S&P Global
Market Intelligence

CTS Corporation NYSE:CTS

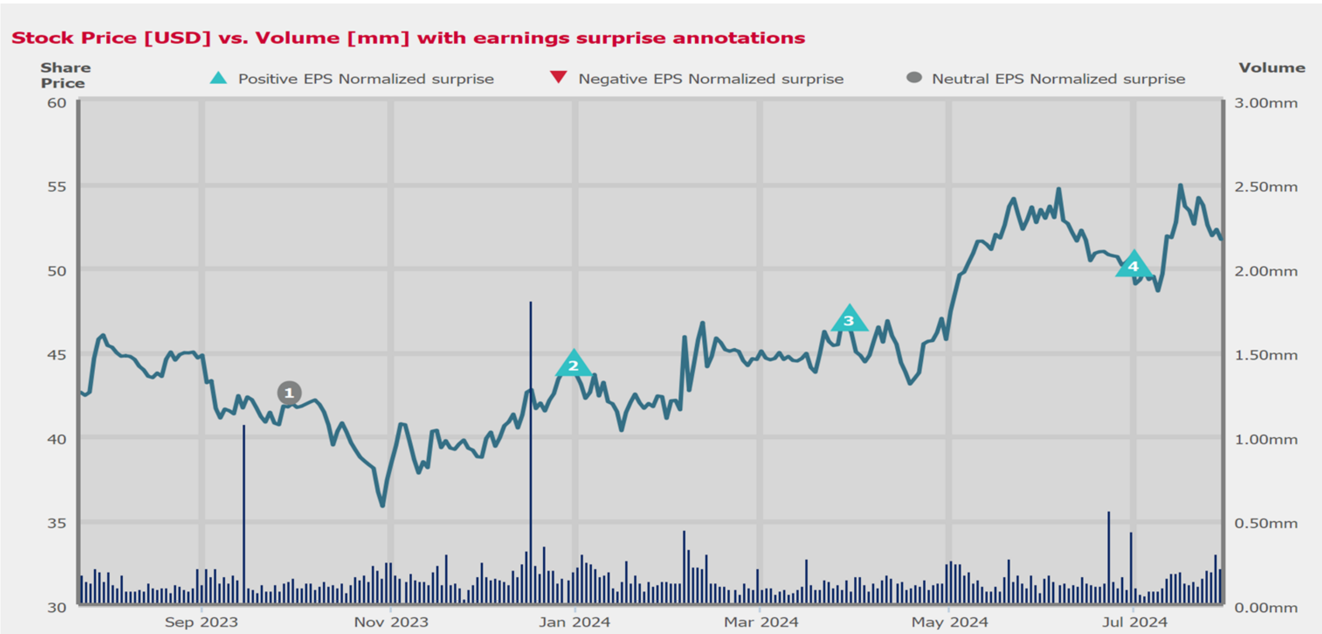
FQ2 2024 Earnings Call Transcripts

Tuesday, July 30, 2024 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2024-			-FQ3 2024-	-FY 2024-	-FY 2025-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.52	0.54	▲1.89	0.62	2.27	NA
Revenue (mm)	133.33	130.16	▼(2.38 %)	143.85	550.72	NA

Currency: USD
Consensus as of Jul-20-2024 12:56 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2023	0.54	0.54	① 0.00 %
FQ4 2023	0.44	0.47	▲② 6.82 %
FQ1 2024	0.41	0.47	▲③ 14.63 %
FQ2 2024	0.52	0.54	▲④ 1.89 %

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Call Participants

EXECUTIVES

Ashish Agrawal
VP & CFO

Kieran M. O'Sullivan
Chairman, President & CEO

ANALYSTS

Hendi Susanto
Gabelli Funds, LLC

John Edward Franzreb
Sidoti & Company, LLC

Joshua Louis Buchalter
TD Cowen, Research Division

Presentation

Operator

Good morning or good afternoon, and welcome to the CTS Corporation Second Quarter 2024 Conference Call. My name is Adam, and I will be your operator today. [Operator Instructions]

I will now hand the floor to CEO, Kieran O'Sullivan, to begin. Sir Kieran, please go ahead when you're ready.

Kieran M. O'Sullivan
Chairman, President & CEO

Thanks, Adam. Good morning, and thank you for joining our second quarter 2024 earnings call. We achieved earnings in line with our expectations despite softness in the transportation end market. CTS is focused on future growth through continued diversification of our customer base and end markets.

Yesterday, we completed the acquisition of SyQwest LLC, a leading designer and manufacturer of sonar and underwater acoustic sensing and electronic solutions, primarily for the U.S. naval defense market. SyQwest's products enable the sonar systems that guide and protect our submarines and surface ships. We extend a warm welcome to Bob Tarini and the SyQwest team, and look forward to leveraging our combined capabilities to drive growth in defense. The acquisition is expected to be accretive in 2025.

Ashish will take us through the safe harbor statement. Ashish?

Ashish Agrawal
VP & CFO

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

Thanks, Ashish.

We finished the second quarter with sales of $130 million, a decline of 10% from the second quarter of 2023. For the quarter, nontransportation sales were up 4%, and transportation sales were down 22% from the same period last year. Sequentially, nontransportation sales were up 11%, sales to the transportation end market were down 3% versus the first quarter of 2024. Nontransportation sales were 51% of overall company revenue in the second quarter.

Our book-to-bill ratio was 0.99 in the second quarter, down from 1.07 in the first quarter of 2024. 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, and was flat sequentially.

Medical bookings were down on a year-over-year basis and up sequentially. Aerospace and defense bookings were up on a year-over-year basis and down sequentially due to the timing of orders. Overall, we continue to monitor the order intake carefully, given the challenging global economic environment.

While we have seen a sequential improvement in nontransportation sales in the second quarter, the growth rate in the second half of 2024 is expected to be more modest than previously communicated. Second quarter adjusted diluted earnings per share of $0.54 were down 10% year-over-year and up 14% sequentially. Ashish will add further color on our financial performance later in today's call.

As I mentioned in my opening comments, we acquired SyQwest, a supplier of robust acoustic sensing solutions for naval surface ships, submarines, autonomous underwater vehicles and torpedoes. The products that SyQwest designs and manufacturers include acoustic payloads, transducers, hydrophones and outboard electronics.

Located in Cranston, Rhode Island, SyQwest brings 60 new team members to CTS. This acquisition strengthens our strategy and scale in the defense end market, further advances our diversification strategy and brings an addressable market of approximately $500 million. Our acquisition of SyQwest is estimated to add $10 million to $14 million in revenue in the balance of this year. I'm delighted to welcome Bob Tarini and his capable team to CTS.

Nontransportation sales continued to improve, increasing 11% sequentially and up 4% in the second quarter compared to the prior year period. In medical markets, sales were up 6% sequentially and 4% from the same period in 2023. We saw mixed signals with some customers performing well and others showing some softness. Bookings in medical were also up sequentially, and we expect continued momentum in the second half.

During the quarter, we had a large win for medical therapeutics, multiple wins for diagnostic ultrasound across all regions and a win for temperature sensing. We added 2 new customers in the quarter, the first, an important win for a new lead-free application and drug delivery and the second, a win for a minimally invasive optical application.

Aerospace and defense sales were up 33% from the prior year period and up 41% sequentially. We expect good momentum for the rest of 2024, given the backlog of orders. We received multiple orders for hydrophones, sonar buoys, underwater unmanned applications and RF filters. We continue to gain traction on European defense growth, securing an order for a new submarine program. We expect the long-term prospects for the aerospace and defense end market to be solid, given our material formulations and the enhanced capabilities with the addition of SyQwest.

In the industrial market, overall sales were up 4% sequentially as we continue to see a gradual recovery in distribution as well as with OEM sales. Sales were down 6% from the prior year period. Bookings were up year-over-year and flat sequentially, which is causing us to temper our growth expectations in the second half of 2024. We were successful with several wins in the quarter for industrial printing, EMC components, temperature sensing, flow metering, RF filters and commercial appliances. We added one new customer in the quarter in test and measurement.

While we saw a small sequential improvement in distribution sales and bookings, inventories continue to return to more normal levels, and distributor POS remains soft. Looking ahead for the year in nontransportation end markets, we expect an improvement in industrial and distribution end market revenue in the second half of 2024, but now expect more modest levels of growth.

For medical markets, while we anticipate some softness with a few customers, we expect to continue growing in the second half. We also expect to make solid progress on the qualification of products for prospective new customers. Sales to the defense customers are expected to remain solid.

Longer term, we expect our material formulations and in-house know-how to continue to support our growth in key high-quality end markets in line with our diversification strategy. Additionally, we anticipate the megatrends of automation, connectivity and efficiency as well as growth in minimally invasive medical procedures will provide us momentum as we continue expansion in these markets.

Transportation sales were $64.2 million in the second quarter, down approximately 22% from the same period last year and down 3% sequentially. We continue to experience a softer demand environment for commercial vehicle products in 2024.

On the light vehicle front, as I mentioned earlier, we continue to navigate the market share dynamics in China, given the competition between local and transplant OEMs. Additionally, we see demand for light vehicles continuing to soften, consistent with most market analysts 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 second quarter, we had wins across various product groups, including accelerator modules with OEMs in North America, Europe and China. We had a sensor win in North America for a chassis ride height application. Across vehicle electrification, we had multiple wins for passive safety applications and a win for current sensing in an off-road application with an existing customer.

We continue to see OEMs delay sourcing decisions as they work to correct their powertrain mix given market changes. Our focus on adding new customers is progressing, and we expect further traction later this year. Interest in the eBrake product, offering weight and cost advantages, continues across several OEMs. We expect the eBrake and other sensor applications will increase our ability to grow content with a potential SAM of greater than $1 billion. Total booked business was approximately $1.1 billion at the end of the quarter.

Turning to our outlook for this year. The North American light vehicle market is expected to be in the 15.5 million to 16 million unit range, with on-hand days of supply now back to more normal levels. European production is forecasted in the 17 million unit range, and showing some softness. China volumes are expected to be in the 28 million unit range. Electric vehicle penetration rates have softened in some regions, while hybrid adoption continues to improve. Overall, we anticipate a down market for light vehicle production due to the China market dynamics and other more recent regional build reductions. We expect softness in commercial vehicle related revenue throughout 2024.

For nontransportation markets, in line with our diversification strategy, we aim to expand the customer base and range of applications in the industrial, medical and aerospace and defense end markets. The green shoots we mentioned last quarter in the form of inventory-level corrections and improved bookings continue, but we anticipate a softer rate of recovery than we previously expected. Demand in the defense market is expected to remain solid, and we expect continued growth in medical. With industrial OEMs and distribution, we expect a more modest revenue improvement in the near term as inventory levels normalize and POS improves.

In terms of guidance for full year 2024, we expect a more moderate growth rate in the second half, and are adjusting our prior guidance. We now anticipate sales in the range of $525 million to $540 million, and adjusted diluted earnings per share in the range of $2.05 to $2.25, included the expected impact from the SyQwest acquisition.

Now I'll turn it over to Ashish, who will walk us through the financial results in more detail. Ashish?

Ashish Agrawal
VP & CFO

Thank you, Kieran.

Second quarter sales were $130 million. While sales were down 10% compared to the second quarter of 2023, we continue to see a modest recovery, with sales up 4% sequentially. As Kieran mentioned, we are seeing softness in transportation end market sales. Nontransportation sales improved year-over-year as well as sequentially. Foreign currency changes impacted revenue unfavorably by approximately $0.5 million.

Adjusted gross margin in the second quarter was 35.8%, an improvement of 80 basis points from the second quarter of last year despite the drop in revenue. Our teams globally continue to focus on plant efficiency and cost improvements. Sequentially, adjusted gross margin was down 45 basis points, mainly due to some onetime charges. We are still experiencing some cost pressures, especially for certain materials and from labor cost increases.

We expect pricing pressure this year, particularly in the transportation markets. We already see pressures in the China transportation market. We remain confident in our ability to drive efficiencies in our supply chain and manufacturing sites to improve our operational performance and profitability. The consolidation of the Juarez facility into our Matamoros site in Mexico has been completed, and the focus now is to improve operating efficiency.

During the second quarter of 2024, we benefited from some discrete tax-related items, and as a result, had a tax rate of 17.6%. For 2024, overall, we expect our tax rate to be in the range of 18% to 21%.

Earnings per diluted share were $0.48 in the second quarter. Adjusted earnings for the second quarter were $0.54 per diluted share compared to $0.59 per diluted share for the second quarter of last year.

Moving to cash generation and the balance sheet. We generated $20 million in operating cash flow in the second quarter of 2024 compared to $23 million in the second quarter of 2023. Our cash balance was $161 million as of June 30, 2024, and the long-term debt balance was $65 million. The SyQwest acquisition was funded with approximately $80 million in cash, and the rest with borrowings from our existing credit facility.

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 228,000 shares of CTS stock, totaling approximately $11 million. Year-to-date, we have returned $26 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] Our first question comes from Joshua Buchalter from TD Cowen.

Joshua Louis Buchalter
TD Cowen, Research Division

I guess for my first -- any more details you can give us on expectations for transport into the back half of the year? I know it sounds like you're expecting directionally down, but I'd be curious if you can maybe quantify that a bit more, in particular, so we can get a picture into what your expectations are for the nontransport growth that's going to offset that?

Kieran M. O'Sullivan
Chairman, President & CEO

Yes, Josh, I think there's 2 parts to it. On the commercial vehicle side, we've seen a decrease in revenue there. We talked about the competition in that market. So for the quarter, I think sales were down approximately about $10 million on a run rate basis. And we expect -- that's going to be a challenging market because the analysts and the reports out there are seeing softening in the commercial vehicle market for the balance of 2024 and more flat market in 2025.

On the light vehicle side, it's -- we feel good about North America. We feel reasonable about Europe. China remains a challenge, and that's where we're really navigating as carefully as we can to make improvements, but that's probably how I describe it overall.

Joshua Louis Buchalter
TD Cowen, Research Division

Okay. I guess the follow-up on that, if I put in some modest assumptions for transport down sequentially in the back half, you've got sort of the industrial and other markets growing probably double digit half over half in the second half of 2024. I guess how much of that is like -- [indiscernible] is coming back to normal versus actual demand improvement? Maybe you could help us on the visibility of what's driving the second half improvement?

Kieran M. O'Sullivan
Chairman, President & CEO

Yes, Josh, probably the best way I'd describe the second half is again, challenging on transportation and then more modest growth rates in the nontransportation area. So if we're looking from an organic perspective, from where we finished in the second quarter of a few million in terms of growth rate by quarter.

Joshua Louis Buchalter
TD Cowen, Research Division

Okay. Great. I'll squeeze one more in. On gross margins, Ashish, you called out some onetime cost headwinds in the second quarter, but also pricing pressure. I mean if I zoom out, you're still at 36% gross margin on some modest growth this year or be actually more of a flattish here. It seems like pricing is hanging in okay. Is that sort of the right read? I know you called out some pricing pressure. And how should we think about gross margins in the second half of the year as that onetime cost headwind abate?

Ashish Agrawal
VP & CFO

So Josh, I think your read on pricing is accurate. We are managing through it right now, but we expect the pressures to continue. And our teams are staying focused on managing it appropriately to make sure that we maintain good long-term relations with our customer base, but also navigate through winning business with them and preserving price as much as possible. So that equation is working okay. As I mentioned, there's a little bit more pressure in China than other regions, but the teams are overall managing okay.

In the second half in terms of the gross margin, we do expect some improvements mainly because of the change in mix of the business, and we expect to continue driving improvements in our factory efficiency levels as we work through the completion of the Matamoros and Juarez transition and other improvements that we are driving through the nontransportation plants as well. So expect modest improvements in profitability in the second half of the year.

Operator

The next question comes from John Franzreb from Sidoti.

John Edward Franzreb
Sidoti & Company, LLC

I'd like to start with the SyQwest acquisition. Could you tell us a little bit about maybe its recent growth profile and its margin profile before you acquired it?

Kieran M. O'Sullivan
Chairman, President & CEO

Yes, John. We're really happy to have Bob Tarini and the team join CTS. SyQwest has one or more products installed in every U.S. surface combatant ship or submarine. And the growth rate is quite robust. We really like it, and the gross margin profile would be above the average for the company.

John Edward Franzreb
Sidoti & Company, LLC

Okay. And can you share with us the EBITDA multiple you acquired the company [at]?

Ashish Agrawal
VP & CFO

John, we don't specifically call that out. But when you look at the growth rate of the business, the profitability, the EBITDA multiples make sense to us. And you know we normally don't like to overpay for businesses, so let me leave it at that. But I think we have -- internally, we are very pleased with the acquisition. We look to the growth momentum that the business has and the profitability that the business brings to us as well.

Kieran M. O'Sullivan
Chairman, President & CEO

John, just to add to that, it's -- the products, just like CTS', are highly engineered. It integrates us from components into sensors and systems and transducers, a very capable team, high-quality business, and we really like the momentum they have and we have in the defense markets and how it's going to really advance our diversification, which is a key part of what we're doing as a company as well. So we feel very good about it and the team and capability.

John Edward Franzreb
Sidoti & Company, LLC

Okay. I'll just keep on sticking to SyQwest here. Are they exposed or overexposed to the Virginia, Columbia class or any particular surface platform? Do you have any -- can you share a sense of what they sell into -- what platforms they sell into?

Kieran M. O'Sullivan
Chairman, President & CEO

John, as I mentioned, they're on every combatant ship and submarine. So Ohio, Virginia, there's several of them in there. And obviously, there's products that are being renewed there. One of the things we see is that the Navy, at this point in time, is at a critical point in terms of modernizing their fleet and their combat readiness as well. So we feel good about the slots they're in and the sockets they have.

John Edward Franzreb
Sidoti & Company, LLC

Okay. And can you take the sense of products and move them to adjacent applications? Or are they protected under military restrictions?

Kieran M. O'Sullivan
Chairman, President & CEO

John, primarily, the growth focus with us here will be in defense. And we talked about the U.S. Navy. But obviously, with the cooperation the U.S. has with other countries internationally, there are opportunities there as well.

John Edward Franzreb
Sidoti & Company, LLC

Got it. Okay. Okay. That's it for SyQwest then. All right. Moving on to the legacy business. In the industrial side of the market, you talked about slowing. But you didn't -- I didn't hear you call out what parts of the or subsets of the industrial market is slowing. If you did, I apologize, but can you talk about that a little bit?

Kieran M. O'Sullivan
Chairman, President & CEO

Yes, John. I mean, sequentially, the business was up 4%, so we see some improvement there. But first of all, I think on industrial printing, and if you look at the building industry at the moment with HVAC and temperature things, things are like flatlining a little bit there in those markets because demand is not up. So that's how I'd best describe it. And with distribution, we've seen some marginal improvement, and we feel like it will improve, but not at the rate we were expecting. So it's a pretty mixed bucket there.

John Edward Franzreb
Sidoti & Company, LLC

Got it. Got it. And does that change any thoughts about your cash flow generation for the second half of the year relative to the first half with the slowing end markets?

Ashish Agrawal
VP & CFO

So John, generally, our cash flow generation is stronger in the second half of the year than in the first. At a high level, I would expect that trend to continue, but the expectations of the amount of cash we would generate would moderate based on the reduction in the sales expectation.

Operator

The next question comes from Hendi Susanto from Gabelli Funds.

Hendi Susanto
Gabelli Funds, LLC

Kieran and Ashish, my first question is about SyQwest. Would you be able to indicate whether the transaction will be accretive, neutral or dilutive to EPS?

Kieran M. O'Sullivan
Chairman, President & CEO

Yes, it will be accretive in 2025, Hendi.

Ashish Agrawal
VP & CFO

Hendi, we expect a small unfavorable impact in 2024 in the range of $0.04 to $0.05. But then as Kieran mentioned, in 2025, we are expecting it to be accretive.

Hendi Susanto
Gabelli Funds, LLC

Okay. And then any indication on how much it will increase your OpEx, Ashish?

Ashish Agrawal
VP & CFO

Let us work through that, Hendi. It's a private business that was run differently than we would be looking to do the accounting and all that. So what is gross margin, what is operating expenses will take us a little bit of time to get all that sorted out. So I expect to have more clarity in the coming months.

Hendi Susanto
Gabelli Funds, LLC

Yes. And then Kieran, I have a question on, let's say, like more modest expectation for the second half. Does that imply that things that you have pointed in terms of softness, the softness will last through the end of the year or whether certain things may see recovery sometime in the fourth quarter?

Kieran M. O'Sullivan
Chairman, President & CEO

Hendi, so in nontransportation, we feel very good about defense. We feel good about medical. But the tone we're setting here is on the industrial side, it's a more modest growth rate than we had expected earlier in the year. So we'll see some growth, but at a much more modest level.

Hendi Susanto
Gabelli Funds, LLC

And then any color on, let's say, your expectation between third quarter and fourth quarter as of now? I know that fourth quarter is still months away.

Kieran M. O'Sullivan
Chairman, President & CEO

Yes. I think, Hendi, if you take the profile where we're coming for with the $130 million in the -- on an organic basis, the $130 million in the second quarter, I think you'll see a small few million improvement in the third and fourth quarter directionally is how I put it.

Hendi Susanto
Gabelli Funds, LLC

Okay. Got it. And then with regard to China, is your expectation -- when you said like challenging, like will it be challenging like throughout the year, meaning that any type of improvement, we should be more patient and then expect that to be more in 2025?

Kieran M. O'Sullivan
Chairman, President & CEO

I think, Hendi, it's going to remain challenging throughout the rest of this year. I've read recently, and you probably saw it too, that the Chinese government has added new incentives going from, I think, it was RMB 7,000 to RMB 15,000 for light vehicles under 2 liters. So that will provide some incentive and help for some of the transplant OEMs, but we think it will just kind of level out the softness there rather than giving us gains.

Hendi Susanto
Gabelli Funds, LLC

I see. Okay. And then last question for me, Kieran. Post-SyQwest acquisition, are you still actively looking for potential acquisitions? Or should we expect that you will focus on integrating this business? And then, therefore, you would be less active on your M&A pipeline?

Kieran M. O'Sullivan
Chairman, President & CEO

So Hendi, 2 parts to that question. Number one, we're really delighted with the SyQwest acquisition, the way it increases our diversification, quality of earnings and the strength it gives us in the defense market. And this team is a very entrepreneurial team. We want to make sure we don't lose that as part of how we integrate together. So Bob Tarini and the team have got excellent momentum there. And on the flip side, we're also active in working our pipeline going forward. We've got a good balance sheet, so we want to make sure we're using it appropriately.

Operator

[Operator Instructions] We have a follow-up from John Franzreb from Sidoti.

John Edward Franzreb
Sidoti & Company, LLC

Yes. Just a follow-up on Hendi's question about the dilution in SyQwest. I think you said $0.04 to $0.05 is the expectation in the second half of the year, but accretive in 2025. So can we assume it recaptures that $0.04 to $0.05 or should we be thinking above that the dilution number for next year?

Ashish Agrawal
VP & CFO

So John, it will be in addition to that $0.04 to $0.05 loss that we are expecting in 2024.

Operator

[Operator Instructions] Because we don't have any further questions, I'll hand the call back to the management team for any concluding remarks.

Kieran M. O'Sullivan
Chairman, President & CEO

Thanks, Adam, and thank you all for your time. At CTS, we remain focused on future growth, driven by the megatrends of increased automation, connectivity, energy efficiency and minimally invasive medical innovation. The continued expansion of our customers and pipeline of opportunities underscore our confidence in our future. We're delighted to add the SyQwest team to CTS, and excited about our future growth potential in defense applications.

Thank you for joining us today. This concludes our call.

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