Customers, clients or suppliers) being greater than expected following the Redomiciliation;
- STERIS's ability to meet expectations regarding the accounting and tax treatment of the Tax Cuts and Jobs Act ("TCJA") or the possibility that anticipated benefits resulting from the TCJA will be less than estimated;
- changes in tax laws or interpretations that could increase our consolidated tax liabilities, including changes in tax laws that would result in STERIS being treated as a domestic corporation for United States federal tax purposes;
- the potential for increased pressure on pricing or costs that leads to erosion of profit margins;
- the possibility that market demand will not develop for new technologies, products or applications or services, or business initiatives will take longer, cost more or produce lower benefits than anticipated;
- the possibility that application of or compliance with laws, court rulings, certifications, regulations, regulatory actions, including without limitation any of the same relating to FDA, EPA or other regulatory authorities, government investigations, the outcome of any pending or threatened FDA, EPA or other regulatory warning notices, actions, requests, inspections or submissions, or other requirements or standards may delay, limit or prevent new product or service introductions, affect the production, supply and/or marketing of existing products or services or otherwise affect STERIS's or Cantel's performance, results, prospects or value;
- the potential of international unrest, economic downturn or effects of currencies, tax assessments, tariffs and/or other trade barriers, adjustments or anticipated rates, raw material costs or availability, benefit or retirement plan costs, or other regulatory compliance costs;
- the possibility of reduced demand, or reductions in the rate of growth in demand, for STERIS's or Cantel's products and services;
- the possibility of delays in receipt of orders, order cancellations, or delays in the manufacture or shipment of ordered products or in the provision of services;
- the possibility that anticipated growth, cost savings, new product acceptance, performance or approvals, or other results may not be achieved, or that transition, labor, competition, timing, execution, regulatory, governmental, or other issues or risks associated with STERIS's and Cantel's businesses, industry or initiatives including, without limitation, those matters described in STERIS's and Cantel's respective Annual Reports on Form 10-K for the year ended March 31, 2020 and July 31, 2020, respectively, and other securities filings, may adversely impact STERIS's and/or Cantel's performance, results, prospects or value;
- the impact on STERIS and its operations, or tax liabilities, of Brexit or the exit of other member countries from the EU, and STERIS's ability to respond to such impacts;
- the impact on STERIS, Cantel and their respective operations of any legislation, regulations or orders, including but not limited to any new trade or tax legislation, regulations or orders, that may be implemented by the U.S. administration or Congress, or of any responses thereto;

- the possibility that anticipated financial results or benefits of recent acquisitions, including the acquisition of Key Surgical, or of STERIS's restructuring efforts, or of recent divestitures, or of restructuring plans will not be realized or will be other than anticipated;
- the effects of contractions in credit availability, as well as the ability of STERIS's and Cantel's Customers and suppliers to adequately access the credit markets when needed;
- STERIS's ability to complete the acquisition of Cantel, including the fulfillment of closing conditions and obtaining financing, on terms satisfactory to STERIS or at all; and
- other risks described in STERIS's and Cantel's respective most recent Annual Reports on Form 10-K and other reports filed with the Securities and Exchange Commission.

Readers are cautioned not to place undue reliance on any forward-looking statements included in this communication, which speak only as of the date of this communication. We undertake no obligation to update or revise any forward-looking statement, whether as a result of new information, future developments or otherwise, except as required by applicable law. This cautionary statement is applicable to all forward-looking statements contained in this communication.

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This announcement is for informational purposes only and is not an offer to purchase, nor a solicitation of an offer to sell, subscribe for or buy any securities, nor the solicitation of any vote or approval in any jurisdiction pursuant to the proposed transactions or otherwise, nor shall there be any sale, issuance or transfer of securities in any jurisdiction in contravention of applicable law. No offer of securities shall be made except by means of a prospectus meeting the requirements of Section 10 of the Securities Act of 1933, as amended.

Additional Information and Where to Find It

In connection with the proposed transaction, STERIS will file a registration statement on Form S-4 with the Securities and Exchange Commission (the "SEC"). INVESTORS AND SECURITY HOLDERS OF STERIS AND CANTEL ARE ENCOURAGED TO READ THE REGISTRATION STATEMENT AND ANY OTHER RELEVANT DOCUMENTS FILED WITH THE SEC, INCLUDING THE PROXY STATEMENT/PROSPECTUS THAT WILL BE PART OF THE REGISTRATION STATEMENT, WHEN THEY BECOME AVAILABLE, BECAUSE THEY WILL CONTAIN IMPORTANT INFORMATION ABOUT THE PROPOSED TRANSACTION. The final proxy statement/prospectus will be mailed to stockholders of Cantel. Investors and security holders will be able to obtain the documents free of charge at the SEC's website, www.sec.gov, from Cantel at its website, www.Cantelmedical.com, or by contacting Cantel's Investor Relations Department at (973) 890-7220, or from STERIS at its website, www.steris.com, or by contacting STERIS's Investor Relations Department at (440) 392-7245.

Participants in Solicitation

STERIS, Cantel and their respective directors and executive officers may be deemed to be participants in the solicitation of proxies in respect of the proposed transaction. Information concerning STERIS's participants is set forth in the proxy statement, filed June 5, 2020, for STERIS's 2020 annual meeting of shareholders as filed with the SEC on Schedule 14A and on certain of its Current Reports on Form 8-K. Information concerning Cantel's participants is set forth in the proxy statement, filed November 18, 2020, for Cantel's 2020 annual meeting of stockholders as filed with the SEC on Schedule 14A and on certain of its Current Reports on Form 8-K. Additional information regarding the interests of such participants in the solicitation of proxies, including direct and indirect interests, in respect of the proposed transaction will be included in the registration statement and proxy statement/prospectus and other relevant materials to be filed with the SEC when they become available.