CPS Technologies Corporation

May 2, 2024

9:00am ET

Operator

Good morning, everyone and welcome to the CPS Technologies' First Quarter Earnings Call. At this time, all participants have been placed on a listen-only mode and we will open the floor for questions after the presentation.

It is now my pleasure to turn the floor over to your host, Chuck Griffith of CPS Technologies. Chuck, over to you.

Chuck Griffith

Thank you, Jenny, and good morning, everyone. Today, I'm joined by Brian Mackey, our President and CEO. We look forward to discussing our first quarter results with you.

But first, Chris Witty, our Investor Relations Advisor will provide a brief safe harbor statement. Chris?

Chris Witty

Thanks, Chuck, and good morning everyone. Before we begin the business portion of today's call, I would like to point out that statements in this conference call that are not strictly historical are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and should be considered as subject to the many uncertainties that exist in CPS' operations and environment.

These uncertainties include, but are not limited to, the wars in Ukraine and Israel, other geopolitical events, economic conditions, market demands and competitive factors. Such factors could cause actual results to differ materially from those in any forward-looking statements. Additional information can be found in our filings with the SEC.

Now I'll turn the call over to Brian to offer his perspective on the first quarter highlights. Afterwards, Chuck will review the financial results in greater detail. Brian?

Brian Mackey

Thank you, Chris. First quarter revenue was $5.9 million with an operating loss of approximately $260,000. Revenue declined year-over-year due to production constraints related to continued quality control testing as well as production inefficiencies due to labor shortages and turnover. Bottom line

results were similarly negatively impacted due to nonrevenue-producing spend in the first quarter, which I will discuss in more detail later.

We anticipate that while demand remains strong across our product portfolio, the coming quarters, as we've discussed in the past, will also face headwinds from the anticipated drop-off in near-term Armor revenue.

I'll now turn the call over to Chuck to provide more details about our financial results, after which I'll provide some additional detail. Chuck?

Chuck Griffith

Thanks, Brian. As mentioned earlier, the company's revenue totaled $5.9 million in the first quarter compared with $7.1 million last year. We've had some level of difficulty filling opening manufacturing positions. Additionally, while we are cautiously optimistic that our quality issues have been resolved, we continue to run tests which occupy machine time that would otherwise been spent on production for customers.

We do however believe that strong demand across our other offerings should lead to top line growth as the year progresses. In addition, our Navy partner Kinetic Protection remains cautiously optimistic about additional work for other Navy ship classes with contracts possible later than 2024. Gross profit in the first quarter totaled $0.9 million or approximately 15.3% of sales compared with $2.2 million or 31.6% of sales last year.

This decrease was due to the lower sales volumes in Q1 2024 on consistent fixed costs as well as the aforementioned testing being done on the quality issues. That said, we anticipate gross margins to improve in the second half of 2024. Selling, general and administrative or SG&A expenses totaled $1.2 million in the first quarter versus $1.6 million in the prior year period as we remain focused on cost controls, even while investing in new business development initiatives aimed to accelerate long-term growth.

The company had an operating loss of $260,000 in the first quarter compared with operating income of approximately $694,000 last year, and we posted a net loss of $143,000 or $0.01 per share versus net income of $459,000 or $0.03 per diluted share in Q1 of fiscal 2023.

Turning to the balance sheet. We ended the quarter with $8.7 million of cash versus $8.8 million at the start of 2024. Trade accounts receivable as of March 30, 2024 totaled $3.8 million versus $4.4 million as of December 31, 2023. Inventories totaled $4.6 million at the end of the first quarter, essentially equivalent with the $4.6 million at the end of the fiscal year.

Turning to the liability side, payables and accruals totaled $3.3 million at the end of the first quarter versus $3.6 million as of the end of December.

Now Brian will provide a more in-depth discussion of the first quarter.

Brian Mackey

Thank you, Chuck. First of all, I would like to discuss CPS vision for the future. Over the last few years, we've invested significant amounts of time, energy and dollars to the growth of CPS, and we continue to do so. Today, we have three more salaried engineers and material scientists than we did in Q1 of 2023, including the addition of a lead for new product introduction in the first quarter of 2024. These additions provide more depth to our technical team, enable us to be more responsive to customer requests and improve our ability to win orders. Having said that, the financial return from these new personnel will take time to develop.

As a direct example, in the first quarter, we completed and shipped eight new first articles. This eight compares to two in the same period last year. These first articles are new parts, which CPS has not made in the past, but if done successfully will lead to significant production runs in the future. Some of these would be an expansion of our portfolio with an existing customer, while others indicate a business opportunity with a new customer. Producing these first articles is engineering-intensive, and this was certainly one factor in the lower margins we saw in Q1.

Nevertheless, we believe that in current costs, such as these today will be a significant contributing factor to the growth of CPS in the future. Also, our manufacturing licensing agreement with Triton Systems for fiber reinforced aluminum composites or FRA, will soon set the stage for expanded offerings to address market needs, expanding our product portfolio heading into fiscal 2025.

Our relationships in the aerospace and defense markets provide insight into the market demand for strong, durable and lightweight materials. FRA composites address these needs. As a reminder, FRA composites are comprised of high-strength aluminum alloys discontinuously reinforced with short ceramic fibers. These materials have demonstrated high strength at elevated temperatures, lightweight and superior endorse characteristics, which will facilitate the introduction of many new products for our military, commercial and industrial end markets.

We are on track to initiate our manufacturing trials for FRA composites later this quarter, and we have already begun speaking with customers about possible relevant applications. We're very excited to have these complementary products coming to market. We also previously announced the award we recently received from the Massachusetts Manufacturing Accelerate Program. In response to customer demand for products requiring 5-axis machine capability, we requested and received $200,000 to support the purchase of a 5-axis CNC machine.

These funds expand our manufacturing capabilities and enable us to be more responsive to customer requirements. We have ordered the CNC machine and also expect to have this up and running later this quarter. Again, this will pave the way for higher production of hermetic packaging and other products later this year. In addition, while our current Armor contract is coming to completion, we are cautiously optimistic that working with Kinetic Protection, new Navy orders may be forthcoming later in 2024. We continue to believe these ballistic solutions have a large potential market across different types of ship classes as well as other military markets.

We also continue to work with another customer on providing ballistic protection against higher threat levels. At the same time, we know that further SBIR opportunities, including follow-on contracts, are possible in the weeks and months to come. At the moment, we have six submitted proposals awaiting funding decisions from the DOE, DOD and NASA including four Phase 1s and two Phase 2s.

These ongoing R&D efforts are enabling us to directly address clearly defined market requirements. I'd like to share some details from our most recently completed SBIR program, which effectively demonstrates our ability to address problems identified by our customers, in this case, the Department of Energy.

CPS was initially funded $200,000 by the DOE in response to our proposal entitled *Modular Radiation Shielding for Transportation and Use of Microreactors*. The problem statement focused on the ability to produce lightweight and low complexity radiation shielding that would be of paramount importance to the deployment of advanced nuclear microreactors. Lower shielding density promotes higher power density during transit for power, remote or mobile applications, including mining operations, disaster relief efforts, shipping and defense.

During the nine-month Phase 1 period, which ended just last week, CPS successfully incorporated its proprietary techniques related to both injection molding and metal matrix composites or MMCs. We designed, fabricated and evaluated a novel MMC consisting of an aluminum matrix with both tungsten and boron-carbide reinforcement particles.

The resulting composite offers both neutron and gamma radiation shielding in an elegant compact solution as opposed to relying on multiple layers of dissimilar materials. Although further optimization is necessary, our baseline composite material demonstrated the capacity for neutron shielding and was highly effective at shielding gamma radiation at much lower mass compared to traditional materials.

In fact, as a barrier to gamma radiation, our composite demonstrated performance similar to lead or tungsten, but with a reduction in mass of more than 55%. Our MMC design to be easily modified to suit different protection needs with variable volumes of both gamma and neutron absorbers. Our proposed solution will greatly reduce the massive material needed while being highly customizable in size, shape and composition.

The novel CPS process improves upon existing research to fabricate integrated radiation fields by achieving greater reinforcement loading with a robust, cost-effective and mature processing technology. It's a great accomplishment, especially for just a Phase 1 program. Our technical team was invited to present its results just last week at the National Reactor Innovation Center Program Review at Idaho National Laboratory. We're now following up on several leads which developed from that event. The feedback that our presentation received also highlighted the value of our approach for stationary applications, i.e., building construction due to the dramatically reduced weight requirements.

We are also awaiting DOE's response to our Phase 2 proposal, which if awarded would provide an additional $1.1 million in funding over a 24-month period. It should come as no surprise, we're very

pleased with the results of this to date, which has already generated meaningful dialog related to near-term opportunities for fielding our solution. DOD initiatives like Project Pele, which is working to demonstrate a mobile nuclear reactor for U.S. military applications, again demonstrate the potential dual uses for our novel material solutions.

Although we do not control the timing of when our proprietary offerings will enter the market, we continue to build our portfolio and service to our customers. Within the last few years, CPS has redoubled efforts to expand its products to meet new technology-based requirements. One key element of this has been our participation in the SBIR programs of various federal agencies.

Within the past three years, five of our 14 Phase 1 proposals have been selected for award. Historically, the government's rate of funding Phase 1 proposals for all applicants has been about 20%, and this has been even more competitive in recent years, perhaps down to 15%. So we're very pleased with our award rate so far, which is over 35%.

This speaks volumes as to the capabilities of our team and our existing intellectual property. But more importantly, we see these awards as the affirmation that we are addressing the problem statements of our customers as they define them within the context of the SBIR format. We know that providing such technical solutions will provide real growth opportunities going forward, many of which have potential applications with both commercial and military customers.

In the meantime, we continue to fulfill the long-term supply agreement announced last year, providing power module components and systems for a variety of rail and other applications to a multinational semiconductor manufacturer. We remain on track for the shipment of product under this contract over the course of 2024.

As I said earlier, we are actively bidding on opportunities to accelerate growth in the future, while mitigating the negative impact this year due to the completion of our current Naval Armor contract. We continue to believe that expansion across other product lines should cover roughly half of the $2 million quarterly revenue shortfall in 2024 related to Armor, setting the stage for growth next year and beyond.

We'd now like to open the call up for questions. Operator?

Operator

Thank you very much. We are now opening the floor for questions. [Operator Instructions]. Your first question is coming from Wolf Scheck. Wolf, your line is live.

Q: Thank you. Good morning gentlemen. Thanks for having the presentation here, and I speak your claims this way. Based on your presentation this morning, it sounds like you have a lot going for the company. What do you think will be the first product that you should be able to unleash, what kind of revenues do you think you'd be able to generate from in this current year?

Brian Mackey

Well, I think probably the most straightforward is the 5-axis particularly for hermetic packaging because that's been a request of customers over a period of time that we've been producing hermetic package products to begin with. So in the past, we've been not cost competitive on those because we don't have that 5-axis capability in-house.

So that's a low-risk, near-term execution opportunity once we have that machining capability in-house, we'll be able to offer those products at a cost competitive pricing. Now that will be first articles, and there'll be customer engagement of that, that will then turn around further down the calendar into volume orders. But that's the most direct answer to your questions.

Other things like the fiber reinforced aluminum, we're setting up manufacturing this quarter to begin trials and then we'll be replicating the performance results that are known to be attributed to FRA materials. And from there, we'll be working with these customers on playing that forward, and that will also have a timeline to it where we validate the performance characteristics against standardized testing criteria for various material performance properties. And then translating that into products for a given application starting in probably the nearest on the timeline with those aerial applications, whether it's bearing liners for rotary aircraft and similar applications.

Q: What companies do you think would be the most interesting to these products, you have any feeling for that type of distribution?

Brian Mackey

Well, on the hermetic packaging, we certainly -- it's customers that we're currently servicing today are the nearest opportunity. They're very familiar with us. We're familiar with them. We know which products are interested in getting quotes on with components that include 5-axis machining. To come back to the FRA, it's the OEMs out there that you could list that are in the business of aerial vehicles, whether it's helicopters or even drones and related aircraft like that, where lightweight, but high strength and durability have value.

Q: Okay. One last thing based on the comments on the conversation, it seems as though maybe you should put out some type of material to the street, so I can fully understand what the company is all about and what the potential is not going excessively, but going within about proper constraints by making people aware of the potential.

Brian Mackey

Right. Yes, that makes sense.

Q: Okay. Thank you.

Brian Mackey

Thanks and welcome.

Operator

Thanks very much. [Operator Instructions]. And our next question is coming from Stephen Fossey. Steven Fuse your line is live.

Q: Thank you. Good morning. So I'm wondering if you could provide a little bit more information or color, whatever you want to call it, about the labor situation. Do you see that as kind of a temporary situation, more of a long-term availability problem that might translate into higher costs?

Chuck Griffith

Sure, Steve. So actually, I think this was -- it was more of a temporary during Q1 problem. We believe that we are now currently fully staffed for purposes of our business that we're going to be -- our production that's going to be going on in Q2, the second half of Q2 and Q3 and on.

So I think that was more temporary. If we get to the point where we have to add a whole bunch of people that might rear its head again. But I think for now, we were just talking about it the other day that we're probably fully staffed or we are fully staffed, and we should be in much better shape going forward.

Q: Okay. Great. Thanks. And if I could ask one more quick question. On the shielding work, you've highlighted it, so you're obviously kind of excited about that. How does that compare in a -- obviously, it's just a Phase 1, but in terms of cost versus current solutions, I mean, do you save cost in the assembled system versus multilayer system? Or is it more of a -- this is a great elegant solution for applications that are more narrow driven by weight? Thanks.

Brian Mackey

Yes. The first application, which we initially responded to was for the mobility of these micro reactors. So you're trying to transit these things to places where either the military might have a setup or there might be disaster relief going on and that kind of thing.

And obviously, the more weight that you have in the protection aspect of that truck, the less weight availability you have for the actual reactor itself. So you're able to increase the power density of the product that's being carried, which has a very real benefit for the user, the customer.

And as we mentioned, would quickly became very apparent was even for non-mobile applications, the construction costs related to massive amounts of concrete have a very real cost factor to the structure of that building, the concrete pad that is built upon and those other things in the crane that's used to move pieces around. So being able to make a less dense, more adaptable piece of material that's uniform, so you can attach to it, you can modify it to suit the shape and the needs of that construction is also more valuable.

Now concrete is not particularly expensive, but when you go to a tremendous amount of it, and it's limiting your ability to build the structure that you want and move things in and out of it for testing and things like that. Those are some of the conversations that we're already having. And we don't have details about that cost comparison, but we can tell from the reaction we've had to it that it's intriguing to the users. So those are the things that we're going to continue to explore further.

Q: Great. Thanks. And if you can indulge me in just one more.

Chuck Griffith

Of course.

Q: The deal with Triton is, how much of that is an application hole versus a technology push? Is it a case of here's an application. We know we can do it. Does the market versus this is a cool thing which expands on our capabilities and as possible markets?

Brian Mackey

The appeal of FRA to the market is fairly obvious. And one of the benefits of where we stand today is that the properties of the material were well evaluated and tested by the Triton team. So the appeal of those, the material performance is known to the market and is of interest.

And what we're able now to do is indicate that we're a reliable, dependable element of their supply chain. If you're a helicopter OEM and you're interested in that material because of its performance benefits, you're not going to take it on, unless you're sure that that supplier is going to be around for a long time. So we're able to do that and address these market requirements by offering this material that is already of interest to them, because they need lightweight, they need durability, and that's what this material provides.

So it's driven by what these aerial applications, first of all require, but we also expect there will be other applications as well as we play this forward.

Q: Okay. Great. Thanks. Appreciate that. That's all.

Operator

Thank you very much. Your next question is coming from Davis Marcie. Davis your line is live.

Q: Hey good morning guys, thanks for the call.

The question, historically, you've had a 40-40-20 split between departments. Do you see that remaining consistent? And which kind of product lines are you seeing the most demand for going forward in growth capacity?

Chuck Griffith

Yes. So I think, obviously, for the short term with the completion of the Kinetic Protection Armor order for the aircraft carriers, that 20 piece is going to make it more like 50-50 with the other two division or maybe 48-48 but whatever with the others. But I think that we do have -- we're very optimistic that there will be something more coming down the Armor pipe either with Kinetic protection or as we continue to work on other armor applications with other possible customers.

But I think in terms of the rest of it, I think hermetic packaging certainly has the opportunity for more growth. It's a bigger market. And we have -- as Brian mentioned earlier, we have -- I think seven of the eight FAIs come in the or first articles that we did in the first quarter come from the hermetic packaging side of the business. So that certainly has the potential for more near-term growth.

I think the other aspects are probably more in the long-term more than long-term area in terms of growth the FRA. The shielding those certainly, the FRA, we may see some small, small amount of revenue before the end of the year, but it's really not going to be material until we get into '25, '26 that kind of thing.

Brian Mackey

Yes. And the armor opportunity is ahead of us, we could quickly bring that back to the historic ratios. So as we wrap up this order, we have ongoing conversations in that direction. Unfortunately, it's lumpy, and we have this current situation, but very real opportunities that could bring that ratio back to the original number that you mentioned in that range, plus or minus.

Q: Got it. And then what kind of capital requirements you're expecting for this year? And do you expect to reach profitability for the full-year 2024?

Chuck Griffith

So I think in terms of the capital requirements, we're in good shape with that. We -- the 5-axis machine, basically, that money has already been allocated. As you can see from our balance sheet, we're in very good shape from a cash standpoint. So even if God willing -- somebody came and said, "Hey, we need you to start making FRA for us at a really high volume, and we needed to go out and buy a new infiltrator for $1 million," that wouldn't be a stumbling block. We could easily handle that. But I think in terms of just generally speaking, we're in good shape on the capital requirement side. We're able to get what we need to get when we get it, and that's not a problem.

Regarding your second question about profitability, that's a good question. At this point in time, I'm not sure. We certainly are expecting, we projected profitability over the last three quarters in total. And that's -- but it's not going to be like two years ago where we had $2 million of profit at the end of the year. It's going to be much more narrow. And certainly, if things go poorly, it could shift to the other side

and could be nonprofitable year, but we're hoping that we can get profitable for the last three quarters anyway. But it will be tight.

Q: Great. Thank you.

Chuck Griffith

Okay.

Operator

Thank you very much. And your next question is coming from Greg Weaver. Greg, your line is live.

Q: Hi, good morning, Brian, Chuck. Just a quick question. So the 5-axis tool, the press release has it as an award. So you -- that money was an award, not a loan, right?

Chuck Griffith

Correct. And we're -- so basically they're covering -- we have to cover what they're awarding us. So basically, we're talking about a $400,000 piece of equipment, including installation blah, blah blah. And we got half of it.

Brian Mackey

Yes. It's a dollar-per-dollar match requirement. So we are receiving the $200,000 from Massachusetts with the commitment to spend that much. A portion of that is on labor and other things. So in aggregate, it's a $400,000 spend, but it's not a loan. It's not -- there's no obligation to return it or anything like that. It's putting it to good use to add jobs to the manufacturing community of Massachusetts.

Q: Okay. Great. That's great. And on the testing constraints you referenced, right, you're trying to make sure the parts are good before you ship them out. Is that a temporary situation? Or is that an ongoing thing now just in line just to be sure? And are you buying more equipment to help use the bottleneck there? It sounds like it's a bottleneck.

Chuck Griffith

Yes. So it is a temporary situation. We basically what it's requiring is that some of our production equipment is going to make, in this case, base plates for further testing. So instead of making them and selling for the customer, we're making them and then we're testing them. And we -- during the initial part of the problem where we're trying to find the solutions, we would do like 50 pieces at a time. In the first quarter, we made a decision, we've got to start getting -- we think we know where we're going. Now we need to start getting statistically significant runs.

So instead of 50 pieces, we're looking at 500 pieces and 500 more and 500 more. So that's a significant amount of production that would otherwise have gone to a customer at a pretty good amount. So we do feel we're getting to the end of that. There is additional testing being done this quarter. But I think the expectation is that, as Brian likes to say, we're not ready to spike the football yet, but we're getting very close to the goal line. So I think, hopefully, we'll be able to put that behind us relatively soon.

Q: Okay. Great. And in the just reported quarter, how large was the Armor revenue roughly?

Brian Mackey

The Armor revenue was between -- it was $1.7 million, maybe something like that.

Q: Okay. And that's basically nil in the current quarter?

Brian Mackey

No, no. There's been some. We've definitely shipped stuff in Q2 as well. It's down, but it's not gone yet.

Q: Okay. Will be gone by Q3. So what should I think about then in terms of gross margin, because as I recollect the Armor business was a nice adder, but you had tier with $1.7 million of Armor you had 15% gross margin, right?

Chuck Griffith

Right. We expect the margin to go up. As I said, I think there was a significant expense that goes through the testing process, and that all -- that becomes part of our cost of sales. So that's definitely had a negative impact on margin.

The other thing is Brian had mentioned that we have three more engineers now than we did a year ago. I think that we're viewing this as sort of an investment. Unfortunately, GAAP says, that's not an investment. You have to expense those people immediately. So I think that I don't expect we're going to be getting back to the levels that we were at a year ago when we were in the high 20s, even I think one quarter, we're at 30.

But I do think that we should be improving over what we had in the first quarter, because of a number of these other expenses that we won't have going forward.

Q: Even at a lower run rate?

Chuck Griffith

Yes. I think my fingers crossed, god willing that this quarter had the lowest that it's going to be. But, yes. But I think it should go up a bit more.

Q: Okay. That will do it for me now. Hopefully, we can catch up the next week at the Sidoti. Thanks.

Chuck Griffith

Great. Thanks.

Q: Bye-bye.

Operator

Thank you very much. Well, we appear to be at the end of our question-and-answer session. I will now hand back over to Brian for any closing comments.

Brian Mackey

Great. Thanks everyone for joining us today and for your ongoing interest in CPS Technologies. We look forward to speaking with you again after the end of the second quarter. If you have any questions in the interim, please reach out to our Investor Relations Advisor. Thanks.

Operator

Thank you very much, everyone. This does conclude today's conference call. You may disconnect your phone lines at this time, and have a wonderful day. Thank you for your participation.