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Earnings Call

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Presentation

Operator

Hello, everyone, and welcome to the Mayville Engineering Fourth Quarter and Full Year 2023 Results Conference Call. My name is Nadia, and I'll be coordinating the call today. [Operator Instructions]

I will now hand over to your host, Stefan Neely at Vallum Advisors to begin. Stefan, please go ahead.

Stefan Neely

Thank you, operator. On behalf of our entire team, I'd like to welcome you to our fourth quarter and full year 2023 results conference call. Leading the call today is MEC's President and CEO, Jag Reddy; and Todd Butz, Chief Financial Officer.

Today's discussion contains forward-looking statements about future business and financial expectations. Actual results may differ significantly from those projected in today's forward-looking statements due to various risks and uncertainties, including the risks described in our periodic reports filed with the Securities and Exchange Commission. Except as required by law, we undertake no obligation to update our forward-looking statements. Further, this call will include the discussion of certain non-GAAP financial measures. Reconciliation of these measures to the closest GAAP financial measure is included in our quarterly earnings press release, which is available at mecinc.com. Following our prepared remarks, we will open the line for questions.

With that, I would like to turn the call over to Jag.

Jagadeesh A. Reddy
President, CEO & Director

Thank you, Stefan, and welcome to those joining us on the call and webcast. 2023 was a year of significant progress for the entire MEC organization, as we continue to advance a multiyear business transformation journey. Our entire team came together under One MEC. One Mission mindset that emphasizes performance excellence and a collaborative customer-first approach. Last year, we sharpened our commercial focus expanding within higher-value market adjacencies while improving our operational discipline, leveraging automation and process efficiencies. We introduced a balanced capital allocation strategy, investing in innovation and robotics, prioritizing high-return, capital-light advancements with payback periods of less than 18 months and inorganic growth while returning capital to shareholders through $2 million worth of opportunistic open market share repurchases.

Our fourth quarter performance was a solid finish to the year. One, highlighted by continued organic revenue growth, substantial year-over-year margin expansion, improved profitability and a second consecutive quarter of record free cash flow generation. During the fourth quarter, demand conditions were generally favorable, primarily driven by new project launches in our power sports, commercial vehicle and other end markets, continued strength in our military end market, coupled with tailwinds from public infrastructure driven demand in our construction and access market.

Importantly, our operational and commercial self-help initiatives are continuing to deliver improved profitability and cash generation through improved cost absorption, value-based pricing and enhanced working capital efficiency. As expected and as previously communicated, our fourth quarter results were impacted by the UAW strikes that were resolved in November together with the ongoing ramp-up of production at our Hazel Park facility. In combination, these factors impacted fourth quarter adjusted EBITDA by $2.9 million.

During the fourth quarter, we generated a second consecutive quarterly record $19.9 million of free cash flow. Consistent with our capital allocation priorities, we reduced our outstanding borrowings by more than $21 million in the fourth quarter, bringing a ratio of net debt to trailing 12 months adjusted EBITDA to 2.1x. As we have stated in the past, our goal is to reduce our leverage to be between 1.5x and 2x by the end of 2024, and we are well on track to do so. In our press release, issued after market close yesterday,

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we introduced 2024 financial guidance, which consists of net sales in the range of $620 million to $640 million, adjusted EBITDA in the range of $72 million to $76 million and free cash flow in the range of $35 million to $45 million. Our financial guidance assumes continued positive momentum in our business even amid some transitional cyclical demand softness in select end markets.

As we move through the year, we expect that new customer project launches and further optimization of our existing plant capacity will position us to deliver on our forecast. While Todd will provide specific assumptions around our '24 guidance shortly, the key takeaway for everyone on the call is that we have a high degree of confidence in this forecast, one that puts us well on pace to deliver on the multiyear targets we introduced at our Investor Day in late 2023.

Recall that by year-end 2026, we expect to deliver between $750 million and $850 million in revenues, expand adjusted EBITDA margins to between 14% and 16% and generate free cash flow between $65 million and $75 million. We believe these targets accurately underscore the significant value creation potential of our business over the coming years, consistent with our unwavering focus on total shareholder returns.

I would emphasize that given discussions with our customers on the trajectory of utilization improvement, we expect to see balanced organic growth and margin improvement throughout 2024. We are expecting demand headwinds in key end markets throughout the year, but will be mitigated by our continued new project launches at Hazel Park and continued market share gains. Furthermore, we continue to expect that our Hazel Park facility will achieve $100 million of annualized sales by the end of 2024, consistent with our prior commentary. Even so, we do believe that the facility will still experience cost under absorption this year, albeit at a lower rate than in 2023.

In the context of the multiyear growth targets we introduced during our Investor Day this past September, we expect the macro demand environment will mask some of the tangible improvements we are making in the business while positioning us for mid-single digit to low-double digit organic growth in 2025 and 2026, as demand recovers, new projects reach full volume ramp and our MSA acquisition begins realizing substantial cross-selling synergies.

Let's now turn to a review of market conditions across our 5 primary end markets. Let's begin with commercial vehicle market, which represents approximately 38% of our trailing 12-month revenues. During the fourth quarter, commercial vehicle revenues decreased by 1% on a year-over-year basis, primarily due to $5 million of estimated net sales impact of the UAW strikes. While normalizing for the impact of the labor union strikes, sales to our commercial vehicle market would have been up 8.4% year-over-year during the quarter. Our performance during the quarter reflects softening overall demand as the industry navigates regulatory changes as well as a general slowing in the economic activity, but was offset by new project launches, which we expect will be a tailwind for MEC throughout 2024.

Currently, ACT Research forecasts the Class 8 vehicle production to decrease 16.2% year-over-year in 2024 to 285,000 units. The current projection indicates that build rates will reach peak levels for the year during the first quarter, stable to the fourth quarter of 2023. ACT expects build rate declines through the second and third quarter of over 20% year-over-year and then recovering modestly during the fourth quarter. For MEC, we expect our new CV project launches to continue ramping in the first and second quarter and completing around midyear, which will help us maintain comparable sales to this end market relative to 2023.

It is also worth highlighting that ACT currently expects Class 8 production to recover in 2025, growing 7.7% compared to 2024 with continued growth of 18.4% from 2025 to 2026, which supports our organic growth expectations over the next 2 years.

Next is the Construction and Access market, which represented approximately 18% of our trailing 12-month revenues. Construction and Access revenues increased 1.7% on a year-over-year basis in the fourth quarter as steady demand in non-residential and public infrastructure markets more than offset softness within residential markets. We expect this trend to continue through 2024, particularly as public infrastructure spending begins to drive incremental demand in this end market, resulting in our expectation of relatively flat growth for the year in this market.

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The powersports market represented approximately 17% of our trailing 12-month revenues and increased by 27.7% on a year-over-year basis in the fourth quarter. We continue to benefit from market share gains, which include new customer programs and were partially offset by a cooling in consumer discretionary spending. Fourth quarter growth in this market was also aided by customer supply chain disruptions that occurred in the fourth quarter of 2022, but have since normalized. Given current market conditions, we anticipate customers' slowing demand and higher interest rates curb discretionary consumer spending, but we expect these dynamics will be more than offset by an ongoing new project launches at MEC, resulting in our expectation of high-single digit growth in 2024.

I would note that our new project launches relate to high-end models where demand has been fairly insulated from the impacts of higher interest rates. Our agricultural market represented approximately 10% of trailing 12-month revenues and increased 15.2% on a year-over-year basis during the fourth quarter. The increase during the quarter was primarily driven by market share gains, which offset continued overall softness in our legacy business. In regards to 2024, we expect our market share gains to offset slowing end user demand in the overall ag industry and excess levels of dealer inventory within large ag, maintaining comparable sales to this end market relative to 2023.

Our military market represented approximately 6% of trailing 12-month revenues and increased 12.9% on a year-over-year basis in the fourth quarter, driven by new program wins and build rate increases. Our customers have solid contractual backlogs with the U.S. government and we continue to see good volumes based on new vehicle introductions and related programs. However, our fourth quarter results do not represent our declining volumes we expect in 2024 due to final fulfillment of expiring projects at the end of 2023. I would also point out that the majority of the revenues from the recently acquired MSA business are represented within our other end market category, which grew by nearly $12 million year-over-year in the fourth quarter. This end market also saw solid organic growth during the quarter as a new project with a battery thermal management customer continued to ramp up.

As I mentioned a moment ago, the MSA integration has gone very smoothly. However, our fourth quarter revenues were modestly impacted by the broader UAW strikes. Nonetheless, we continue to see strong coating activity from existing customers as we make headway on our cross-selling efforts. In 2024, we see MSA generating between $20 million to $30 million of incremental net sales with revenue synergies beginning to ramp up in the second half of the year. Long term, we continue to expect MSA to achieve $100 million of sales by 2026 with at least $25 million coming from revenue synergies with legacy MEC customers. During the fourth quarter, we continued to progress in the implementation of our MBX value creation framework, further positioning us to deliver above market growth through the cycle.

Commercially, we are targeting expansion within higher-value, high-growth adjacent markets, including fleet electrification as well as energy transition while expanding our share of wallet among our current customer base. Demand for lightweight materials fabrication remains a significant market opportunity for MEC entering 2024, while steel fabrication has been our core area of focus for much of our history, recent customer investments in the aforementioned energy transition-related technologies require solutions expertise with comparably lighter-weight materials such as aluminum and composites. Our recent acquisition of MSA puts us in a strong position to capitalize on this market more fully.

We also remain highly focused on deploying value-based pricing models across our customer programs. Year-to-date, the teams have been working tirelessly to implement a programmatic pricing model and we expect these initiatives to drive meaningful financial results in 2024. We had some strong new wins in the fourth quarter, including the following.

Starting out, we were able to win significant content with one of our top customers across turf, agriculture and construction markets. Many of these new awards were a result of the capacity we have installed in Hazel Park and we look forward to launching these next-generation products. During the fourth quarter, we continued to expand share supporting the expansion of our customer relationship with supplying battery thermal management products to multiple end customers. This relationship will continue to expand as our customer grows their electric vehicle battery systems, while we are also working on significant outsourcing programs with this customer.

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In the quarter, we expanded share with our access customer as they expand their capacity, utilizing MEC as a supplier of choice to support their growing production. We made progress in filling our new aluminum extrusion capacity with an award from a construction products customer. We expect further wins through synergies with this account and we are very happy to see where our sales pipeline is on extrusions as we continue our cross-selling focus. We have continued to gain additional market share as our commercial vehicle customers plan for their vehicle updates, both our next-generation products and battery electric vehicle platforms. We expect to continue to grow share over the next 2 years with the amount of change that will occur in this industry.

Operationally, we are focused on driving further productivity and utilization enhancements, including the centralization of management functions to optimize our performance across our manufacturing footprint. To that end, we restructured our operations management team during the fourth quarter, which we expect to help further streamline the implementation and oversight of our MBX initiatives. As before, we have continued our rigorous implementation approach centered around our quarterly President's Kaizen implemented by monthly operational and commercial excellence kaizens.

Overall, our team has performed over 125 MBX lean events through the end of 2023 with a focus on implementing lean inventory management processes, improving our inventory turns from approximately 6x to approximately 8x and sustainability of cost-saving measures identified. Going into 2024, our financial guidance reflects contribution from our initiatives in the areas of business process efficiency, asset optimization, productivity and operational standardization. In addition, the execution of these initiatives puts us on track to achieve the 100 to 150 basis points of margin improvement we expect by 2026.

In summary, we expect that for the full year 2024, we will deliver $2 million to $4 million from our MBX lean initiatives and another $1 million to $2 million from our commercial pricing initiatives, net of inflationary pressures in adjusted EBITDA. In terms of capital allocation, we remain very focused on aggressively reducing our outstanding borrowings, putting us on pace to achieve a net leverage ratio of between 1.5x to 2x by the end of 2024. Our expected $35 million to $45 million in free cash flow generation this year will be used predominantly for this purpose, along with our opportunistic share repurchases under our existing $25 million authorization.

Opportunistic M&A remains a key part of our multiyear growth and business transformation strategy as we look to expand into high-growth adjacent end markets. To that end, while we are aggressively reducing our leverage, our team is building a backlog of potential acquisition targets that will meet our criteria. As we are able to achieve our targeted net leverage levels, we will be opportunistic in pursuing M&A that continues to build on our market-leading capabilities and position the company to further capitalize on multiyear secular growth trends in energy transition and OEM outsourcing.

In summary, as I have highlighted today, our fourth quarter results capped off a successful year in our multiyear transformation efforts. 2024 will be a year of transition for MEC as our organic growth initiatives take hold and set us up for significant multiyear growth exiting the second half of this year. As a team, we remain highly focused on delivering a high [indiscernible] ratio, one where a continued focus on program execution is at the center of all we do. Collectively, we remain focused on delivering a superior return on invested capital, whether through organic investments, acquisitions or the repurchase of our own common equity. As we look forward to the coming year, we will continue to hone and refine our approach to capital allocation as we seek to maximize value for all our shareholders.

With that, I will now turn the call over to Todd to review our financial results.

Todd Butz

Thank you, Jag. I'll begin my prepared remarks with an overview of our fourth quarter and full year financial performance, followed by an update on our balance sheet and liquidity that will conclude with a review of our 2024 financial guidance.

Total sales for the fourth quarter increased 15.6% on a year-over-year basis to $148.6 million, driven by a combination of the MSA acquisition and improved organic sales volumes, partially offset by the $5 million

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impact from the UAW strikes, which was primarily in our CV market, as well as softening demand in our agricultural end market. When excluding the MSA acquisition, organic net sales growth was 6.1% on a year-over-year basis.

Our manufacturing margin was $18.2 million in the fourth quarter as compared to $13 million in the same prior year period. The increase was primarily driven by increased organic volumes, MBX initiatives and the acquisition of MSA. These tailwinds were partially offset by the impact of unabsorbed fixed costs associated with the new project launches, operational restructuring expense and the impact of the UAW strikes. Our manufacturing margin rate was 12.3% for the fourth quarter of 2023 as compared to 10.1% for the prior year period or an increase of 220 basis points. Profit sharing bonus and deferred compensation expenses decreased by $500,000 to $3.6 million for the fourth quarter of 2023, which is driven by the stock forfeitures related to the restructuring of our operations team.

Other selling, general and administrative expenses were $7.2 million for the fourth quarter of 2023 as compared to $6 million for the same prior year period. The increase was primarily driven by an additional $1.1 million of legal expenses relating to our former fitness customer.

Interest expense was $3.6 million for the fourth quarter of 2023 as compared to $1.2 million in the prior year period due to higher interest rates and higher borrowing under our credit facility. The increase in borrowings is due to the acquisition of MSA, which closed on July 1, 2023. We continue to expect debt reduction during 2024 that may provide for further interest rate step-downs as we achieve our net leverage goal of between 1.5x and 2x by year-end. Additionally, as we go into 2024, we expect that the applicable interest rate will be approximately the same as the fourth quarter, pending any reductions that fed policy rate.

Adjusted EBITDA increased to $17.7 million versus $11.6 million for the same prior year period. Adjusted EBITDA margin percent increased by 290 basis points to 11.9% in the current quarter as compared to 9% for the same prior year period. Increase in our adjusted EBITDA margin was primarily due to the increased organic volumes, the MSA acquisition, MBX initiatives and a $500,000 improvement in our fixed cost absorption at Hazel Park, partially offset by the $1.6 million impact from the UAW strikes. Adjusted EBITDA margin progression is evident and demonstrates early advancement towards our 2026 goal of 14% to 16%.

Now I'd like to provide a brief summary of our full year 2023 results. Net sales for the full year were $588.4 million, an increase of 9.1% as compared to the full year 2022. Our full year 2023 net sales growth includes organic net sales growth of 4.3%. Our full year 2023 manufacturing margin was $69.7 million as compared to $61.1 million in 2022. This reflects a manufacturing margin rate of 11.8% of net sales, which is an increase of 50 basis points as compared to 11.3% in 2022.

Full year 2023 adjusted EBITDA was $66.1 million as compared to $60.8 million in 2022. Our adjusted EBITDA margin percent during 2023 was 11.2%, which was comparable to 2022, but note that our 2023 results includes $6.2 million of losses associated with the ramp-up of production at our Hazel Park facility and the $1.6 million impact from the UAW strikes.

Turning now to our statement of cash flows and balance sheet. Free cash flow during the fourth quarter of 2023 was a positive $19.9 million as compared to a negative $690,000 in the prior year period. As Jag mentioned, this is our second consecutive quarter of record free cash flow generation since the IPO. The improvement in free cash flow year over was primarily due to the $13 million decline in capital expenditures resulted from the completion of the Hazel Park facility and improved inventory terms as we continue to implement lean inventory management processes.

As of the end of the fourth quarter of 2023, our net debt, which includes bank debt, financing agreements, finance lease obligations, and cash and cash equivalents was $149.5 million as compared to $74.9 million at the end of the fourth quarter of 2022 and resulted in a net leverage ratio of 2.1x as of December 31st. As we have stated previously, it is our intention to use free cash flow generation to reduce our net leverage ratio to between 1.5x to 2x by the end of 2024. During the fourth quarter alone, we repaid $21.8 million in borrowings using available free cash flow.

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Turning now to a discussion of our 2024 financial guidance. For the full year 2024, we expect the following: net sales of between $620 million and $640 million; adjusted EBITDA of between $72 million and $76 million; and free cash flow of between $35 million and $45 million.

Please note that our risk-adjusted outlook takes into account the expected macro softening in the second half of the year, stable raw material and scrap income pricing, as well the under-absorbed fixed overhead costs associated with the Hazel Park facility as we ramp up to the $100 million run rate by year end. Our current full year 2024 net sales guidance reflects organic net sales growth of between 1.5% and 2.5% driven by new project wins associated with the ramp up of production at our Hazel Park facility.

Additionally, our guidance reflects the Hazel Park facility achieving an annualized run rate of $100 million of sales entering into 2025, which is in line with our previous expectations and will have no material impact to adjusted EBITDA as we're expecting this facility to achieve a breakeven return in 2024.

Our 2024 net sales guidance also reflects a pro-rata contribution from MSA of between $20 million to $30 million in the first half of the year, and we expect to achieve revenue synergies in the second half of the year, which are in line with the expectations we articulated at our Investor Day in September of '23.

Furthermore, embedded within our 2024 adjusted EBITDA guidance is a $2 million to $4 million reduction in cost associated with our MBX operational excellence initiatives, $1 million to $2 million of strategic value-based pricing initiatives, net of inflationary pressures, along with a $4 million to $6 million pro-rata contribution from the MSA acquisition.

In regards to SG&A, we expect that our SG&A expenses will grow to the high end of our near-term SG&A target of 4.5% to 5.5% of net sales during 2024. This increase is due to the higher compliance costs associated with SOX implementation, a full year of MSA SG&A expenses, and general inflationary costs. This increase was contemplated in the guidance we provided at our Investor Day in September, and we continue to target reducing our SG&A at a percentage of net sales to between 4.5% and 5% by 2026.

Regarding our 2024 free cash flow guidance, we currently expect that our capital expenditures for the full year will be in the range of between $15 million and $20 million, focusing the high return, capital aid automation advancements with payback periods of less than 18 months, such as recently implemented Cobots technologies and other investments to support organic growth.

Based on our free cash flow guidance, we expect to achieve our target of between 1.5x and 2x net debt leverage by year-end. Please note that our organic growth assumptions for 2024 are risk adjusted to reflect the degree of macro uncertainty that currently exists across some of our key end markets and the impact that this uncertainty may have on the demand for new projects as they launch throughout the year.

Lastly, I would like to reiterate that 2024 will be a transitional year, one that positions MEC to deliver mid-single digit to low-double digit organic growth in 2025 and 2026 as the macro demand environment rebounds, new project wins reach their full run rates, and our MSA acquisition continues to realize cross-selling synergies.
With that, operator, that concludes our prepared remarks. Please open the line for questions as we begin our question-and-answer session.

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Question and Answer

Operator

[Operator Instructions] And our first question goes to Mig Dobre of [Mayville Engineering].

Peter Alexander Kalemkerian
Robert W. Baird & Co. Incorporated, Research Division

Hey, guys. This is Peter Kalemkerian, on for Mig this morning. So first, you mentioned 5 million negative impact to sales and commercial vehicles in the fourth quarter. Will there be catch-up on this in the first quarter? Is that embedded in full year guidance at all? Any color around that?

Jagadeesh A. Reddy
President, CEO & Director

Yes. Generally, I would have said with order books pretty full and significant backlogs for most of OEMs in the CV market, that 5 million miss would carry forward into 2024. Having said that, that same customer continues to have, as they have publicly indicated, some supply chain challenges as well in Q1. So, given that, it's possible that could just move into 2024. But also, there's a general slowdown expected in 2024 for CV industry as a whole, as we mentioned. So, it remains to be seen. Our forecast includes that potential carryover into 2024 in that market.

Peter Alexander Kalemkerian
Robert W. Baird & Co. Incorporated, Research Division

Great. This one might be a little more specific, but in your end market outlook, just looking at the slides, you now have the ag industry outlook down. It was revised from flat to down, I believe. But the company outlook for MEC to be flat was unchanged. I understand the share gain commentary, but with all the OEMs now talking about sizable declines in large ag, production cut, probably going to end somewhere in the magnitude of 10%, 15%. What gives you confidence in your outlook for ag on the MEC side being flat year over year? And if it's all share gains, is there a way to add some color or even quantify what you're looking at there?

Jagadeesh A. Reddy
President, CEO & Director

Yeah, that's a good question. You're absolutely correct. Most of our ag customers have indicated a decline in the range of 10% to 15%, both in large ag and small ag as well. As you recall, MSA that we acquired mid-year last year also had some exposure to ag. I would say the incremental ag revenues from MSA, they'll lap right in 2024, is approximately $4 million. So that's one plus. Significant share gains, as we talked about, and significant new project launches that we have mentioned in this call and previously, right, will continue to help us maintain a flattish growth in that end market. As you guys have seen from recent ag shows, some of our customers are highlighting some new technologies and new platform launches. We are on multiple of those programs. So that gives us confidence that as the market is slowing down, but with new project launches and new product launches from our ag customers, we continue to benefit from that growth as well.

Peter Alexander Kalemkerian
Robert W. Baird & Co. Incorporated, Research Division

One quick last one for me, actually. Any update on the lawsuit, the fitness customer lawsuit? Any changes to the timeline there?

Jagadeesh A. Reddy
President, CEO & Director

Yeah. Look, the lawsuit, I guess the wheels of justice turned slow. All kidding aside, the parties have cross-appealed the court's order on the motion to dismiss. Peloton appealed the portion of the order

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that denied, the motion to dismiss the claim for breach and anticipatory repudiation of contract, and MEC appealed the portion of the order that dismissed the claim for breach of the duty of good faith and fair dealing. Both appeals are pending. Additionally, Peloton filed a counterclaim alleging that Peloton was induced by fraud to enter into supply agreement and seeking the session of supply agreement and damages, among other forms of relief. So we have answered Peloton's counterclaim as well, denying the allegations. So as we continue to pursue this claim, we continue to remain confident in the protections within our agreement. So that's a long way of saying the lawsuit continues and we're confident in eventual outcome in the legal system.

Todd Butz

And Peter, this is Todd, 1 comment I would make -- 1 comment I would make is in our guidance, we have reflected about $1.5 million to $2 million of legal costs as this case continues to develop. So just know that when we provided guidance, we've contemplated all those scenarios and included that already in our '24 outlook.

Operator

The next question goes to Tim Moore of EF Hutton.

Timothy M. Moore
EF Hutton LLC, Research Division

And nice EBITDA guidance for this year and free cash flow generation was quite impressive in the fourth quarter. As you embark on that $200 million cumulative free cash flow through 2026 goal, it was also nice to see the Auto Workers strike wasn't as bad as originally expected. And I just want to kind of reconcile 1 thing, Todd and Jag. For your sales guidance for this year, thanks for giving that organic growth guidance. That includes the $20 million to $30 million incremental sales until your anniversary on July 1st for the MSA acquisition.

Seems about $10 million-like compared to what maybe I was forecasting, but your EBITDA of $46 million was exactly what I had in my model. So how confident are you in that 20% EBITDA margin, incremental? And I'm just wondering, is there any end markets that might be lighter in the first half of the year for MSA, which doesn't really have commercial vehicles, but you've got the, I don't know, 19% ag sales exposure it had, but RVs bottomed out. So I guess what I'm kind of getting at is what's maybe the end market delta on sales for MSA in the first half of this year and what gives you confidence on 20% EBITDA margin?

Jagadeesh A. Reddy
President, CEO & Director

Look, I don't think that there's any particular end market that's got a delta that we're forecasting against what we have indicated in the past. Todd, anything you want to add?

Todd Butz

Yeah. What I would say is within our guidance, certainly we've contemplated numerous scenarios and we've risk adjusted. When you think of the first quarter sequentially coming out of Q4, we would expect to see a rise in volumes and sales about, between 2% and 4%. Second quarter, again, similar growth, but knowing that there's going to be, you know, a decline in the CV market that begins in the second half. Now, we're highly confident we're going to be able to buffer that through our new launches and other activities, but certainly we'll see a little bit of maybe top line deterioration just because of that offset, right? And, fourth quarter certainly would, just shortened, let's call it working days and expected shutdowns.

So when you think of all these market dynamics happening, the CV is primarily the largest change and that really begins in the second half. Ag, we've contemplated, powersports, again, we're indicating that it's up year over year despite, you know, the macro environment showing it down. Margin progression, again, we expect to continue to see that as Hazel Park, comes online in a more significant way in the second half. So, as Jag mentioned on the call, our degree of confidence in this forecast is very high. And we did look

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at it, all end markets and really put a lot of thought into, if things were to deteriorate slightly from where they are today, we're at the low end of that guidance. Certainly if things improve, we're at the higher end.

So I think we've encapsulated everything that we think can happen this year. And I would hope that this does reflect, when you look at our markets, our resilience. When you think of our historical ability to kind of offset declining markets, and this is another demonstration of that, that despite our markets and some of them being down double-digit, we're expecting flat type of sales growth, That's because of our ability to reposition and gain market share during these times. And when you think of the progression to '25 and '26, you get that multiplier impact. These markets are expected to rebound. And with that, we're going to get the top line sales, utilization, and the nice margin progressions as we move forward.

Jagadeesh A. Reddy
President, CEO & Director

Let me hit on, Tim, the points that Todd made, while -- when I was joining the company in 2022, I've talked to a lot of customers, a lot of shareholders, and obviously investment community, right? One of the big concerns that was raised was that MEC tends to, many of the end markets that MEC plays in, right, whether it's ag or commercial vehicle or, construction, right, they tend to move in the same direction given the macro exposure, right? And that could be a challenge in a down year, right? So what we're saying here, as we have laid out clearly end market by end market, when CV is going to be down 16%, we're going to be flat. When ag is going to be down, 10% to 15%, we're going to be flat, right?

When powersports is going to be down, right, let's say mid-single digits, we're going to be up, right? That demonstrates the significant work the MEC team has put in place for the last number of years to continue to grow our business, continue to gain share, and continue to offset, potential downturns with new program launches. And, of course, bringing on incremental capacity, not only through Hazel Park, but also through our MBX initiatives, we have unlocked significant open capacity in previous years where the sales team might have said, hey, we don't have capacity to bring on new business. Now we have completely opened that up, right?

We have significant capacity we can bring on so we can confidently continue to sell, right, even though, right, the market may be up. So what that's helping us in a down year is that we have significant backlog that we're going to be able to deliver in 2024. And then when the markets come back up in '25 and '26, that's going to be a significant tailwind for us, right? So that's why we feel really confident about our end market exposure, but more importantly, how we have been able to offset, any potential declines in a year where multiple end markets are going to be going in a downward direction.

Timothy M. Moore
EF Hutton LLC, Research Division

And you made a really good point, Jag, on how construction could move with CVs, because I was more obsessed with the MSA side and given that they have RVs at bottom, that shouldn't be a headwind for you this year. And they don't have any really CV exposure much now, but they have the construction access and agriculture. And it was really nice to hear about the open capacity -- the open capacity point's a really good point. I know we talked about it [went to lunch] a year ago.

So I just got 2 more quick questions. They're pretty easy, maybe for Todd. Todd mentioned Hazel Park maybe break even this year. Todd, how are you thinking about how much under-absorbed costs do you think in the first 9 months? Let's say you get to that $25 million quarterly run rate fourth quarter, you're looking like $3 million drag through the 9 months, including launch and onboarding, new customer costs?

Todd Butz

Yeah, good question, Tim. So really, it's going to be more front-end loaded. So in the first half, we would expect some under-absorption of costs. I'd say $1 million to $2 million range. And then, really, that second half, when you think of third quarter, you're starting to get -- you have some under-absorption in Q3, but getting closer to that break even. And certainly, Q4, we'd be in the green or the black, right? And really, for the whole year, that offsets what you'd see primarily in the first half. Again, most of these projects that we've been launching and working on over the last, let's call it 12 to 18 months, are really

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taking shape and hold and launching in the second half of the year. So that's when we'll start to see the utilization happening. And again, break even for the year, but as we exit Q4 at that $100 million run rate.

Timothy M. Moore
EF Hutton LLC, Research Division

Yeah, I'll keep my $3 million through nine months. But do you expect the raw material pass-throughs and scrap prices to be neutral this year? I know they were dragged last year.

Todd Butz

Yes, that is our expectation. And one of the items that I commented on was that our assumption is material pricing and scrap income pricing will be stable. Now, we don't expect any changes. But again, material pricing, keep in mind, is a pass-through to our customers. So the risk of when prices rise or decline really is very minimal.

Timothy M. Moore
EF Hutton LLC, Research Division

And just 1 last one for Jag, and I'll hand over the questions. Just on energy transition, I just think it's so interesting for you. You have that customer win that was pretty big for battery thermal management in Hazel Park. Could Jag just maybe elaborate maybe more on like some specific end markets and types of products you're working on for the lightweight deposits, aluminum, just the whole energy transition topic, if you can kind of give us a little sneak peek.

Jagadeesh A. Reddy
President, CEO & Director

Yeah, just a reminder, we do not play in passenger vehicles, right? So that's, I want to put that out there, right? There's a lot of news over the last 6 to 9 months around the passenger end markets on EVs, et cetera, right? We have no exposure in that space. Our business development has been mostly around commercial vehicles, potentially powersports, and potentially other end markets. We have taken 2 approaches, right? One, we're directly working with a couple of CV customers and powersports customers as they transition their platforms to battery electric vehicles. So we're directly supplying components to their EV platforms.

Secondly, the other customer we have mentioned in the past, right, who's got multiple systems that they're deploying into multiple vehicle platforms. And we're continuing to supply components to them. And then they're putting them together as sub-assemblies or assemblies, and then they're supplying to other end users and other OEMs. So we're participating in this energy transition both directly and indirectly.

Coming back to some of our legacy customers, as our legacy customers, particularly in the CV market, right, as they refresh their platforms, they're looking to add more and more lightweight materials, even in non-battery electric platforms. But also, as they transition to battery electric platforms, we're finding opportunities to supply aluminum extrusions, aluminum fabrications into the CV market. I just want to mention that we have gotten multiple customer codes. What that means is they have qualified MSA as a supplier. That's the first step. We have completed IATF certifications and other qualifications for the facilities that MSA operates. So all of this will help us continue to win. We did talk about last quarter a significant win in the CV market for MSA, and we continue to pursue additional CV opportunities and powersports opportunities with MSA capabilities.

Timothy M. Moore
EF Hutton LLC, Research Division

And I'd love to set up a -- possibly, hopefully, conservative organic sales growth guidance this year, depending on macro. But that's it for my questions.

Operator

The next question goes to Ted Jackson of Northland Securities.

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Ted Jackson

Hey, so the fun questions I had have been asked, but I got a couple of small ones for you. The first one, just kind of switching back over to the commercial vehicle business and the guidance you gave, are you expecting the second half of your sales in that category to be down relative to the first half? Is that what I -- when I listened, is that what I should be thinking about as I read below my model?

Jagadeesh A. Reddy
President, CEO & Director

Yeah, I think that's a fair assumption, Ted. I think the base business, obviously, is going to be down. The market is going to be down 16%. We're expecting the first quarter to be reasonably good, given the strong backlog and order rates. I think yesterday or so, ACT released another report saying that the February orders held. So, I think Q1, we expect it to be pretty good. Q2 will be okay, and then we expect Q3 and Q4 for the base CV business to continue that decline. I mean, we can't really predict which month or which quarter exactly the downturn will be, but it will be second half. Having said that, we have launched fuel tanks for one of our top customers, as we mentioned last time. So, all of that will continue to ramp and should offset some of the declines in the second half with some of the new program launches that we have.

Ted Jackson

Okay. Simple question for Todd. What do you think the tax rate, what we should use for a tax rate for '24?

Todd Butz

Well, certainly, as we wrapped up our 2022 tax returns, which were filed in October, we had found some opportunities on research and development, smaller credits that we could utilize. So, we did have a little bit of benefit in the fourth quarter from those activities. And as you look into the forward guidance you think of '24 and beyond, I would continue to say that it's 27%. We think of 21% federal and about your 6%, 7% state tax rate. So, we're going to do everything we can to hopefully minimize those impacts, but I think as you model that or look at it, to try to go out on a limb and say we can beat the effective tax rate every quarter is probably a bit difficult.

Ted Jackson

Okay. And then something maybe a little more entertaining, but just skipping over the military segment in terms of top line. I mean, there was nothing really changing in regards to your guidance, but given the fact that the world just is increasingly a more dangerous place and we've got 2 wars of substance going on. And all this concern with regards to Taiwan, is there anything that you see on the horizon that would result in a shift in your guidance?

I mean, if Congress was to actually get its act together and pass funding and actually give Ukraine money and Israel money, would that change anything here? Is there anything kind of out there that would say, oh, well, we have some wind in our sails, or is there nothing that would change your outlook for that segment?

Jagadeesh A. Reddy
President, CEO & Director

Yeah. Ted, I don't think even if there's a funding release for these 2 major conflicts get done this year, right? I don't think that will change our outlook. Specifically, we're already on 2 major programs, right? One is JLTV, other is Humvee, right? So those are 2 major programs that we're on. We had a significant program that came to an end at the end of last year that will not repeat. And that's the reason why we're being fairly prudent about our forecast in the military market.

JLTV program is transitioning from one customer to another customer. And then in general is our Humvee producer, right? They're taking over the JLTV program. So we expect that's actually a tailwind for us, but given that we will have more content in the new OEM versus the current OEM, but that program doesn't kick in, the volumes don't kick in until sometime in 2025, right? So that's why 2024, I think, in our

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forecast is pretty stable and reasonable and where we sit here and then see how this market is going to perform in 2024.

Operator

The next question goes to Larry De Maria of William Blair.

Lawrence Tighe De Maria
William Blair & Company L.L.C., Research Division

Hey. Hazel Park, obviously, you seem to have confidence in getting towards that $100 million run rate. I guess, real question is how much of it is already booked versus go get? And I assume most of it at this point is sort of in the backlog?

Jagadeesh A. Reddy
President, CEO & Director

Yeah. So as we indicated in the past, Larry, approximately $75 million of that $100 million is booked. And we feverishly continue to launch those programs. And we expect we'll be able to fill the other delta with new programs that we continue to win and pursue, but also potentially other transfers based on customer requirements, where we may put a new program in a different plant and then may end up moving some of that volume into Hazel Park based on customer requests and other factors. But otherwise, we feel pretty confident about filling that $100 million pipeline with new business.

Lawrence Tighe De Maria
William Blair & Company L.L.C., Research Division

Okay. But in other words, there hasn't been any change from the 75 of the 100 books since the last time?

Jagadeesh A. Reddy
President, CEO & Director

No. We continue to win new programs and we'll continue to look at in a way to slot those programs.

Lawrence Tighe De Maria
William Blair & Company L.L.C., Research Division

And then obviously, we discussed some of this already in the call, but there's a lot going on this year with MSA, Hazel, some, mixed end markets, but new wins and the outperformance. Can you give a little bit more, maybe a finer point on the cadence of the year for sales and margins, even if it's first half, second half, obviously because in the back half you have CV rolling off, but you have Hazel Park ramping up and maybe that margin hasn't been going away. So, I don't know, any kind of color around the actual cadence for the year, like I said, even if it's first half, second half instead of quarterly would be helpful.

Jagadeesh A. Reddy
President, CEO & Director

Yeah. So, Larry, when you think of first half sale from a top line perspective, we would expect sequentially come out of Q4, Q1, like I stated being up, 2% to 4%, second quarter sequentially up a few percentage points versus first quarter. But then, and again, your first half is up, right? As you look at the second half, certainly we're going to see some declines in the CV market that 16% annualized reduction rate really begins in the second half. And so with that, even though we have new project launches buffering that, we do expect to see a little bit of sales decline in the second half.

And then when you think of fourth quarter, just because it's shorter number of days and then planned shutdowns that customers do each year around the holidays, we would expect to see even a little more top line reduction. Now, it doesn't matter, volumes in the normalized course are really changing. It's just a matter of cadence and then certainly CV market being a big driver of that. When you think of EBITDA margin progression Q1 for the most part will be a little bit down as you compare to Q4. And the reason is, I mean, some of it is again, it's a risk adjusted budget. We are expecting our healthcare to have significant increases this year, and that's been contemplated in the guidance, as well as the compliance costs that

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we had mentioned earlier, that really started, Q1, day one, when you think of not only SOX integration or migration, but also cybersecurity measures and other things that we're putting in place.

So we will be at the higher end of SG&A percentage for '24. And then when you think of that margin profile, sequentially, it'll begin to grow. And it's a little bit muted in the second half, because keep in mind, even though Hazel Park will improve, and we'll get better utilization there, with the CV market declining, some of our other plants will have less volume. And not that there'll be an under-absorbed position, but certainly, it does put a little pressure and negate some of the impact of the Hazel Park launch. So again, sequentially, after Q1, we would expect to see margins -- EBITDA margin percentage improve. And when you think of SG&A expenses, it's really a step cost. This is the kind of transitional year. As we look into '25 and '26, we expect to be in that low end, 4.5% to 5%, because we're not going to have that incremental step up going forward.

Lawrence Tighe De Maria
William Blair & Company L.L.C., Research Division

And then just to clarify, we should expect Hazel Park to generate around $25 million sales in 4Q. Is that about right? Based on the obviously $100 million run rate?

Jagadeesh A. Reddy
President, CEO & Director

That's the current plan, Larry.

Lawrence Tighe De Maria
William Blair & Company L.L.C., Research Division

And will that be a kind of normalized margin, or there'll still be some friction in the fourth quarter?

Todd Butz

There'll be a little bit of friction in the fourth quarter. Certainly, it'll be a positive net income or EBITDA result, but it will be still progressing through the quarter. So as you think of the ending Q3, we'll still be, going through the volume ramp ups as we enter Q4. So there'll be a little bit of drag yet [happening].

Operator

[Operator Instructions] It appears we have no further questions. I'll now hand back to Jag for any closing comments.

Jagadeesh A. Reddy
President, CEO & Director

Once again, thank you for joining our call. We appreciate your continued support of MEC, and we look forward to updating you on our progress next quarter. Should you have any questions, please contact Noel Ryan or Stefan Neely at Vallum, our Investor Relations Council. This concludes our call today. You may now disconnect.

Operator
Thank you. This now concludes today's call. Thank you for joining. You may now disconnect your lines.

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