Executive Change Note:
Brady Corp. (BRC)
December 1, 2014

BRC: Turn-around Challenges Continue

J. Michael Nauman (52) was appointed as Brady Corp's new CEO in August after a 9 month search process, which indicated a lack of succession planning. Nauman's predecessor Frank Jaehnert (57) was an efficiency driver who developed BRC into a successful lean-based serial acquirer but, after a poorly executed $300 million acquisition of PDC, resigned on a Monday morning last October (unexpectedly and with little explanation) leaving a leadership vacuum after his ten year tenure. We like that the new CEO is an outside hire, coming from Molex, but think he faces a multitude of legacy issues and a risk adverse, family controlled, Board that may slow progress. Nauman's primary skills are in finance and a new perspective will likely help Brady's languishing results, but we don't see a strong fit in terms of operating skill in the new CEO. Former long time CFO, and interim CEO, Tom Felmer has moved to a new role as President of the Workplace Safety group (a dubious "promotion"). The new CFO, Aaron Pearce (43), has been with the firm since 2004. We don't like either of these internal promotions given weak financial results at the Company, including over $350 million of impairments in the last 2 years.

New President & CEO Nauman came from electronic component firm Molex Inc. where he spent 20 years. We note Molex, like BRC, was family controlled before being sold to Koch Industries last year for $7 billion. **Nauman was President of Global Integrated Products at Molex for 7 years, where he led 6 divisions including cable fiber, industrial and networking products with 12k employees and revenues of $1.2 billion.** Before that, he spent 2 years as President of Integrated Products, Americas after a year as President of High Performance Products and another as President of the Fiber Optics group. He joined Molex in 1994 to help launch the High Performance Cable Assembly Unit and spent 9 years rising from Product Manager to General Manager. Nauman, a CPA, started as a tax accountant with Arthur Andersen before joining industrial manufacturer Ohio Associated Enterprises where he spent 3 years as Controller and then 5 as President & COO. He holds a BS in Management from Case Western Reserve University. **We see little likely change with new CFO Pearce who is the former Treasurer and a CPA. We think the combination of a new CEO and CFO, who have redundant backgrounds, is likely to delay top-line operating traction where stalled sales growth has pinched margins despite impairment charges and divestitures.**

BRC's executive pay levels are reasonable but we don't like that the Board has reacted to poor results by shifting from mostly performance-based incentives to wholly time-based vesting in recent years. CEO Nauman receives a salary of $675k, an annual bonus targeted at 100% of salary, and targeted equity awards of $1.8 million for FY2016. The equity awards are split between options and restricted stock (RSUs), for total pay of $3.2 million. 57% of his pay is in equity but it is a negative that only 21% of his pay is determined by performance metrics. The new CEO also received a grant of $1.5 million in RSUs, which vest in equal time tranches in years 3, 4 and 5. Management's annual cash incentive plan (AIP) pays based on a set of good metrics: organic sales growth (30% weighting), income from continuing operations (30%), net income from continuing operations (20%) and team goals (20%). The long term incentive plan (LTIP) awards an equal split of options and RSUs, both of which vest solely on time ratably over 3 years. Investors will note that performance conditions were removed entirely for FY2014 LTIP awards. There were no AIP awards and minimal LTIP vesting in FY2014 because of missed marks.

BRC is a dual-class, family controlled firm. Officers and Directors have a strong beneficial ownership stake of 3.7 million non-voting A shares or about 6.8% of BRC. We like the fact that Officers hold the majority with a 3.6% stake. Grandchildren, William Brady, III and Director Elizabeth Pungello (47), have voting control through their 50/50 ownership of the B shares. (See our October 2012 Report). We like that the Board has increased equity holding requirements for the CEO to 5x his salary (132k shares) with the senior team required to hold at least 30k shares each. Capital allocation has shifted from serial acquisitions to organic growth. The team at BRC used to be quite acquisitive but there were no acquisitions in 2013 or 2014. *End*