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Neenah, Inc. (NP)

Q4 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is, David, and I'll be your conference operator today. At this time, I'd like to welcome everyone to the Neenah Q4 2021 Earnings Conference Call. Today's conference is being recorded. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you. Kyle Anderson, Vice President of Corporate Strategy and Investor Relations, you may begin your conference.

Kyle Anderson

Vice President-Corporate Strategy & Investor Relations, Neenah, Inc.

Good morning, and thank you for joining us on Neenah's Q4 2021 earnings call. With me today are Julie Schertell, Chief Executive Officer; and Paul DeSantis, Chief Financial Officer. Julie and Paul will discuss recent activities and results, as well as share thoughts on our full year highlights and our strategy as we look ahead.

We issued a press release covering financial results yesterday afternoon. And, hopefully, you've had a chance to review that information. Following our prepared remarks, we'll open up the call for questions. As a reminder, our comments include forward-looking statements. Actual results could differ from these statements due to risk outlined both, on our website and in our SEC filings.

As we get started, a few opening highlights. In the fourth quarter, we continued our top line growth momentum and set another quarterly record with net sales up 28% over last year. Adjusted earnings were \$0.45 per share, excluding \$0.86 of unusual costs.

In Q4 2020, adjusted earnings were \$0.87 per share and excluded \$0.28 of unusual costs. Details of these adjusting items, along with a reconciliation to GAAP amounts, can be found in our press release.

With that, I'd like to turn it over to Julie.

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

Thanks, Kyle. And good morning, everyone. I'd like to start with our highest priority, employee safety, a strategy of proactive risk identification continued to show strong progress. Our recordable rate decreased by 30% during 2021, and I'm pleased to say that incidents are at an all-time low. While it's great to see this improvement, there's still work to do to get to zero injuries across all of Neenah.

Fourth quarter results demonstrated continued strong top line growth and margin improvement. Total volume was up 22% with Fine Paper and Packaging, up 16%, and Technical Products up 25%. We delivered sales of almost \$265 million, up 28% from last year. This is our second consecutive quarterly top line record, a clear indication that our growth focus and efforts are being realized.

From a bottom line perspective, as expected, margins improved from Q3 to Q4, but continued to be challenged by number of factors. Input costs continued to increase throughout the quarter and to a greater degree than originally anticipated. Energy costs, particularly in Europe, were volatile and came in higher than expected.

Ongoing supply chain disruptions, primarily shortages of several specialty chemicals combined with labor availability challenges, negatively impacted manufacturing costs. In the fourth quarter, the net impact of selling prices and raw material costs reduced operating margins by over 500 basis points, and EPS by over \$0.50 per share versus the prior year.

We have aggressively taken a number of actions to address these input costs and operational challenges and can clearly see some early improvements in 2022.

Adjusted operating profit margin increased in Q4. Although short of our long-term targets, we saw continued meaningful traction and sequential improvement driven by increased volume and price.

In Fine Paper and Packaging, we were pleased to see adjusted margin improved from 7% to 13%, reflecting the strength of volume growth, strong mix and pricing initiatives. As expected, margins in Technical Products declined due to ongoing escalating input prices, but this will be addressed primarily by our annual filtration pricing adjustments that took effect in January. We have also recently taken additional pricing and surcharge actions in most of our categories to address additional inflationary pressures seen late in the year.

We've made progress addressing the labor shortage by increasing staffing in our facilities to match the level needed to satisfy the opportunities of our robust top line growth while accelerating our automation efforts.

Our R&D and procurement teams have continued to work closely with customers to qualify alternate products to address the impact of raw material availability. As we mentioned last quarter, we have reformulated or identified alternate sources for approximately \$200 million of annual sales. As a result, we can now offer our customers an expanded set of product options.

Sales mix, which had been unfavorable over the prior several quarters, primarily driven by raw material availability, was neutral in the fourth quarter; evidence of the improved raw material availability and substitution improvement.

Finally, we've streamlined our Fine Paper and Packaging portfolio to simplify operations and improve our cost position, including over a 30% reduction of grades and we're seeing early benefits in 2022. So, while it's a

challenging environment, we've been aggressive in our actions and to position the business for further growth and margin improvement this year.

Lastly, in 2021, we saw a meaningful progress in our ESG effort, including continued reduction in energy usage, water consumption and greenhouse gases. We received recognition from leading sustainability rating agencies including the EcoVadis Gold Medal in Spain and Silver Medal in all other locations.

With that, I'll turn it over to Paul to cover financial results. And then, I'll wrap up with some comments on our strategy.

Paul F. DeSantis

Executive Vice President, Chief Financial Officer & Treasurer, Neenah, Inc.

Thanks, Julie. First, let me begin with a quick review of the fourth quarter financial statements. Consolidated sales reached \$264 million, up \$57 million from last year's comparable quarter. Itasa accounted for \$38 million of sales in the quarter.

We saw very strong growth in several areas, including all the Fine Paper and Packaging, industrials and specialty coatings. Volume accounted for growth of 22% overall, with Itasa contributing 18%, while price accounted for another 6%, partially offset by currency of around 2%. Both segments demonstrated continued volume growth.

Adjusted earnings were \$14 million compared to \$21 million in last year's fourth quarter. Favorable pricing of \$13 million was offset by input cost increases of \$25 million netting an unfavorable \$12 million. Transportation and manufacturing costs were also unfavorable. We were able to offset a significant portion of that gap through favorable volumes, including volume and margin from the Itasa acquisition.

Consistent with our discussions over the last few quarters, the input cost and supply chain environments remained volatile. But we expect to see margins improve over time as our pricing actions, strong volume and efficiency initiatives gain momentum.

Technical Products sales were \$167 million, up 27% from 2020 and up 3% excluding Itasa and Appleton. Adjusted earnings were \$6 million, down from a very strong \$18 million last year, reflecting the impact of raw material cost increases along with labor, transportation and chemical availability. Technical Products continues to bear the brunt of the input cost increases and was the most impacted by contractual timing with filtration annual pricing, which took effect January 1.

Fine Paper and Packaging sales were \$98 million, up 29% from last year's level, and adjusted earnings were \$12 million for the quarter, up from last year's \$8 million. We continue to perform above our original expectations of recovery, reflecting the strength of the commercial print, packaging and consumer products businesses.

In both segments, we believe, we're on track to offset the 2021 unrecovered input costs, as well as the expected inflationary pressures during 2022.

To summarize our pricing and cost impacts for the quarter, our pricing actions accelerated and we saw \$13 million of pricing benefit in the fourth quarter, compared to \$8 million in the third quarter. And that increase continues to gain momentum with additional pricing actions in 2022, especially in filtration.

During the fourth quarter, we saw input cost rise even higher than our expectations entering the quarter to about \$25 million over the prior year. For the full year, we experienced almost \$47 million of increased input costs with

pricing of \$19 million overall, \$13 million of which we realized in the fourth quarter as pricing momentum continued to take hold.

Regarding Appleton, the facility was closed at the beginning of the fourth quarter and we expect this action will save us approximately \$7 million to \$8 million, annually.

A few other key items to update. First, in late January, we had a fire above the dryer section of the paper machine in our manufacturing facility in Brownville, New York. Fortunately, and most importantly, there were no injuries. Thanks to the rapid response of our team. With the help of local first responders, the fire was quickly contained. This is one of our smaller facilities, and we're continuing to assess the timing of a restart. We've moved production into other facilities where possible, but we're expecting unfavorable profit impact in the first quarter, primarily in Fine Paper and Packaging. The business is insured and we currently do not expect material losses for Neenah. We will have more details during the first quarter call.

During 2021, we took actions that resulted in more than \$80 million of adjustments to earnings. Those included the facility closure, restructuring our debt, buying Itasa. And, lastly, I want to highlight actions we took to simplify our pension position.

During the quarter, we recorded a non-cash charge of \$70 million related to pension settlement. As a continuation of our strategy to reduce our pension risk and obligations, we purchased an annuity for the retirement benefits of approximately 1,400 retirees. This transaction was funded from Trust assets and did not require any cash outlay from Neenah. We expect to save more than \$7 million over the life of the pension plan through reduced administrative costs, all without impacting our retirees.

Turning to the balance sheet and cash flows. As of year-end, liquidity remained strong. 2021 cash flow from operations of \$53 million was down from \$93 million for 2020. The difference continues to be driven in large part by working capital, reflecting the strong top line along with higher foreign income tax payments.

2021 adjusted EBITDA was \$117 million, compared with the \$101 million in 2020, as we saw the benefits of our continued growth and the impact of the Itasa acquisition offset by higher input costs, not completely recovered by pricing realization. Adjusted net leverage was 3.7 times at year-end, up slightly from Q3, reflecting the impact of the input cost increases on EBITDA.

2021 CapEx was \$28 million versus \$19 million last year as spending returned to more normal levels after a tight 2020. For 2022, we expect to be at 4% to 5% of net sales as we invest for growth. Our annual effective tax rate was a benefit of 16% in 2021 and in 2020. Both periods were impacted by the unusual costs, which resulted in pre-tax losses each year. Absent these unusual items, our tax rate on non-GAAP earnings was 21% in 2021 and 19% in 2020.

This increase was driven primarily by higher non-GAAP earnings in 2021, which slightly diluted the impact of new R&D tax credits.

Looking ahead, 2022 is starting off with continued inflation and volatility in raw materials, energy, labor and other supply chain elements. Fiber prices started to moderate in the fourth quarter. Recently, that moderation has reversed course, and there was now upward momentum, in part due to transportation issues. Once these issues are resolved, we would expect gradual declines.

In terms of specialty chemicals, we're seeing cost declines from the 2021 peak in some base materials used as inputs to many of our chemistries, notably butadiene and propylene. But these costs remain elevated from pre-pandemic levels and many downstream chemicals are still very tight.

Energy cost volatility continues to be challenging, especially in Europe, where aggressive increases were seen in late 2021. We're implementing surcharges to cover the increased costs. From a supply chain availability standpoint, widespread supply shortages are much improved. But a few key materials are still structurally short of our demand. In most of these cases, supply constraints are expected to ease in the coming quarters.

That said, other near-term supply challenges remain plentiful, such as roadblocks at the border and COVID impacts at our suppliers. Our teams remain active and agile to adapt to the changing conditions, but near-term manufacturing efficiencies will continue to be impacted.

With this backdrop, Q1 will be characterized by a strong top line, driven by growth in both segments, including the impact of the January 1 filtration pricing agreements and pricing increases broadly across the rest of the organization, tempered by continued input cost and supply chain issues previously mentioned.

Combined with the loss from the Brownville fire, where we could have up to \$3 million of impact, Q1 performance is likely to be more consistent with Q4 of 2021 and below a comparable Q1 of 2021, where the input costs and supply chain environment were more normalized.

As the pricing momentum continues and supply availability expands, we expect to see margin improvements over the course of 2022, particularly in the back half of the year. That said, no matter the timing, we have strong pricing and other cost containment actions in place. We're seeing positive momentum, have a strong volume demand and top line and are confident that over time we'll achieve our margin objectives.

And on that note, I'll turn it back to Julie.

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

Thanks, Paul. As you can see, we have very focused initiatives to drive performance in our business. Now, I'd like to spend some time talking about how we're activating our strategy for the future.

As we've mentioned on previous calls, we have longer term goals for Neenah, 5% top line growth, 10% bottom line growth and greater than 15% EBITDA margins. We have a clear strategic framework to achieve these goals focused on our four key growth platforms, filtration, specialty coatings, engineered materials and image and packaging. Within this framework, we disproportionately focused our resources and efforts allowing us to lever our technical expertise and customer relationship into logical growing markets in which we have a strong right to win. We activate these growth ambitions through our efforts and innovation, the Neenah Operating System, organic capital investments and M&A.

First, I'd like to highlight a couple of developments regarding our organic investments. I'm pleased to announce a €25 million investment in meltblown capacity in our German filtration facility. As we continue to grow in industrial, air and HVAC filtration markets, our three existing meltblown lines are approaching full capacity utilization. This capacity expansion supports some of our highest margin business and will support our continued strong growth trend in targeted filtration markets. We expect to start up this new asset in early 2024.

This expansion is in addition to the \$13 million investment we previously announced to increase our specialty coating capacity with another state-of-the-art asset in our facility in Mexico. This project is underway, on track and expected to start up mid-year of 2023.

Moving now to innovation, we revamped our innovation process in 2021, aligning our projects with our growth platform and connecting our key efforts with megatrend themes such as sustainability and health and wellness. While early, we are beginning to see increased traction from our efforts. A couple of recent examples. During the quarter, we launched a new specialty coating application used in radiation protection clothing for medical personnel. Also, in the fourth quarter, we joined the Soteria Battery Innovation Consortium, a global organization promoting light, safe and cost effective solutions for lithium ion batteries. Our innovation team will leverage our technologies and material science knowhow for electric vehicles and other battery markets.

M&A also continues to be a priority for our business. We have a very active pipeline and we proactively approach targets that we feel would accelerate our strategy through capability, scale, or greater market access. The Itasa acquisition was a great addition in 2021, and it's performing ahead of plan. We couldn't be happier with the strong talent and the financial results. We look forward to using the Itasa transaction as a foundational acquisition as we grow the specialty coatings platform.

Lastly, we continue to make solid progress on our deployment of the Neenah Operating System. Over the course of 2021, we implemented the approach at some of our largest facilities and we're pacing ahead of target. We've seen this benefit in our safety performance and we've unlocked capacity on some of our key assets supporting our top line growth. As anyone who has launched a lean type of initiative such as the Neenah Operating System, knows it is a journey and I'm encouraged by the early traction.

In summary, 2021 was a foundation building year for Neenah, and we took decisive and significant actions to drive value in 2022 and beyond, including achieving record safety performance, delivering 30% top line and 16% adjusted EBITDA growth with volume growth in both segments, taking aggressive pricing actions to yield an expected net \$25 million of benefit in 2022, acquiring Itasa, a GDP plus growth business with the mid-teen EBITDA margins and strong cash flows, providing a foundation in specialty coatings, revamping our innovation process and demonstrating our ability to quickly pivot by sourcing alternate materials and reformulating about 20% of our entire portfolio.

Closing our Appleton facility, generating an expected \$6 million of incremental savings in 2022. Increasing organic growth capital investments in both, filtration and specialty coatings. Refinancing our debt to give us a more flexible capital structure and lower interest expense. Implementing the Neenah Operating System to drive significant long-term value creation in our manufacturing facilities. Driving improvements on our ESG initiatives and raising our dividend for the 11th consecutive year.

We are expecting to see the benefits of these actions as we move through 2022 and we'll continue to remain agile in our approach to the markets in which we compete.

I'd now like to open the call for questions.

QUESTION AND ANSWER SECTION

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

Hi. This is Julie. If you can hear me, if you have questions.

A

Jon E Tanwanteng

Analyst, CJS Securities, Inc.

Hi. Can I ask a question?

Q

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

Yes. Thank you. I think our operator may have dropped off for a second.

A

Jon E Tanwanteng

Analyst, CJS Securities, Inc.

Hey, Julie. It's Jon Tanwanteng at CJS. How are you?

Q

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

Hi, Jon. Good. How are you?

A

Paul F. DeSantis

Executive Vice President, Chief Financial Officer & Treasurer, Neenah, Inc.

Hey, Jon.

A

Jon E Tanwanteng

Analyst, CJS Securities, Inc.

Doing well. Thanks. Thanks for taking me, and that's where our operator went. That's okay. I was just wondering if you could clarify that Brownville's comment of the \$3 million impact. Is that an EBIT impact or a revenue impact? How should we think about that?

Q

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

It is a bottom line impact and that's our current expectation, Jon. It happened in late January. So, we're still working through testing the equipment for damage and we're transitioning a number of products to other facilities. It is covered by insurance as well. So, that's our current estimate for Q1 bottom line impact.

A

Jon E Tanwanteng

Analyst, CJS Securities, Inc.

Okay. Great. Thank you for that. And then, Julie, you mentioned the \$25 million net pricing benefit. I assume that's just catching up to the \$47 million from last year and the \$13 million you realized in 2021. Should I take that

Q

to assume that ex anything else you will see \$25 million better just from pricing alone this year, or has inflation already gotten away from that in the first two months of the year so far?

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

A

So, what we're seeing right now, Jon, is it is an effort to catch up from 2021, and then run forward and recover in 2022, based on our current view of inflation. I think, all of us are seeing the volatility moving pretty quickly every day and in different areas than we've seen traditionally to a greater degree like energy, particularly in Europe and some of our specialty chemicals. So, we are expecting to recover. We're seeing that recovery really nicely in our Fine Paper and Packaging business. It's been a little bit more lagged in Technical Products, where we have annual agreements.

We also made some changes in our pricing mechanisms this year and how we approach pricing. So, meaning in filtration, where we have annual agreements that go into effect on January 1, we've made those semiannual for the most part this year, which gives us greater flexibility to have another round of the pricing discussions should we need to.

And then in our industrial solutions business, which is heavily driven by pricing modifiers, we've changed those to include other elements such as energy and some of our specialty chemicals and added surcharges, again, giving us greater flexibility as we move through this year to be a little bit more agile in our Technical Products business on pricing. So, even as it unfolds in Q1 and we see additional raw material cost, we're addressing that with additional pricing actions and surcharges.

Jon E Tanwanteng

Analyst, CJS Securities, Inc.

Q

Got it. That's helpful. And it's good to hear that you're able to change the filtration price a little more frequently than yearly now. Okay. Paul, can I get a sense of how much inflation has outpaced the price maybe you set in January 1 at this point already? It's just – I don't know if there's any metric that we can use, to usually get these your inflation recovery costs or you have at least through the last two or three quarters?

Paul F. DeSantis

Executive Vice President, Chief Financial Officer & Treasurer, Neenah, Inc.

A

Yeah. Jon, I have a – so, I mean, I think what we're thinking about for 2022, we said a net \$25 million of favorable benefit in – what we're looking at right now is, pricing of about \$60 million, 6-0-million and costs rolling over, particularly in the first half of the year of \$35 million. So, if you think about how the cost increases unfolded in 2021, they really started in the second half of the year. And so, we've got a rollover of that effect. So, Q1 and Q2 will see the higher cost increase. We've got the momentum on our pricing coming through. And so, net-net, we're expecting a \$25 million benefit as we work our way through the year, but it'll unfold quarter-by-quarter a little bit differently.

Jon E Tanwanteng

Analyst, CJS Securities, Inc.

Q

Okay. That's helpful. Thank you for that. And then, finally, I was wondering if you could talk about just the labor situation. I know you had some short supply in the technical business. I assume that can't be getting better just given the COVID wave earlier this year, labor, wage inflation. Just give me a sense of how you're dealing with that and when that that bottleneck improves for you guys? And then, kind of, what the timing of that is?

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

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Sure. So, when we were addressing labor, I mean, it was a combination of labor availability, raw material availability, inefficiencies that are created in our manufacturing environment by having new operators running very challenging sequences as we're hand to mouth on some chemicals that results in extra waste in training costs, lost efficiencies and overtime.

I would tell you, staffing is stabilizing. And so, we're seeing a moderation in some of those supply chain constraints, both from a labor standpoint and on some of our most key chemicals. We've increased staffing levels in anticipation of higher turnover. We've implemented new training programs and retention programs and we're accelerating our automation efforts to pull in some projects into our capital list to move more quickly towards automation. So, we are seeing some stability more recently.

All-in that impact was about \$8 million in 2021. And, we believe, we'll continue to climb out of that as we move through 2022, it'll get better as the year moves on. We're not actually seeing, you know, facilities going down or losing shifts for the most part, because of COVID, it's more turnover, availability of labor and raw material availability.

Jon E Tanwanteng

Analyst, CJS Securities, Inc.

Q

Okay. Got it. If I could squeeze one more just on that bit. You usually or you have in the past given [ph] above use (00:29:31) for SG&A. How you think about this year with just the inflation in labor cost?

Paul F. DeSantis

Executive Vice President, Chief Financial Officer & Treasurer, Neenah, Inc.

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Yeah. So, right now, our SG&A estimate in total is about \$120 million for 2022. And keep in mind, when Itasa came over, they brought about \$20 million in. So, on a Neenah-equivalent basis, roughly \$100 million going back in time for total SG&A.

Jon E Tanwanteng

Analyst, CJS Securities, Inc.

Q

Okay. Got it. Thank you, guys.

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

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Thanks.

Operator: [Operator Instructions] Okay. Next, we'll go to Chris McGinnis with Sidoti & Company.

Chris P. McGinnis

Analyst, Sidoti & Co. LLC

Q

Thanks.

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

A

Hi, Chris.

Chris P. McGinnis

Analyst, Sidoti & Co. LLC

Good morning. Good morning.

Paul F. DeSantis

Executive Vice President, Chief Financial Officer & Treasurer, Neenah, Inc.

Hey, Chris.

Chris P. McGinnis

Analyst, Sidoti & Co. LLC

Thanks for taking my questions. I appreciate it. I think just to start off around the pricing, can you just talk about how your customers are handling the price increases? And has there been any pushback or how are those being implemented given the timing and just the acceptance?

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

Sure. Yeah. I mean, I would tell you no one loves the magnitude of the increases we're taking and the multiple increases we're taking. I'll also tell you, intellectually, they understand them, because they're being impacted across their business in a similar manner from many suppliers. And, obviously, we're hearing and seeing inflation all around us in the markets in which we compete. Our traditional paper customers can pass through pricing and we have the leading brands in that space, so that business implements and executes and realizes the value very quickly.

The customers that are on modifiers and agreements are more of a negotiated process that we go through. So, it's always tough conversations as you would imagine, but I think the team has taken bold actions and made significant structural changes in our pricing strategies as we head into 2022 that will be responsive to the market and create some agility for us that we need in the dynamic market that we're competing in.

Chris P. McGinnis

Analyst, Sidoti & Co. LLC

And just, one of the answers earlier around, you're changing up the structures of the contracts on pricing. How are they open to that conversation given, I think, historically it's been on an annual for a long time?

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

It's a challenging conversation. And I think right now is the time when customers remember how you treat them. And it's important that we communicate in an open, honest and transparent manner and we work to meet our customer needs. And Neenah does that really well. And we've mentioned a couple of times, the innovation and reformulation we've used to ensure that we keep our customers in stock even when supply has been very challenged.

There's clearly openness and warmth associated with that from a customer relations standpoint. So, it's not easy to do difficult conversations, but it's also the environment we're in. And if nothing else, this environment creates the opportunity to say, we cannot do things the same, we have to do things dramatically different, and we

need to take more bold actions than we have in the past in this area. So, I think, again, intellectually, they get that. And then it's just working through the emotional conversation.

Even though the most emotional conversations and some of our largest customers where we're challenged and taking those actions, they're still working with Neenah very closely and giving us new business. I mean, we've won new business with our largest, most strategic customers and have programs out 10-plus years with some of them for opportunities to grow further.

Chris P. McGinnis

Analyst, Sidoti & Co. LLC

Just around Itasa, I don't know if you can give this. But what was the organic growth that you saw in Q4 with Itasa?

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

Total, total – excluding Itasa, you mean or total growth? Total full-year growth.

Chris P. McGinnis

Analyst, Sidoti & Co. LLC

Sorry. I meant just specifically on Itasa, the growth rate you're seeing there. If you did mention, I apologize.

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

Oh. It's almost in the low-double-digit area. So, they've grown for about 8% over the past 10 years consistently and we expect that 8% to 10% growth rate to continue. And that's part of the rationale for investing in the new coater in Mexico is to continue to unlock the capacity we need.

Chris P. McGinnis

Analyst, Sidoti & Co. LLC

Have they've been hit with any of the supply chain issues or the other inflationary environment that you've talked about?

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

Yes. They have definitely been hit with the supply chain issues from unavailability standpoint with significant COVID surges, and with the energy volatility that we're experiencing primarily in Europe. That is a team that continues to exceed our expectations. So, having record performance, top line and bottom line this year is really spectacular to see and I think that's a great way to further solidify. That's the foundational acquisition that we'll continue to build upon to build out our specialty coatings platform.

Chris P. McGinnis

Analyst, Sidoti & Co. LLC

Great. And then just two or three more quick ones. The investment that you're making in Europe, congrats on getting those facilities up as high as they are in terms of operational. Is that demand that you see coming in that you're working with now? Can you just talk a little bit about the investment itself...

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

Yes.

A

Chris P. McGinnis

Analyst, Sidoti & Co. LLC

...and what you're seeing?

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Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

Sure. It is exactly what you described. So, a couple of things, it's to support our highest growth and most profitable business, our filtration business. It's the fourth sister asset in our German filtration facility. So, it's very similar to the other assets in that facility. It's driven by growth in industrial filtration, air purification, air pollution control, HVAC, and it's growth primarily with existing customers and existing products that has qualified on our existing three meltblown lines. So, we're excited about the investment opportunity. It will start up in mid-2024, and we're looking forward to growing that business more.

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Chris P. McGinnis

Analyst, Sidoti & Co. LLC

Great. And one of the new product offerings you were talking about, you talked about the EV solution. Can you just talk a little bit about what that is? And I know you have a lot of little different things happening with new products, but can you just explain that and the potential there?

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Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

Sure. I mean, as a reminder, EV – less than 2% of Technical Products business sales goes into new cars and about 4% is filtration. So, we're primarily secondary market and heavy duty. But, we want to make sure that we're engine-agnostic and that we continue to move forward with solutions for our customers to meet their needs as they continue to evolve.

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So, the consortium that we've joined and the leadership team that we've joined is a part of that and we work together to develop those unique solutions and with our customers to develop their unique solutions for the EV market.

Chris P. McGinnis

Analyst, Sidoti & Co. LLC

And then, just last question around potential M&A, just the balance sheet is improving. This year should be better. Just your thoughts on the M&A environment that's out there. Thanks.

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Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

[indiscernible] (00:36:58) to be a healthy M&A environment. And I think Neenah has a great list of targets that we continue to review and work on and look at. Given our current leverage, we're at about 3.7 times. We would not be looking to do something as large as like an Itasca that we'll continue to build upon our growth platforms as we continue to bring our leverage down.

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Chris P. McGinnis

Analyst, Sidoti & Co. LLC

Great. Thanks for taking my questions and good luck in Q1.

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Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

Sure. Thank you, Jon.

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Paul F. DeSantis

Executive Vice President, Chief Financial Officer & Treasurer, Neenah, Inc.

Thanks.

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Operator: And next, we'll go to [ph] Gokula Kannan (00:37:32) with Infosys.

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

Good morning.

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Operator: Your line's open. You may be muted.

Daniel Berlin

Analyst, Elmwood Asset Management

Good morning.

Q

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

Good morning.

A

Daniel Berlin

Analyst, Elmwood Asset Management

Hi. This is Dan Berlin from Elmwood. I'm not sure if they took my name or not, but I'm going to ask my questions now while I have the floor. Thank you guys for the call. And I just want to ask a quick question, just conceptually, so there's a lot of moving parts last year. So, Julie, as you pointed out sort of all-in for the year, there was \$117 million of EBITDA. And then, if you included Itasa's contribution for the first quarter, that would have been another \$5 million. And then savings from Appleton would have \$6 million. So you put that all together, you're at like \$128 million or sort of like a pro forma-type EBITDA number.

Q

And then, you noted that \$25 million of pricing actions were input really, I guess, I want to make sure I understood this correctly. There was \$25 million of net pricing actions that will benefit 2022, but how much of those were reflected in 2021 versus how much of those haven't been reflected yet and will only sort of begin flowing through in 2022?

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

A

Sure. I'm hoping I understand your question correctly, but I think what you're asking is, pricing last year versus this year, what the incremental amount of that is.

Daniel Berlin

Analyst, Elmwood Asset Management

Yeah.

Q

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

Last year we ended up taking about \$20 million of pricing. This year, what we have planned and announced and are implementing is, roughly \$60 million of pricing, of additional pricing. So, that net \$25 million is net of our expectation around input cost inflation in an effort to recover the shortfall from 2021 and run ahead of what we're seeing in 2022.

A

Daniel Berlin

Analyst, Elmwood Asset Management

And that reflects the filtration annual price increases?

Q

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

That is correct. Yes.

A

Daniel Berlin

Analyst, Elmwood Asset Management

So that \$117 million LTM plus the \$5 million for Itasa's first quarter contribution plus the \$6 million savings from Appleton is \$128 million plus \$25 million net would be – which is reflects higher costs in the first half of the year, I think, right? So that gets you to \$153 million pro forma adjusted if you think about the price impact – the impact of price increases?

Q

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

Yeah.

A

Daniel Berlin

Analyst, Elmwood Asset Management

I'm not asking for guidance. I just want to make sure [indiscernible] (00:40:04).

Q

Paul F. DeSantis

Executive Vice President, Chief Financial Officer & Treasurer, Neenah, Inc.

Okay. Good. Yeah.

A

[indiscernible] (00:40:05)

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

And I would just remind you I think you're taking all of the positives that...

A

Daniel Berlin

Analyst, Elmwood Asset Management

Well, and that's where I want to get. And then what I want to make sure that I understand all the negatives. So, that's...

Q

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

Yeah. I think...

A

Daniel Berlin

Analyst, Elmwood Asset Management

...\$153 million, but that includes higher cost as well, I would think in the first half. Because like you said, it was \$60 million of pricing, net of \$35 million of higher costs. So, what are some of the other headwind to sort of net against that number, which to think about more like on a normalized basis?

Q

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

Sure. I think it does include the higher input costs. What it doesn't include are things around continuing challenges on labor availability, raw material availability, getting our new operators up to speed, getting our efficiencies back to where they've been, because we have new operators and we're seeing extra waste and training costs and overtime, availability of chemicals so that we can run more efficiently in our facilities. And it doesn't include the fire in Brownville that we mentioned that happened in late January that we're still assessing and testing the equipment for damage.

A

I would say the other thing is, there's a lot of volatility, particularly in energy and particularly in Europe. And so, it's moving pretty, pretty dramatically and can move pretty quickly. We do forward buy a portion of that, but not the majority of it. So, there is some volatility that we'll see from that as well.

Daniel Berlin

Analyst, Elmwood Asset Management

Okay. So, all of those issues, how much of that was reflected in the second half of 2021? So, we'll put the first half away, but when a lot of labor issues did start perking up, and obviously all the inflationary issues. So, we saw a lot of that already begin sort of rear its ugly head in the second half of the year. Is a lot – do you think that it's going to be materially incremental to what we saw in the second half of 2021, or will it just be similar and it just has to flow through for the first half of the year?

Q

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

Yeah, Dan, where we saw it really start to hit was in the fourth quarter. And, we calculated about an \$8 million impact from those different areas I've mentioned. About five, over five of that was in the fourth quarter. And then, we know, no light switch occurred on January 1 that changed everything dramatically. So, we're continuing to see those challenges.

A

Our labor market is starting to stabilize, but it will take us some time to come up to speed with new employees to get chemicals lined out to get some of the raw material availability issues lined out. So, Q4 was where we really felt it. I expect that to continue, particularly in the first half of 2022.

Daniel Berlin

Analyst, Elmwood Asset Management

Q

Got it. So, maybe a better way to think about it, so that it embeds a lot of other issues would be that if you annualize the fourth quarter and provided some benefit for Appleton, and the net pricing benefit. Is that may be a better way to look at it?

Paul F. DeSantis

Executive Vice President, Chief Financial Officer & Treasurer, Neenah, Inc.

A

Dan, I think part of what we're trying to do is, we're trying to say, look, we've done all these foundational things in 2021 to set the business up, including Appleton, like you mentioned, including the Itasa acquisition, including trying to get out ahead of pricing in the back half of the year. I don't think we really want to speculate on what that's going to look like each quarter as we rolled through 2022. Because like Julie said, we've got an expectation for addressing the efficiency issues that we talked about. So, that's underway.

We've got all sorts of pricing actions that we've got going on. But it's an unstable inflationary environment, I think, as you know out there right now. And so, as we're trying to get work our way through the year, we're putting the foundational pieces in place and we're going as aggressive as we can against the pricing for to offset all the raw material cost and impact, but we really don't want to put ourselves in a position of trying to come up with a number that we would then be talking about eternally for where we think 2022 could be given the amount of volatility and uncertainty in there. So, we're telling you each one of the component pieces, but we're not going to tie that together into a number and say, that's our number.

Daniel Berlin

Analyst, Elmwood Asset Management

Q

Got it. I appreciate that. And as a public company, I would never want to back you into that. That's really not – I'm just trying to figure out as a snapshot in time, because pricing actions were severely lagged, because of the annual contracts. And so, 2022 on a net basis should look different. And I agree that there's a lot of other things kind of flowing through. And so, what I'm really just trying to figure out is, from here today, if I was to just look at today, just the net impact of those pricing impacts. And then, I can sort of – we can all sort of think about all the other things, but – and so that's ultimately my objective. Because I don't think that if you look at the fourth quarter that – and it was roughly \$25 million of EBITDA. To me, that's clearly not indicative of what the business looks like, even when you crossed over from 2021 to 2022, because of material changes to your pricing agreements. And...

Paul F. DeSantis

Executive Vice President, Chief Financial Officer & Treasurer, Neenah, Inc.

A

Right. And I think that, I mean, we – I think we made this comment. I know I made it in my prepared remarks. But, if you look at the first quarter of 2021, or you look at the first quarter of 2020, so before COVID hit and before we had all this crazy raw material inflation, we were sitting at mid-teen EBITDA margins in the business, which is our goal we want to get back to.

So, I think the question is – and since that time, we've repositioned the business with the Itasa acquisition, with the closure of the North American facility that I think helped strengthen the foundation of the business. So, the question is, when do we get to that kind of margin again? And that's going to depend a lot on what's happening with that unstable inflationary environment. If it calms down in the back half of the year, then we've got all these pricing initiatives and that will look one way.

If it continues going up all year and we have to continue to chase it, it's going to look like something different. So, the business itself can perform and has performed at those levels. And the question I think from our point of view is, we're doing everything we can to address the issues that we see and get out in front of them and we know what the business can do from a performance perspective.

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

A

Yeah. I agree with Paul. I think what we're trying to message is, we expect progress toward our goal as we work through 2022. Demand is very strong, our assets are running full, we've taken aggressive actions in pricing in 2021, and more aggressive and bold actions in 2022. The issue is, we are not in a stable supply chain or inflationary environment, and that is really the wildcard. And our goal is to take the actions of the things we can control and remain and improve our agility and flexibility in this environment that is more volatile than we've seen in the past. I believe all those things combined means we will continue to make progress towards our goal from a margin standpoint.

Daniel Berlin

Analyst, Elmwood Asset Management

Q

Excellent. I appreciate you guys walking through that with me. Thank you.

Julie A. Schertell

Chief Executive Officer, President & Director, Neenah, Inc.

A

Sure.

Paul F. DeSantis

Executive Vice President, Chief Financial Officer & Treasurer, Neenah, Inc.

A

Thanks.

Operator: There are no further questions. I'll now turn the call back over to Kyle Anderson for any additional or closing remarks.

Kyle Anderson

Vice President-Corporate Strategy & Investor Relations, Neenah, Inc.

Thank you for your time today. To recap, demand for our products is strong. However, the global supply chain and manufacturing environment remains challenging. We've taken a number of actions to address these near-term pressures to support recovery of our margins, and we continue to advance our strategic agenda, making investments to position the company for long range growth and value creation.

We're looking forward to updating you on our continued progress next quarter, and we'll also be attending the upcoming JPMorgan High Yield Conference on March 1. Thanks and have a great day.

Operator: This concludes today's conference call. You may now disconnect.

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