# CTS Corporation NYSE:CTS

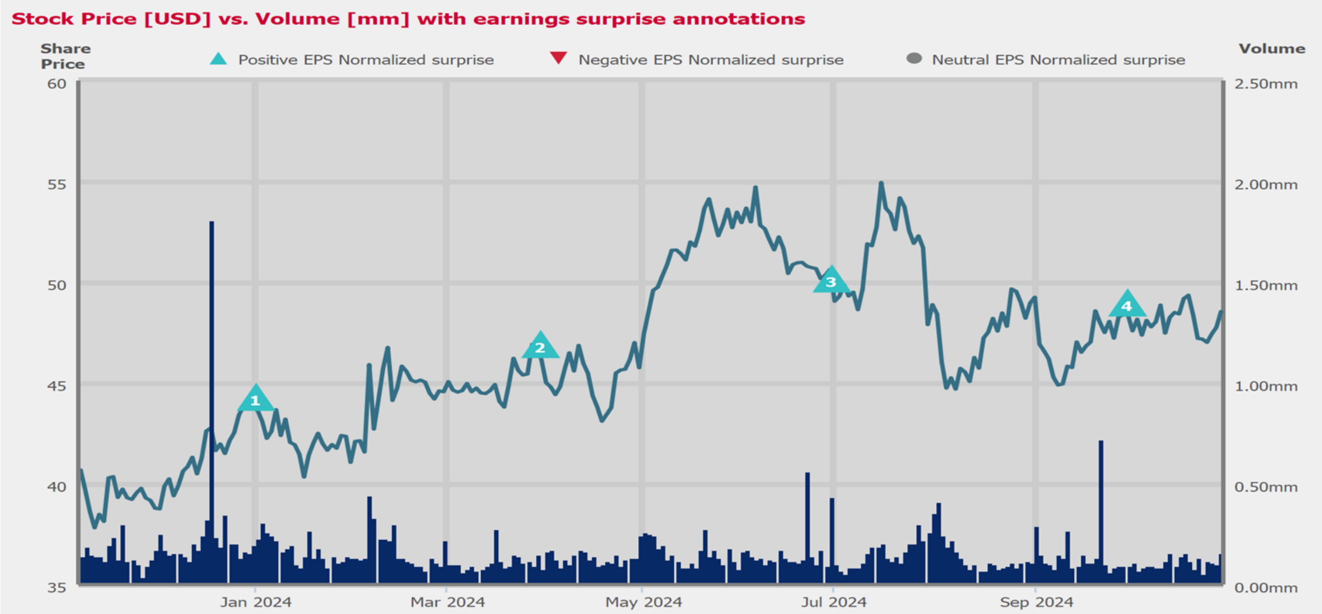
# FQ3 2024 Earnings Call Transcripts

## Tuesday, October 29, 2024 2:00 PM GMT

## S&P Global Market Intelligence Estimates

| | -FQ3 2024- | | | -FQ4 2024- | -FY 2024- | -FY 2025- |
|---|---|---|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | CONSENSUS |
| **EPS Normalized** | 0.54 | 0.63 | ▲16.67 | 0.56 | 2.10 | NA |
| **Revenue (mm)** | 132.48 | 132.42 | ▼(0.05 %) | 138.25 | 526.64 | NA |

Currency: USD
Consensus as of Oct-18-2024 1:33 PM GMT




**- EPS NORMALIZED -**

| | CONSENSUS | ACTUAL | SURPRISE |
|---|---|---|---|
| **FQ4 2023** | 0.44 | 0.47 | ▲1 6.82 % |
| **FQ1 2024** | 0.41 | 0.47 | ▲2 14.63 % |
| **FQ2 2024** | 0.52 | 0.54 | ▲3 1.89 % |
| **FQ3 2024** | 0.54 | 0.63 | ▲4 16.67 % |

# Table of Contents

# Call Participants

EXECUTIVES

**Ashish Agrawal**
*VP, CFO & Principal Accounting Officer*

**Kieran M. O'Sullivan**
*Chairman, President & CEO*

ANALYSTS

**Hendi Susanto**
*Gabelli Funds, LLC*

**John Edward Franzreb**
*Sidoti & Company, LLC*

# Presentation

**Operator**

Hello everyone, and welcome to the CTS Corporation Third Quarter 2024 Earnings Call. My name is Nadia, and I'll be coordinating the call today. [Operator Instructions]. I will now hand over to your host, Kieran O'Sullivan, President and CEO, to begin. Kieran, please go ahead.

**Kieran M. O'Sullivan**
*Chairman, President & CEO*

Good morning, and thanks for joining us today. Let's start with some key highlights for the quarter. First, third quarter saw revenue of $132 million and adjusted earnings per share of $0.63. Second, we continue to execute on our diversification strategy with revenue from diversified markets now accounting for approximately 52% of overall revenue in the quarter. Diversification will continue to be a strategic priority, and we expect further progress next year. Third and finally, we expanded overall adjusted gross margin by 416 basis points in the quarter, including foreign exchange favorability.

We are excited by the momentum in medical, where our products enable critical ultrasound diagnosis, and our technology enables minimally invasive procedures, helping improve patient experience and save lives. We have accelerated our defense growth with the SyQwest acquisition, which moves us up the value chain for sensors, transducers and subsystems, and longer-term, has the capability to expand into new products. Demand across the industrial market continues to rebuild slowly. In transportation, where we are navigating near-term market softness, interest in our eBrake product continues with a pre-development award for a premium European OEM and additional wins in electrification with current sensing. And more recently, in early October, we added a new customer in North America for an accelerator modules on a premium truck platform. Ashish will take us through the safe harbor statement. Ashish?

**Ashish Agrawal**
*VP, CFO & Principal Accounting Officer*

I would like to remind our listeners that this conference call contains forward-looking statements. These statements are subject to a number of risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements. Additional information regarding these risks and uncertainties is contained in the press release issued today, and more information can be found in the company's SEC filings. To the extent that today's discussion refers to any non-GAAP measures under Regulation G, the required explanations and reconciliations are available with today's earnings press release and supplemental slide presentation which can be found in the Investors section of the CTS website. I will now turn the discussion back to our CEO, Kieran O'Sullivan.

**Kieran M. O'Sullivan**
*Chairman, President & CEO*

Thank you, Ashish. We finished the third quarter with sales of $132 million, down 1.6% from the third quarter of 2023. For the quarter, diversified medical, aerospace and defense, and industrial sales were up 18%, while transportation sales were down 17% from the same period last year. Diversified medical, aerospace and defense, and industrial sales were 52% of overall company revenue in the third quarter. Our book-to-bill ratio was 1 in the third quarter compared to 0.92 in the third quarter of 2023. The book-to-bill ratio reflects some positive improvement in the industrial end market with both OEM and distribution customers on a year-over-year basis as inventories continue to improve.

Bookings in the industrial end market were up 17% year-over-year. Medical bookings were up 19% on a year-over-year basis. Aerospace and defense bookings were up 92% on a year-over-year basis, excluding the impact of the SyQwest acquisition. Third quarter adjusted diluted earnings per share of $0.63 were up 17% year-over-year. Ashish will add further color on our financial performance later in today's call. Diversified sales continued to improve, up 18% in the third quarter compared to the prior year period. Excluding the SyQwest acquisition, third quarter diversified sales grew 12% year-over-year. In medical markets, sales were up 3% from the same period in 2023. We expect softness in the fourth quarter as customers manage year-end inventories.

During the quarter, we had wins for medical ultrasound with several customers, drug delivery and a medical device win for a pacemaker application. We added a new customer for a vision correction application and made further progress on an innovation project with one of our key customers advancing capability for ultrasound. Finally, we received an order for a new application to support sonic lumen tomography, which provides real-time dimensions of the artery and veins using a disposable catheter application.

Aerospace and defense sales were up 89% from the prior year period. Excluding the impact from the SyQwest acquisition, sales grew 56% year-over-year in the third quarter. We expect good momentum for the rest of 2024 given the backlog of orders.

We received multiple orders for sonar applications with customers in North America and Europe. We continue to make progress on RF filter wins in anti-jamming and added a new customer to our SyQwest team. We expect the long-term prospects for the aerospace and defense end market to be solid given our material formulations and enhanced capabilities with the addition of SyQwest. The integration of the SyQwest business is tracking to plan, and the business continued to expand its opportunity funnel with qualification work across two new countermeasure and underwater communication platforms. In the industrial market, we see a gradual recovery in distribution as well as with OEMs. Sales were up 2% year-over-year. Demand recovery continues to be tempered by inventory burn down, OEMs with exposure to China, and a tightening of inventory management. We were successful with multiple wins in the quarter for EMC, switches, industrial printing, flow metering and temperature sensing. We added a new customer in Europe for a piezo control valve application.

Looking ahead for the balance of the year in the industrial and distribution end market, we expect improvement in revenue. For medical markets, we anticipate softness in the fourth quarter with some customers, but overall market growth as we move into next year. We also expect to make solid progress on the qualification of products for prospective new customers. We are excited by the prospects for growth in minimally invasive applications where our products enable medical professionals with enhanced ultrasound images, detect artery restrictions and deliver treatment medications. We are proud to highlight that our products support solutions that save lives.Â

Over time, we expect the volume growth in portable ultrasound diagnostics and therapeutics will enhance our growth profile. Sales to defense customers are expected to remain solid. Our strategy is focused on moving from a component supplier to a supplier of sensors, transducers and subsystems. We also expect to expand our product range and market opportunity. Longer-term, we expect our material formulations supported by 3 leading technologies to continue to drive our growth in key high-quality end markets in line with our diversification strategy. The megatrends of automation, connectivity and efficiency enhance growth in industrial applications. Transportation sales were $63 million in the third quarter, down approximately 17% from the same period last year.

We are experiencing a softer demand environment for commercial vehicle products in 2024. On the light vehicle front, we continue to navigate the market share dynamics in China given the competition between local and transplant OEMs. Additionally, we see the regional demand for light vehicles continuing to soften. This is consistent with most market analysts that are forecasting reduced build rates. The near-term growth rates for ICE versus EVs and hybrids are less of a concern for us, given our products are mostly agnostic to the drivetrain technology. In the third quarter, we had wins across various product groups, including sensor wins for chassis ride height sensing, brake position sensing and passive safety sensing. We had an accelerator module win with Japanese, Chinese, European and North American OEMs. We had a current sensing win with a European Tier 1 supplier. OEMs continue to delay sourcing decisions as they work to correct their powertrain mix given market changes.

However, even with these dynamics, we have been making progress in key areas. For example, after the quarter close, we added a new North American customer for an accelerator module deploying our new modular design for a future premium truck platform. In addition, interest in our eBrake product offering weight and cost advantages continues across several OEMs, and we received a predevelopment award post quarter end with a premium European brand. We expect the eBrake and other sensor applications will increase our ability to grow content. During the third quarter, we added a new customer and had 5 EV platform wins, mostly in China and Europe. Total booked business was approximately $1.1 billion at the end of the quarter.

Turning to our outlook for the year. For medical, industrial, aerospace and defense markets, in line with our diversification strategy, we aim to expand the customer base and range of applications. Industrial demand has shown small improvement sequentially, and we expect this to continue. Demand in the medical market is expected to soften in the fourth quarter due to near-term inventory adjustments. In aerospace and defense, demand is expected to remain solid given our backlog of orders and momentum from the SyQwest acquisition. Across transportation markets, production volumes have softened as also reflected in the IHS industry reports and by other industry analysts. The North American light vehicle market is expected to soften in the fourth quarter with the full year in the range of 15.5 million to 16 million units with on-hand days of supply growing. European production is forecasted in the 17-million-unit range and showing some increased softness due to overcapacity pressure from Chinese OEMs and the upcoming Euro 7 emission changes in 2025. China volumes are expected to be in the 28-million-unit range with the recent government subsidies only serving to stabilize demand.

Electric vehicle penetration rates have softened in some regions, while hybrid adoption continues to improve. Overall, we anticipate a soft market for light vehicle production due to the China market dynamics and other recent regional build reductions. We expect softness in the commercial vehicle-related revenue throughout the remainder of 2024. For the full year 2024, we are updating guidance for sales in the range of $515 million to $525 million compared to the prior range of $525 million to $540 million. Based on our operational performance, we are reiterating the adjusted diluted EPS guidance to be in the range of $2.05 to $2.25. Now I'll turn it over to Ashish, who will walk us through the financial results in more detail. Ashish?

**Ashish Agrawal**
*VP, CFO & Principal Accounting Officer*

Thank you, Kieran. Third quarter sales were $132 million. As Kieran mentioned, we are seeing softness in the transportation end market with sales down 17% year-over-year. Our sales to diversified end markets grew 18% compared to the third quarter of 2023. Our recent acquisition, SyQwest, contributed $3.6 million in revenue during the quarter. Foreign currency changes impacted revenue favorably by approximately $0.5 million. Adjusted gross margin in the third quarter was 38.6%, an improvement of over 400 basis points from the third quarter of last year, and sequential improvement of 286 basis points from the second quarter.Â

Our teams globally continue to focus on plant efficiency and cost improvements that contributed to the margin expansion. The change in end market mix away from the transportation end market also impacted gross margins favorably. We had a favorable impact of approximately $1.5 million from foreign currency changes. During the third quarter of 2024, we benefited from some onetime tax items worth approximately $0.02 of EPS, and as a result, had a tax rate of 16.8%. For 2024 overall, we expect our tax rate to be in the range of 18% to 20%.Â

Earnings per diluted share were $0.61 in the third quarter. Adjusted earnings for the third quarter were $0.63 per diluted share compared to $0.54 from the third quarter of last year. Now focusing on cash generation and the balance sheet. We generated $35 million in operating cash flow in the third quarter of 2024 compared to $22 million in the third quarter of 2023. We continue to focus on driving efficiency and cash usage within the business, and saw improvements in our controllable working capital during the quarter. We completed the acquisition of SyQwest during the quarter using a combination of cash on hand and borrowings from our credit facility.Â
At the end of the third quarter, our cash balance was $95 million, and the long-term debt balance was $103 million. We remain focused on strong cash generation and continue to support organic growth, strategic acquisitions and returning cash to shareholders. During the quarter, we repurchased 245,000 shares of CTS stock totaling approximately $12 million. Year-to-date, we have returned $39 million to shareholders through share repurchases and dividends. This concludes our prepared comments. We would like to open the line for questions at this time.

# Question and Answer

**Operator**

[Operator Instructions]. And our first question goes toÂ John FranzrebÂ of Sidoti & Co. John, please go ahead.

**John Edward Franzreb**
*Sidoti & Company, LLC*

I guess I'd like to start with the third quarter in and of itself. A couple of things kind of stood out to me. First and foremost, the gross margin was better than my expectations. Can you talk a little bit about what are the puts and takes that's going on in the gross margin profile?

**Kieran M. O'Sullivan**
*Chairman, President & CEO*

Yes, John, just at a high level, and I'll hand over to Ashish. The mix change is the primary driver in terms of our diversification strategy. We've been driving this approach strategically to move in this direction from a capital allocation as well, and you're seeing the results in the gross margin materialize here. So, Ashish?

**Ashish Agrawal**
*VP, CFO & Principal Accounting Officer*

Yes. John, the other things, we talked about foreign currency change, which had a favorable impact of about $1.5 million for the quarter. And then the other thing that's extremely important as part of our culture is driving continuous improvement through our factories, and that contributed across different parts of our business in a meaningful way to the gross margin improvement as well.

**Kieran M. O'Sullivan**
*Chairman, President & CEO*

And John, one other point I would add here, as we go forward, you saw it in my comments as well, the path on diversification is moving in a good direction. We expect it to improve next year. So, we expect to keep this gross margin improvement, maybe not completely at this upper level, but to be improving as we go forward.

**John Edward Franzreb**
*Sidoti & Company, LLC*

The other item that kind of stood out to me was the R&D sequentially dropped and has been dropping all year long. Is there anything unusual going on in reimbursements in the quarter? Or are you just conserving cash?

**Ashish Agrawal**
*VP, CFO & Principal Accounting Officer*

It's primarily related to the timing of customer reimbursements, John. We are continuing to focus on the growth opportunities, obviously, prioritizing the ones that we want to fund, the ones that we don't want to fund. But the gross -- the R&D spend that you're seeing for the quarter, the fluctuation in that is primarily driven by the timing of customer reimbursements.

**John Edward Franzreb**
*Sidoti & Company, LLC*

Okay. Regarding SyQwest, can you talk a little bit about the business' contribution during the quarter, not only on the sales side, but how it's impacted the mix? And was it accretive or dilutive at the end of the day for the quarter?

**Kieran M. O'Sullivan**
*Chairman, President & CEO*

So, John, overall, with SyQwest, with Bob and the team there, the integration is going very well. The sales in the quarter were about $3.6 million. I think Ashish highlighted that in his comments. We said on the last earnings call, we expect it to be in the $10 million to $14 million range for the year, and is still tracking to that. And the team is also doing really well with the next qualifications for countermeasures and undersea sonar applications. So, it really is moving in a good direction. We're very pleased with it. Obviously, we've got a lot of work still to do here, but happy with how it's moving along. And Ashish, on the margin?

**Ashish Agrawal**
*VP, CFO & Principal Accounting Officer*

Yes. So, John, when you look at the gross margin and EBITDA level, the business is definitely accretive to our numbers. With the interest expense burden and everything, EPS is slightly dilutive this year, and we expect accretion at the EPS level in the second half of next year.

**John Edward Franzreb**
*Sidoti & Company, LLC*

Got it. I guess one last question, and I'll get back into queue. Can you talk a little bit, Kieran, about your expectations on the markets in 2025? We're getting to that point where everyone is planning the year ahead. There seems to be a lot of uncertainty. What are your thoughts about the transportation market? What are your customers telling you? It certainly seems that most of your other non-transportation end markets are looking to improve, except you did call out weaker medical. Just some high-level thoughts about what you see, how you see the year ahead playing out?

**Kieran M. O'Sullivan**
*Chairman, President & CEO*

So, John, we'll give a better picture on 2025 in our next quarter update. But just at a macro level, to touch on some of the things you commented, from a diversification perspective, we're doing really well with growth there. Some of those markets like industrial have been down for several quarters, and we saw a 2% improvement in revenue this quarter, and we expect that to continue in the fourth quarter. Medical, you touched on, we said near-term, just in the fourth quarter, we're going to have a little bit of softness. It's an overall growth story, but some of the customers are adjusting their revenue, and we feel very good about that market as well going into next year. Defense, we've got a strong backlog doing well. It will be a positive story as we move forward as well.

And then on the transportation side, hard to tell you much about next year at this stage. We thought this year would have been a little bit different for most people. If you read the industry reports out there, I think people are talking about, in general, about a 1% growth, but we haven't given a guide for next year at this point in time. I would tell you, though, that we're very pleased with the progress on eBrake, electrification, and adding a new customer, which we were -- this customer we wanted to add for the last 3 years, and we feel really good about that. So, more to come.

**Operator**

[Operator Instructions]. And the next question goes to Hendi Susanto of Gabelli Funds.

**Hendi Susanto**
*Gabelli Funds, LLC*

My first question about the transportation market in China. So, the local OEMs are doing really well. And where do you see opportunity with local Chinese OEMs? I'm wondering, let's say, like if certain products are agnostic, I think there are pockets of growth opportunities, including, for example, let's say, peddles with like new emerging players. So, would you share what your puts and takes in terms of opportunities in China transportation market, especially with the local players?

**Kieran M. O'Sullivan**
*Chairman, President & CEO*

Yes, Hendi, we've talked now for probably 2 or 3 quarters in terms of the headwinds we are facing there and our transplant, mostly Japanese customers and some European and North American are facing in that market. We don't think those headwinds are going away. We think that's going to be just a bit of a tough grind, but we're working selectively with OEMs that we believe will be in the long run in the Chinese local OEM sphere. So that's probably the best way how I phrase it, and we've done well with electrification in that area, and we expect that to continue to improve.

**Hendi Susanto**
*Gabelli Funds, LLC*

And then Kieran, I think automotive takes a long time in terms of, let's say, like design win and then the product lifetime, product life cycle. In general, when you work with new OEMs in China, how long may it take?

**Kieran M. O'Sullivan**
*Chairman, President & CEO*

Hendi, traditionally outside of China, it can be anything from 2 years to 3 years depending on the type of product. But I would tell you, we see much faster development periods in the China market. And when it comes to our sensing solutions and electrification, for some electrification solutions, we can be in production after development a period of maybe 18 months or even less. And I think you have to be in that market if you want to compete.

**Hendi Susanto**
*Gabelli Funds, LLC*

And then a question for Ashish. Ashish, I'm wondering, I think I may not catch the SyQwest expected revenue run rate?

**Ashish Agrawal**
*VP, CFO & Principal Accounting Officer*

Yes. So, Hendi, we had talked about for the period in 2024 that they are under our ownership from starting, say, August through the end of the year, a range of $10 million to $14 million.

**Hendi Susanto**
*Gabelli Funds, LLC*

And then do you have any information in terms of the last 12 months revenue run rate?

**Ashish Agrawal**
*VP, CFO & Principal Accounting Officer*

We haven't disclosed that publicly, but extrapolating the period that we have it, Hendi, will give you a pretty decent range. And as Kieran has pointed out, we expect good growth momentum from them as we look ahead into 2025.

**Operator**

We have a follow-up from John Franzreb of Sidoti & Co.

**John Edward Franzreb**
*Sidoti & Company, LLC*

Yes. Just I'm curious about your thoughts about additional M&A and your diversification efforts. Do you think it's time that you're going to take a step back and maybe consolidate the SyQwest purchase? Or are you still going to be aggressive on the M&A front?

**Kieran M. O'Sullivan**
*Chairman, President & CEO*

John, we're going to be disciplined and advance our diversification strategy. We're actively working our pipeline, and we see this as a chance to enhance our diversification in the end markets of industrial, aerospace and defense, and medical. And at the same time, making sure we're investing for growth in our transportation, where we've got some key products that can be nice winners for us in the future, too.

**John Edward Franzreb**
*Sidoti & Company, LLC*

Okay. Fair enough. And can you talk a little bit about your thoughts on debt repayment? How aggressive you're going to be on that front? Do you have any targets on debt leverage ratios you'd like to be at by the end of next year?

**Ashish Agrawal**
*VP, CFO & Principal Accounting Officer*

So, John, the priority on capital allocation, as Kieran mentioned, we are continuing to work the M&A pipeline. We have an elevated level of buybacks as well. From a debt standpoint, we don't feel that we have a lot of debt at this point. It's a modest increase in the debt after the SyQwest acquisition. We'll first focus on those 2 priorities on capital allocation and then look at, obviously, if we have still excess cash, then we'll pay down the debt. But that's not the biggest priority at this point.

**Operator**

We have another question from Hendi Susanto of Gabelli Funds.

**Hendi Susanto**

*Gabelli Funds, LLC*

Ashish, I have one additional question for debt. What kind of interest expense rate that we should model?

**Ashish Agrawal**
*VP, CFO & Principal Accounting Officer*

So, Hendi, some of our debt is hedged already and those details you can see in our public filings. The overall rate that I'm using internally is in the range of 5% to 6%.

**Operator**

We have no further questions. I'll hand back to Kieran for any closing comments.

**Kieran M. O'Sullivan**
*Chairman, President & CEO*

Great, Nadia. Thank you, everybody, for joining us this morning. We will continue to advance our strategy on diversification and electrification to improve the quality of our earnings, and we look forward to updating you in the next quarter. Thank you.

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