



November 2, 2023

9:00am ET

Operator

Good day, everyone, and welcome to the CPS Technologies Third Quarter 2023 Earnings Call. At this time, all participants have been placed on a listen-only mode. and we will open the floor for your questions and comments after the presentation. It is now my pleasure to turn the floor over to your host, Chuck Griffith, Chief Financial Officer of CPS Technologies. Sir, the floor is yours.

Chuck Griffith

Thank you, operator, and good morning, everyone. Today, I'm joined by Brian Mackey, our President and CEO, and we look forward to discussing our quarterly 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's operations and environment. These uncertainties should 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 will turn the call over to Brian to offer his perspective on the third quarter results. Afterwards, Chuck will review the financial results in greater detail. Brian?

Brian Mackey

Thanks, Chris. Today, we're pleased to announce third quarter revenue of \$6.3 million and an operating profit of approximately \$131,000 for the period ending September 30, 2023. As discussed on our previous earnings call, the quarter was negatively impacted by shipment timing, with certain deliveries being pushed into the last three months of 2023. Our original expectations for 2023 as a year are unchanged. The company remains on track for 2023 to be its best year ever in terms of revenue as well as underlying results. Chuck will review this further in a moment.

During the third quarter, we announced two noteworthy wins for the company. First, we received an award valued at approximately \$7.7 million from a major long-standing customer for power module components and solutions. This contract represents a 50% increase for that customer over the prior four quarters, with the systems to be employed primarily in high-speed rail, wind turbines, and other green energy applications. This client is a multinational semiconductor manufacturer based overseas which

has come to rely on our unique capabilities for its cutting-edge requirements, and we're pleased to once again provide modules for the many important markets they serve.

Also, we recently announced that the company had received a Phase 1 SBIR award valued at approximately \$200,000 from the United States Department of Energy, our first such grant from the DOE. This study, entitled Modular Radiation Shielding for Transportation and Use of Microreactors, will be led by Matthew Karnick, a talented material scientist at our company, opening further potential customer penetration avenues for CPS.

Notably, this is our fifth SBIR/STTR award in the past two years. It's the first of these five from the Department of Energy and the third different member of our team to win an SBIR award within the last couple of years. Our renewed focus on R&D continues to provide external funds to help bolster our intellectual property portfolio, validate our long-term strategic vision and support our goal of accelerating the growth trajectory of our top-line.

Aside from these wins, the company is actively pursuing opportunities across all 10 markets, from military armor to transportation products, electronics and industrial applications. The overall outlook for the company remains bright. HybridTech® Armor panels from Kinetic Protection, the U.S. Navy's prime contractor, continue to provide best-in-class protection for the country's aircraft carriers. The panels are an integrated component of advanced ballistic shields and protection system upgrades by the Navy, and we're pursuing opportunities across the rest of the fleet. We had previously discussed that we will be testing other iterations of our armor as it related to a potential ground vehicle armor opportunity.

Unfortunately, that testing did not go as well as anticipated. We're working to address the issues uncovered during those tests, but this will further delay any new order for our armor with this potential customer. The continued growth of hermetic packaging for use in aerospace, defense and power electronics also positions CPS for further growth going forward, as well increasing demand for our Metal Matrix Composites industrial solutions. We believe our unique technology and innovative approach to solving complex design problems, along with our expanding array of customers in the government and commercial space, place us at the beginning of our next phase of growth.

Whether it's electric vehicles, trains, aerospace and defense or electronic applications, CPS can provide the best approach to advancing our clients' new product development initiatives. Our strong balance sheet can and will provide us with the financial flexibility to continue to invest in increasing our product development capabilities and pursuing opportunities that will accelerate top line growth and improve operating results. In the near-term, we anticipate a very strong finish to the current fiscal year and remain on track for it being our best performance ever. I continue to be upbeat about the company's ability to convert bids into backlog and backlog into revenue as we leverage our innovative solutions across a growing set of markets and new industry applications.

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

Chuck Griffith

As was mentioned earlier, the company's revenue totaled \$6.3 million in the third quarter compared to \$6.7 million last year, with a slight decline year-over-year due to shipment timing and the delay of certain deliveries into the fourth quarter. Given our solid overall backlog, we anticipate posting a very strong finish to fiscal 2023. At this time, we fully expect to significantly exceed the 2022 revenue total of \$26.6 million.

Gross profit in the third quarter totaled \$1.2 million or approximately 20% of sales compared with \$1.9 million or roughly 28% of sales last year. The decrease in both profit and gross margin year-over-year reflects the lower level of sales as well as some inventory write-offs due to higher scrap than usual during the quarter. We anticipate fourth quarter gross margins to be more in line with the second quarter.

Selling, general and administrative expenses totaled \$1.1 million in the third quarter versus \$1.2 million in the prior year period. This SG&A amount represents a notable decrease from our SG&A numbers in the first half of this year. The company generated operating income of \$131,000 in the third quarter compared with approximately \$709,000 last year and posted net earnings of \$0.01 per diluted share versus \$0.07 per diluted share in fiscal 2022.

Turning to the balance sheet. We ended the quarter with \$8.8 million of cash, up from \$8.3 million at the end of 2022, reflecting working capital changes and the impact of the decline in deferred revenue. Trade accounts receivable as of September 30, 2023 totaled \$5 million versus \$3.8 million as of December 31, 2022. Our other receivable account balance was \$17,000 compared to \$686,000 at the end of last year, primarily reflecting the receipt of the employee retention tax credit in April. Inventories totaled \$4.8 million as of September 30 compared to \$4.9 million at the start of the fiscal year.

Turning to the liability side, payables and accruals totaled \$3.2 million at the end of the third quarter versus \$2.7 million at the end -- as of December 31, 2022. Deferred revenue decreased from \$2.8 million at the end of 2022 to \$1.7 million as of September 30, 2023. As a reminder, deferred revenue predominantly represents prepayments for large orders to help appraise the impact on cash of large inventory purchases for those orders. A number of these were shipped in 2023, resulting in the recognition of revenue, and thus, a decrease in deferred revenue.

So thank you. And now, Brian will discuss his first 90 days in CPS and what he sees for the future. Brian?

Brian Mackey

Thanks, Chuck. As everyone may recall, I joined CPS at the beginning of August, about three months ago. As I expected when I accepted the opportunity to come to CPS, my background is highly relevant to what we're doing here. I've spent many years in leadership positions of technically-oriented companies, including a focus on material science to achieve growth, with the goal of providing advanced solutions to our customers' greatest challenges.

I'm excited by a number of things that we have in place today at CPS and by the opportunities that we have before us. We have a long history of close relationships with a number of large, stable customers both domestically and abroad, particularly in Metal Matrix composites and hermetic packaging. We'll continue to support our customers' growth objectives by providing high-quality products that meet their needs. We have a highly capable and motivated team here at CPS as well. 2023 looks to be a record year, and we're motivated to build on our own momentum.

I'd like to take a moment to focus on just one aspect of our growth strategy, which is externally-funded product development. As we've mentioned, we've seen a number of recent successes in this area to help build our product portfolio for the future. As a quick review, we pursued a Phase 1 SBIR regarding thermal management for the Navy. They then asked us to continue with an option phase and asked us to submit a Phase 2 proposal, which is currently under evaluation.

We completed a Phase 1 STTR regarding the use of tungsten materials for the Army. Again, we will be submitting a Phase 2 proposal to build on what we accomplished in Phase 1. We also completed a Phase 1 SBIR regarding Army helicopter flooring for the United States Army. While the Army has elected not to designate any funds for a potential Phase 2 study, our flooring passed its testing in Phase 1 with flying colors. We know that this is of interest to helicopter OEMs, and we're pursuing this opportunity.

As previously discussed this morning, we're currently working with new funding from the DOE on another Phase 1 SBIR. You can expect to see us continue development efforts to build our product portfolio for the future. These externally-funded efforts, in conjunction with our internally-funded work, are a key part of our plan to add relevant growth path within the advanced materials space. These opportunities leverage our know-how related to our current products and also take advantage of the technical expertise within our talented team. I'm excited about the future here at CPS. Operator, if you could please open up the line for Q&A.

Operator

Certainly. [Operator Instructions] Your first question is coming from Jim McIlree from Dawson James. Your line is live.

Q: Thank you. Good morning. Can you share with us the bookings and the backlog for the quarter?

Chuck Griffith

We don't normally give that information out, but our -- certainly, our backlog is very solid going forward for the next, certainly for the next several quarters. I don't think I really want to give out any numbers at this point.

Q: Okay. Can you tell us if bookings were greater than revenue?

Chuck Griffith

In the trailing 12 months, it's actually exactly even. It's 100% or 1:1.

Q: Okay. Great. Thank you. I'm sorry, Brian you talked about the externally-developed -- external development as a source of funding research. And I understand the philosophy behind that and I understand the benefits for it, but what I'd like to try to understand is how large a portion of revenue that would be currently? And if you were to get what you wanted out of those projects, what percent of revenue would it be generating, let's say, 12 months or 24 months from now?

Brian Mackey

Yes. So to the two parts of your question, the revenue from the Phase 1 is relatively small. Those are typically \$200,000 of funding. Could be \$150,000, it could be \$250,000, but it's typically in that range, normally a Phase 2 amount of funding for an SBIR would be. Whereas the Phase 1 of say \$250,000 might be over a nine month period. Phase 2 would typically be more around the range of \$1.1 million or \$1.2 million to fund research over a period of 24 months. That's what's most typical from the DoD and DOE.

So on the revenue side, it's nice revenue, but it's mostly -- the value to us is to fund that future growth. The timing of that, to translate that into what would be considered a Phase 3 or a commercial effort with funding from literally customers buying those products is going to depend on the success of the Phase 2 and the interest.

The nice thing about the DoD is they're typically funding that research because they have a real need. And if you can get to the finish line, technically, the ideal outcome is that they're ready to purchase and you're going to be scaling up volume to meet those needs. And of course, that's going to depend on the application and what the technology is that we're working on.

So it's difficult to project the revenue, but the nice thing about that SBIR with the DoD is, again, it's a need that they have, but it also comes with the intellectual property that's developed under that program, which remains the company's property. Even though it was funded by the Department of Defense, and it also eliminates the need for future competition.

So typically, the DoD contracting office is going to say we need competitive bids to make sure we're getting competitive pricing, and the response to that is that the original SBIR proposal was a competitive bid during Phase 1. And the reward for the small business of succeeding in its technical development is the singular ownership of that intellectual property for many, many years after that.

Q: Right. Understood. Got it. Okay. So it sounds like Q4 is going to be a nice rebound from Q3.

Brian Mackey

That's right.

Q: Because of that, will you be requiring additional working capital? You mentioned in your commentary that working capital was a source of cash in Q3, so can we expect a reversal of that in Q4?

Chuck Griffith

Probably. But certainly, it won't be an issue for us. We're with almost \$9 million as of the end of the quarter. That's plenty of cash in order to fund that working capital. And as I think you guys know, we've got our \$3 million line of credit if we need it with our banks. So I mean, there's nothing due on it at this point. It hasn't been for a while, but -- so we do have that extra source if it's necessary. But I don't think it will be. I think we'll still have -- even with the working capital increase that we may need to generate the higher sales for the quarter. We'll still be in very good shape from a cash standpoint.

Brian Mackey

But we do expect Q4 to be more in line with Q1 and Q2 from this year in a variety of respects versus what we have experienced currently in Q3.

Q: Got it. Okay. That's it from me. Thanks a lot.

Brian Mackey

Thank you.

Operator

Thank you. [Operator Instructions]. Your next question is coming from Ron Richards. Your line is live.

Q: Hey guys, the November 2022 conference call, it was mentioned that the hermetic packaging revenues will be about \$10 million, and they still predicted, but those revenues could double by 2024. I was wondering if you're still in that projection for \$20 million in revenues in hermetic packaging for 2024?

Chuck Griffith

I would say not. We've had some reductions from one of our major hermetic package customers. If we take -- I mean, you can't. But if we were to take that out, then the Hermetic Packaging business regarding other customers is growing significantly. We've got one customer in particular that was virtually not -- well, they were extremely non-material about a year ago, and they're going to be well over -- or they already are this year, well over \$1 million. And we expect and hope that that piece anyway will at least double in this coming year as well in 2024.

But in terms of the total doubling of hermetic packaging, I don't think that's going to happen. But certainly, it's continuing to grow even in spite of that's one major customer.

Brian Mackey

Yes. So it's continuing to grow, and it's certainly an area of focus for us. We see opportunities there for us to continue to drive those numbers up, and I think you'll see that going forward.

Q: Okay. And then one other question. On the navy ships, you were talking about expanding to other ships besides the aircraft carriers. Do you have any guess on a timeline when you might get some orders for those ships?

Brian Mackey

It's an area where we're actively pursuing translating that technology from the aircraft carriers to other vessels. The timing of that is hard to predict, but we know we've got a good solution there with our partner and we're actively working that, but it's difficult to predict timing.

Q: Okay. Thank you.

Operator

Thank you. [Operator Instructions]. Your next question is coming from Greg Weaver from Invicta Capital. Your line is live.

Q: Hi, good morning. Good morning and welcome to Board, Brian. So I guess what would you consider the best unexploited opportunities now that you've been at the company for a while? And kind of maybe any changes or improvements you want to focus on?

Brian Mackey

Well, I think we have a number of opportunities. As I just mentioned, I think we clearly have growth opportunities with hermetic packaging. I think we have some interesting things that we're considering within metal matrix composites. We also have this ongoing installations of armor solutions on the aircraft carriers, which is exciting knowing that we have a solution that the Army is excited by and interested in lightweight, kind of ballistic protection, et cetera.

And what I consider our fourth category, which is these new things that we're actively working on, I think that's going to yield results. And as I mentioned a minute ago, I mean, when the DoD needs something, they need something, sometimes you have to wait for their validation process and the right program timing to come along. But I think we've got interesting opportunities there.

And this organization as a company, I mean, we're continuing to improve. We've got a strong team. We've seen a number of changes over the last few years that we're continuing to implement to drive our growth, so I think our customers will see that when it comes to quality of product and things like that. So I'm excited about what we're doing.

Q: Okay. And on the AISiC front, I mean, specifically like heat sinks and things like that, that's kind of not as much a focus?

Brian Mackey

There's ongoing discussions there with the interest of our customers and how we can make those products better and move those to both improvements in what we're providing on a day-to-day basis as well as what the next generation of product would be and how we can address that. So that's what the advantage of these long-term relationships where we can have these collaborative discussions. I think it's another area that we're pursuing that can yield results in the future.

Q: Okay. That's helpful. Thank you. And Chuck, on the gross margin, you helped a little bit saying there was inventory write-offs in, like, due to scrap in the quarter. But I mean, the incremental flow through is over 100%, right? I mean your revenue drop versus the gross profit dollar drop sequentially? And you didn't burn inventory either, so.

Chuck Griffith

No. So basically, the biggest individual factor, of course, was the reduction in revenue and the impact of that on our fixed costs. But the secondary one was, so we had a quality issue with one of our major customers. We set up some significant reserves for potential returns. And we also had to go through our inventory to look at it for those quality issues, and we had a number of parts that we ended up scrapping.

Now we think that we are close to the root cause for that quality issue and that it should go away soon, but it is something that we're working on to fix. And that's really why we have a fairly large reserve in there in our -- which reduced revenue and increased our liability, when we look at reserve.

Q: The reserves so that was top line and [indiscernible] [00:24:15]?

Chuck Griffith

Correct. Yes.

Q: Right. That makes sense. Okay. And what product area was this quality control issue in?

Chuck Griffith

It's in the MMC, it's in AISiC. It's just kind of an odd oddity. Yes. I don't want to get into the science of it, because it's not my area.

Brian Mackey

Yes. It was a number of events that came together. And as Chuck indicated, we've made a lot of progress on the root cause, and then we'll finish that up and turn that to implementation et cetera. We

think the reserve that you see reflected, it's going to satisfy that, but we're not quite at the end of that road to make sure we're to the bottom of it.

Q: All right. So for the current quarter we're in, there's still some yield issues, but the reserve is going to cover that and you've absorbed that in Q3?

Brian Mackey

We believe so, yes.

Q: Right. Okay. So we're back to the -- I mean, you had great margins over the last few quarters. It's one of the things I'm most excited about, that you can get the earnings going. So this 30%-ish margin area is not unrealistic then that wasn't a fluke?

Chuck Griffith

Correct.

Brian Mackey

Yes. We think as this gets cleaned up, we think we'll return to that, certainly strongly in that direction what you saw in the first half. We think that's more representative of what you see going forward including this quarter Q4.

Q: Okay. Perfect. Thank you. Appreciate it. And good luck.

Chuck Griffith

Thank you.

Brian Mackey

Thank you.

Operator

Thank you. [Operator Instructions] Thank you. That concludes our Q&A session. I'll now hand the conference back to President and Chief Executive Officer, Brian Mackey, for closing remarks. Please go ahead.

Brian Mackey

Okay. Thank you for joining us today, for your ongoing interest in what we're doing here at CPS Technologies. We look forward to speaking with you again after the end of our fiscal year. If you have

any questions in the interim, please reach out to our Investor Relations advisor. There's no further questions. I think that concludes the call. Thank you.

Operator

Thank you, everyone. This concludes today's event. You may disconnect at this time, and have a wonderful day. Thank you for your participation.

About CPS

CPS is a technology and manufacturing leader in producing high-performance energy management components that facilitate the electrification of the economy. Our products and intellectual property include critical pieces of the technology puzzle for electric trains and subway cars, wind turbines, hybrid vehicles, electric vehicles, the smart electric grid, 5G infrastructure and others. CPS hermetic packages can be found in many Aerospace and Satellite applications including the GPS III satellite and the Mars rover. CPS armor products provide exceptional ballistic protection and environmental durability at very light weight. CPS is committed to innovation and to supporting our customers in building solutions to this planet's problems.

Safe Harbor

Statements made in this document that are not historical facts or which apply prospectively, including those relating to 2022 financial results, are forward-looking statements that involve risks and uncertainties. These forward-looking statements are identified by the use of terms and phrases such as "will," "intends," "believes," "expects," "plans," "anticipates" and similar expressions. Investors should not rely on forward looking statements because they are subject to a variety of risks and uncertainties and other factors that could cause actual results to differ materially from the company's expectation. Additional information concerning risk factors is contained from time to time in the company's SEC filings, including its Annual Report on Form 10-K and other periodic reports filed with the SEC. Forward-looking statements contained in this press release speak only as of the date of this release. Subsequent events or circumstances occurring after such date may render these statements incomplete or out of date. The company expressly disclaims any obligation to update the information contained in this release.

Investor Relations:

Chris Witty

646-438-9385

cwitty@darrowir.com