

Kimball Electronics Inc
First Quarter Fiscal Year 2025 Financial Results
November 5, 2024

Presenters

Andy Regrut - Treasurer and Investor Relations Officer
Ric Phillips - Chief Executive Officer
Jana Croom - Chief Financial Officer

Q&A Participants

Mike Crawford - B. Riley Securities
Jaeson Schmidt - Lake Street
Anja Soderstrom - Sidoti

Operator

Good morning, ladies and gentlemen. Welcome to Kimball Electronics' First Quarter Fiscal 2025 Earnings Conference Call. My name is Maria, and I will be the facilitator for today's call. All lines have been placed in a listen-only mode to prevent any background noise. After the completion of the prepared remarks from Kimball Electronics' leadership team, there will be a question-and-answer period. To ask a question, simply press star and the number one on your telephone keypad.

Today's call, November 5, 2024 is being recorded. A replay of the call will be available on the Investor Relations page of the Kimball Electronics website.

At this time, I would like to turn the call over to Andy Regrut, Treasurer and Investor Relations Officer. Mr. Regrut, you may begin.

Andy Regrut

Thank you, and good morning, everyone. Welcome to our first quarter conference call. With me here today is Ric Phillips, our Chief Executive Officer, and Jana Croom, Chief Financial Officer. We issued a press release yesterday afternoon with our results for the first quarter of fiscal 2025 ended September 30, 2024. To accompany today's call, a presentation has been posted to the Investor Relations page on our company website.

Before we get started, I'd like to remind you that we will be making forward-looking statements that involve risk and uncertainty and are subject to our Safe Harbor provisions as stated in our press release and SEC filings and that actual results can differ materially from the forward-looking statements. Our commentary today will be focused on adjusted non-GAAP results. Reconciliations of GAAP to non-GAAP amounts are available in our press release.

This morning, Ric will start the call with a few opening comments, Jana will review the financial results for the quarter and guidance for fiscal 2025, and Ric will complete our prepared remarks before taking your questions.

I'll now turn the call over to Ric.

Ric Phillips

Thanks, Andy, and good morning, everyone. Before we get into the quarterly results and our continued theme to control what we can control, I'd like to take a moment to highlight the progress we have made thus far to strategically position the business for the future. First, we restructured the company by divesting the noncore AT&M business, and we folded the medical CMO business into our core EMS portfolio, allowing us greater focus on key and growing areas of the medical vertical. We are seeing the differentiation and potential new customer opportunities from this shift.

Next, and consistent with this move, we have sharpened our strategic focus in all three of our vertical markets to target attractive current and new market spaces that fit our capabilities. Some examples of these spaces include domain controllers in automotive, off-highway equipment and energy storage solutions in industrial and high-level assemblies and drug device combinations in medical.

Another set of actions to position our business for the future has been on the cost side, where we've been very proactive in adjusting our resources and cost to the ongoing market demand softness. This will serve us well as demand returns to more stable levels.

In addition, we've been shoring up our balance sheet, lowering inventory levels by over \$150 million and generating significant positive cash flow.

Finally, last night, we announced a streamlining of our manufacturing footprint with the closure of our Tampa manufacturing facility, which I'll discuss more in a moment. But from a strategic perspective, this move will both drive efficiency for the future and will help provide the necessary dry powder to meaningfully invest in growing the core business, which we intend to do. Collectively, we believe this series of strategic moves will position us very well for the future.

As I mentioned a moment ago, we announced last night that we made the difficult decision to close our facility in Tampa as part of our objective to sharpen the strategic focus of the company. This will help us improve competitiveness by leveraging capacity in our global footprint while streamlining the operating structure. Production activities on existing customer programs will be transferred out of Tampa with the majority of the work going to the newly expanded facility in Mexico and to our Jasper facility.

We expect operations in Tampa to cease by the end of the fiscal year, and we anticipate the facility will close in Q1 of fiscal 2026. As you can imagine, shutting down a location is a difficult

decision and one that we did not take lightly. But we feel it's an appropriate path forward, considering the preferences of our customers, our outlook for U.S. manufacturing and an objective of returning the company to profitable growth and stronger performance. We are grateful to the employees in Tampa and their accomplishments since the Reptron acquisition in 2007. The team there played a vital role during the pandemic, supplying ventilators to those in need, and we appreciate their contributions as part of Kimball.

Throughout this process, we remain committed to doing the right thing for our people, our customers, our suppliers and the local community. These actions have been designed to set Kimball up for a bright future. We look forward to sharing more with you as our strategy unfolds in the quarters to come.

Now turning to the first quarter, with Q1 representing another chapter of controlling what we can control while navigating the challenging operating environment stemming from sustained end market weakness. Our results were in line with expectations considering the difficult comparisons from a record setting Q1 last year. We continue to adjust costs, improve working capital management and generate positive cash flow to pay down debt, which was nearly \$50 million in Q1, reducing our debt levels to a two year low. Net sales in the quarter totaled \$374 million, a 15% decrease year-over-year. When excluding AT&M from both periods, the decrease was 13%. From an end market perspective, each of the three verticals we serve posted declines.

Starting with automotive, net sales were \$188 million, down 11% compared to the first quarter last year and 50% of total company sales. The decrease in Q1 occurred in Europe and North America, partially offset by a modest increase in Asia. The decline in the quarter is due to volume softening, a result of overstocking, lower demand and dynamic timing of NPIs versus end-of-life production.

As we announced in August, we are working through a setback with an electronic braking program, our customer, a Tier 1 supplier, learned they will no longer be producing the system for the OEM. We are supporting the wind down of production and transfer as necessary and expect operating activities to conclude by the end of Q3. As such, there was no impact to revenue in the quarter due to this program ending. On a positive note, we're on schedule with this same customer for the launch and ramp up of a new braking program in Romania in Q3. We expect growth in the vertical to return when vehicle sales burn through the elevated inventory levels that exist in the industry wide supply chain.

Next is medical with net sales in the first quarter of \$90 million, a 12% decrease compared to the same period last year and 24% of total company. The decline in the quarter was heavily concentrated in Asia, driven by volume declines due to excess inventory. Additionally, North America and Europe were both down slightly.

As we look forward, we're encouraged by the growth prospects in this vertical market with our focus on higher level assemblies and finished medical devices. We were recently selected as the

sole supplier of the Respiratory Care Final Assembly and HLA business for our largest medical customer, and we are working toward the fiscal 2026 launch of this program. Our expertise in manufacturing selected drug devices such as auto-injectors is a differentiator in an overall very attractive market, and we're encouraged about our current customer discussions and future opportunities in this area.

Finally, industrial, with net sales of \$96 million, down 22% year-over-year. When excluding AT&M from both periods, net sales were \$94 million, a decrease of 17% and 25% of total company sales. The decline predominantly occurred in North America and Europe; sales in Asia were down slightly with weak demand for internal climate control systems, public safety products and smart meters in Europe, which have been commoditizing. We expect to return to growth coming from a rebound for climate control products and opportunities in other sub-verticals within the industrial space.

I'll now turn the call over to Jana for more detail on the quarter and insights on the outlook. Jana?

Jana Croom

Thank you, and good morning, everyone. As Ric mentioned, our decision to close the facility in Tampa was very difficult, and I echo his gratitude to our team in Florida. This decision did not impact the first quarter, and it has not changed our outlook for adjusted results for the full year. We will, however, be incurring additional restructuring expense, which I will outline in a moment.

Net sales for the first quarter were \$374.3 million. Foreign exchange had less than a 1% impact on sales in the quarter. The gross margin rate in Q1 was 6.3%, a 180 basis point decline compared to the first quarter of fiscal 2024, with the decrease coming from lower absorption, a result of declining sales. As we continue to right-size the company, we should see a pickup in gross margin in the coming quarters.

Adjusted selling and administrative expenses in the first quarter were \$11 million, a \$3.5 million or 24% reduction compared to the \$14.5 million we reported in Q1 last year. The decrease was driven by our efforts to align discretionary spending with current market demand and lower bonus expense, along with only one month of expense from AT&M in the quarter. When measured as a percentage of sales, adjusted selling and administrative expenses were 2.9%, a 40 basis point improvement compared to 3.3% in Q1 last year.

Adjusted operating income for the first quarter was \$12.6 million or 3.4% of net sales, which compares to last year's adjusted results of \$21 million or 4.8% of net sales. As a reminder, we have adopted the industry norm of excluding stock comp expense from the calculation on this metric. The results from last year has been recast to reflect this change.

Other income and expense was expense of \$6.2 million, virtually flat with last year's expense of \$6.3 million with lower interest expense in the period offset by an increase from foreign currency translation.

The effective tax rate was negative 9.4% in the first quarter compared to a positive 18.6% in Q1 of fiscal '24, with the rate this quarter driven by a favorable ruling on a prior period tax audit. We expect to resume a normalized tax rate in the mid-20s going forward. Adjusted net income in the first quarter of fiscal 2025 was \$5.5 million or \$0.22 per diluted share compared to adjusted net income in Q1 last year of \$12 million or \$0.48 per diluted share.

Turning now to the balance sheet, cash and cash equivalents at September 30, 2024, were \$76.6 million. Cash flows generated by operating activities in the quarter was \$45.5 million, our third consecutive quarter of positive cash flow and another example of our focus on controlling what we can control, improving our balance sheet as we work through the challenges of declining revenue. Cash conversion days were 108 days compared to 103 days in the first quarter of fiscal 2024 and 100 days in Q4 last year. We are continuing to focus on improving cash conversion days by actively managing the components.

Inventory ended the quarter at \$335.3 million, which represents a \$147 million or 30% reduction compared to Q1 last year. We are pleased with our progress in reducing inventory, and we'll continue to work with our customers to right-size the current demand outlook. Capital expenditures in the first quarter were \$13.5 million, balanced between maintenance requirements and investments in longer term growth. Borrowings on our credit facility at September 30, 2024, were \$245.9 million, a \$48.9 million reduction from last quarter and our lowest level of debt in two years.

Short-term liquidity available, represented as cash and cash equivalents plus the unused portion of our credit facility, totaled \$263.4 million at the end of the first quarter. In Q1, we invested \$2.9 million to repurchase 160,000 shares. Since October 2015 under our Board-authorized share repurchase program, a total of \$94.7 million has been returned to our shareholders by purchasing 6.1 million shares of common stock. We have \$5.3 million remaining on the repurchase program.

We are confirming our guidance for fiscal year 2025. As a reminder, we expect net sales to be in the range of \$1.44 billion to \$1.54 billion, adjusted operating income of 4% to 4.5% of net sales and capital expenditures of \$40 million to \$50 million. We anticipate the Q2 revenue decline versus prior year to be roughly in line with Q1, but with margin improvement as we continue our restructuring efforts. As part of the facility closing in Tampa, we expect to incur approximately \$8 million to \$11 million in total exit costs, including most significantly \$6 million to \$7 million in employee termination benefits and \$2 million to \$3 million of logistical costs to transfer and validate programs at our other facilities as well as other ancillary costs. We expect these costs will be predominantly cash expenditures.

In terms of its relative size, Tampa has annual revenue of approximately \$75 million, primarily for customers in the medical and industrial verticals. By comparison, we delivered \$500 million in sales in Mexico in fiscal 2024. We expect the programs transferred out of Tampa to go to Reynosa or come here to Jasper. To minimize disruption to our customers, the setup and qualification

process at the new facility will be run in parallel with the normal production runs in Tampa and will be supported with low levels of safety stock. Once the transfers are complete and operations have ceased, we expect to sell the building and land in Tampa with proceeds from the sales exceeding the exit cost.

I'll now turn the call back over to Ric.

Ric Phillips

Thanks, Jana. Before we open the lines for questions, I'd like to share a few thoughts in closing. With fiscal 2025, representing another year of controlling what we can control, our decision to leverage capacity within our global footprint and streamline our operating structure will improve our competitiveness and drive efficiency. The closure of the facility in Tampa aligns our electronics manufacturing footprint in the U.S. with current and long-term market demand and positions the company to better utilize our facilities in low-cost regions.

However, we also recognize that we cannot cut our way to greatness and that controlling what we can control means also focusing on top line growth. We continue to actively pursue new opportunities where our core manufacturing capabilities support emerging technologies, most notably in medical high-level assemblies and drug device combinations. With our strategic focus on EMS operations and a strong balance sheet that now supports different avenues of growth, we have intensified our efforts on where and how to profitably grow.

Last quarter's announcement by our largest medical customer making Kimball the sole supplier on the Respiratory Care Final Assembly and HLA business is a great example where we see the opportunity. I'm excited for the future of the company and thank you for your support.

Operator, we would now like to open the lines for questions.

Operator

Ladies and gentlemen, analysts may ask a question at this time by simply press star, one on your dial pad. You may remove yourself from the queue by pressing star, two on your dial pad. We ask that, if you're using a speakerphone, you pick up your handset before asking your question. One moment please for the first question.

Our first question comes from Mike Crawford with B. Riley Securities. Please proceed with your question.

Mike Crawford

Thank you for giving us all that detail on the Tampa Bay facility. Can you remind us what it's on the books for currently? And again, clarify whether the proceeds that you expect from selling the land and the building just exceeds this \$8 million to \$11 million you're talking about or the book cost, as well, of the land and building?

Jana Croom

Yeah, so what we have on the books for is considerably less than what we would expect to sell the building for. And so our estimate for the price that we could fetch for the land and building is somewhere around \$18 million to \$20 million, which significantly exceeds the exit cost. It's more than -- it's roughly 2x the exit costs we expect.

Mike Crawford

Okay, excellent. And then, Jana or Ric, could you maybe help us look at the business by vertical market and maybe characterize where the life cycle is of the majority of the programs within there, whether they're programs that started out NPI and are still ramping up for years to come or if they've been in production for years and maybe are starting the long tail decline?

Jana Croom

Yeah, you want me to--yeah, okay--

Ric Phillips

--Yeah. Okay. That's an interesting way to look at it.

Jana Croom

No, he's trying to figure out the portfolio of revenue, which I appreciate, Mike. So Industrial has the shortest life span and probably the most NPIs that you're going to see, particularly over the next 24 months. And then we've got three fairly significant programs ramping in automotive over the next 18 months that are going to actually bring down the average life of that portfolio, one in Poland, one in China, and we announced the braking program that's coming on in Q3 in Romania. And then in Medical, Medical has a really nice steady stream of business coming on over time, and so the life of that portfolio tends to remain fairly stable in the five to six year range.

Mike Crawford

Okay, thank you, Jana. And just one more for me - so I know you've been studying potential adjacencies where you can find new avenues of growth, such as, I don't know, the off-highway equipment market. Is there any tangible progress there or any further focus on exactly what you might -- what looks promising at this point?

Ric Phillips

Yeah, we haven't disclosed any specific wins, Mike. But the -- what I would say is the -- as we've sharpened our focus on -- and again, this isn't all new things, right? I mean, these are areas that we continue to monitor to see is this the attractive space that we want to be in, such as braking and steering and automotive, which we continue to believe. Areas like domain controllers, energy storage, off-highway equipment and particularly auto injectors and medical are those spaces where I guess I would characterize it as our level of discussion and quoting and readiness for investment is very high, and we're quite optimistic.

Those obviously take time to ramp up. So we don't have any specific win that we can disclose at this point based on our agreements with customers, but we're really pleased with the activity and also the long-term attractiveness of some of those spaces.

Mike Crawford

Okay, thank you very much.

Ric Phillips

Thank you, Mike.

Operator

Our next question comes from Jaeson Schmidt with Lake Street. Please proceed with your question.

Jaeson Schmidt

Hi, guys, thanks for taking my question. You noted sort of the elevated inventory in auto. Just curious what sort of visibility you guys have to that sort of clearing out? And how should we think about the potential timeline?

Ric Phillips

It's a great question, Jaeson. What we do is we drive around and we see how many closed malls have lots of cars in there as holding stations.

No, we're obviously in close touch with customers all the time about what they're seeing in demand. We update our demand regularly. To your point, we have seen this sort of inventory glut that has persisted for a period of time. And so we adjust, we see ups and downs, but I wouldn't say we say it's a quarter from now, it's two quarters from now when this opens up. It's something that we have to monitor and try to get ahead of as best we can and adjust to. So I don't think we have a clear line of sight to that demand stability, but we're on it.

Jaeson Schmidt

Okay. No, That's more than fair. And how should we think about gross margin trending? Obviously, it's going to be sort of revenue dependent, but any help on sort of the trajectory for the remainder of fiscal '25.

Jana Croom

Yeah, Jaeson. And it's something that we -- that's where I'm spending the bulk of my time, right - so revenue by geographic area and the rightsizing and restructuring that we're doing. So dependent upon revenue and also dependent on how quickly we can drive the cost out of the facilities, and the challenge with that is, to your previous question, when do we see volumes start to return in the space and what's the measured approach of cost containment versus being ready when demand comes back.

So what I can tell you is gross margin of 6.3% is disappointing to everyone. It's something that we've been after. We had \$2.3 million of restructuring costs in the quarter; expect restructuring costs in Q2 to be similar to that in terms of rightsizing the workforce for the demand that we see. And so I would expect a measured improvement in Q2 and more significant improvement in the back half of the year.

Jaeson Schmidt

Okay, that's really helpful. And then just the last one for me, and I'll jump back into queue - should we consider September to be the low watermark for the year from a revenue perspective?

Jana Croom

Well, if you look at the guide, and I realize I just gave it to you so you probably can't do math on the fly, we're seeing Q2 decline in line with Q1 decline quarter-over-quarter, which would indicate that Q2 revenue would be just slightly below Q1, as indicated. And so that would say to me that likely October is probably the low watermark. And I may have just (inaudible).

Jaeson Schmidt

Perfect. Thanks a lot, guys.

Ric Phillips

Thank you, Jaeson.

Operator

As a reminder, if you would like to ask a question, please press star, one on your telephone keypad.

Our next question comes from Anja Soderstrom with Sidoti. Please proceed with your question.

Jana Croom

Morning, Anja.

Anja Soderstrom

Thank you for taking my -- good morning, everyone. Thanks you for taking my questions. I just want to clarify, when you talk about the sequential decline in the second quarter to be on par with the first quarter, is that by dollar amount?

Jana Croom

By revenue, yes.

Anja Soderstrom

(Inaudible)

Jana Croom

But with improved gross margin.

Anja Soderstrom

Okay, yeah, yeah, and operating margin, right? And then I'm just curious to follow up on the inventory in the auto. Do you have a lot of inventory there because of the falloff from that program? And is there any remedy you can get from your customer there?

Jana Croom

Automotive has the longest lead time of inventory, and here's why that's challenging. You ordered 12 months from now -- and remember, a year ago, we were ordering 18 months from now, and before that, much further out as we were dealing with supply chain challenges. So you order, and then six months after you've placed the order and the inventory is coming, the demand drops and you get the updated demand from customers. And so auto inventory is the most challenging to deal with, right? So what can you cancel, what can you push out to align with the demand that has a six month lag associated with it.

At the end of the day, you will work with your customers to right-size it. And so it becomes a timing issue of just that inventory and the corresponding cost of that sitting on books. We're getting better at faster demand signals, but we're going to see the impact of it creep up on us over the course of the year. We're managing it as effectively as we can, though.

Anja Soderstrom

Okay, thank you. And--

Ric Phillips

--Sorry, Anja, just one follow up (it's Ric) you mentioned the program cancellation. We are certainly working with that Tier 1 customer on recovery and how we work through the wind down of that program. So, yes, but that's still in process.

Jana Croom

Yeah, we'll fully recover the inventory.

Anja Soderstrom

Okay. Thank you. That was helpful. And then the \$11 million in the exit cost, is that going to fall more in the back half of the year or--

Jana Croom

--We will begin the TOW process immediately. And so I will tell you that we've contacted all of the customers, we're in process. And so I would expect to see some of that cost come through in Q2.

Anja Soderstrom

InComm Conferencing

Okay. And have you quantified what kind of savings you expect to get from that closure?

Jana Croom

I expected this question. We have not disclosed the savings. What I can tell you is, when you figure out the depreciation, the indirect labor, the administrative overhead burden of closing a facility, you will absolutely feel it on the consolidated. It would be a meaningful pickup to North America and certainly to the consolidated enterprise. If you will be patient with me, I would like to -- when we report Q2, that's when we'll give you more information.

Anja Soderstrom

Okay.

Ric Phillips

But as you would expect, the utilization of those other North American facilities that are going to receive transfer will improve as a result.

Anja Soderstrom

Yes, yes, yes. No, I understand. That was all for me. Thank you.

Anja Soderstrom

Thanks, Anja.

Operator

This concludes our question-and-answer session and does conclude our conference call. A telephone replay will be available shortly. To access the replay, please dial 877-660-6853 or 201-612-7415, then enter the access ID1 13749564. You may disconnect your lines at this time. Thank you.