

26-Jul-2022

CTS Corp. (CTS)

Q2 2022 Earnings Call

CORPORATE PARTICIPANTS

Kieran M. O'Sullivan

President, Chief Executive Officer & Chairman, CTS Corp.

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

OTHER PARTICIPANTS

Justin Long

Analyst, Stephens, Inc.

John E. Franzreb

Analyst, Sidoti & Co. LLC

Joshua Buchalter

Analyst, Cowen & Co. LLC

Hendi Susanto

Analyst, Gabelli Funds LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Bailey, and I will be your conference operator today. At this time, I would like to welcome everyone to the CTS Corporation's Second Quarter 2022 Conference Call. All lines have been placed on mute to prevent background noise. A supplemental slide presentation, to accompany the prepared remarks, can be found on the company's website. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

At this time, I would like to turn the call over to Mr. Kieran O'Sullivan, CEO of CTS Corporation. Mr. O'Sullivan, you may begin your conference.

Kieran M. O'Sullivan

President, Chief Executive Officer & Chairman, CTS Corp.

Thanks, Bailey. Good morning and welcome everyone to our second quarter 2022 earnings call. We delivered another strong quarter. In addition, we finalized the acquisition of Ferroperm Piezoceramics at the end of June, further advancing our diversification strategy. I'm excited to have this talented team join CTS, which will allow us to expand our market opportunities and support a broader range of customers.

Sales in the second quarter were \$145 million, up approximately 12% compared to the second quarter of 2021. Second quarter adjusted gross margin was 36.1%, down 70 basis points from 36.8% in the second quarter of last year.

Adjusted EBITDA margin of 22.4% was up 90 basis points from 21.5% in the same period last year. Second quarter adjusted earnings per diluted share of \$0.62 were up almost 20% from \$0.52 in the second quarter of 2021.

As I already mentioned, during the quarter, we completed the Ferroperm acquisition. The acquisition is expected to be accretive in 2023. Ashish will take us through the Safe Harbor statement. Ashish?

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

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 in the Investors section of the CTS website.

I will now turn the discussion back over to our CEO, Kieran M. O'Sullivan.

Kieran M. O'Sullivan

President, Chief Executive Officer & Chairman, CTS Corp.

Thank you, Ashish. We have a solid quarter with sales increasing 12% to \$145 million versus the second quarter of 2021. Organic sales were up approximately 9% for the quarter. These results underscore our investments in business development as front-end sales enabled us to expand our customer base. The TEWA acquisition added \$4 million in sales in the quarter and the business is performing well. Demand was solid across medical and industrial markets, while defense was softer. Demand for transportation products was impacted by COVID-19 lockdowns in Asia and some OEM production cuts. Our global team continues to execute well and remains committed to both operational excellence initiatives and achieving our long-term goals.

Adjusted gross margin for the second quarter was 36.1%, down 70 basis points from 36.8% for the same period last year. We are operating in a very dynamic environment as we continue to be impacted by rising commodity prices, supply chain headwinds, and other macro challenges, which are likely to further pressure margins.

However, we continue to partner with our customers to offset or share cost increases, and we expect freight costs to improve in the quarters ahead as transpacific container volumes to the US return to more normalized pre-pandemic levels.

Operationally, we are seeing savings materialize from our restructuring activities. As we move forward, we will continue to evaluate and refine our footprint to optimize our ability to serve our customers, while also enabling us to deliver improved operating leverage. We are also continuing to gain traction with our CTS operating system with over 90 continuous improvement projects driving incremental performance.

Adjusted EBITDA margin was 22.4%, up 90 basis points from 21.5% in the second quarter of 2021. Second quarter adjusted earnings per share of \$0.62 were up almost 20% from \$0.52 in the same period last year. Improved transportation awards and solid electrification wins, drove new business awards in the quarter to \$173 million, increasing from the prior quarter. We remain confident in our robust pipeline of opportunities and see good momentum for awards in the coming quarters. By continuing to focus on growth and diversification, we added six new customers in the quarter, four in industrial and two in medical.

Additionally, we delivered samples for new products to multiple customers across all end markets. We remain well positioned in end markets that offer attractive growth opportunities. The quality of our material formulations

supported by leading-edge technologies, our deep industry experience, and vertical integration leveraged over several end markets differentiate us from our competitors, helping us deliver long-term value to our customers.

As we noted earlier, we completed the acquisition of Ferroperm during the quarter. The company was founded in 1952 and specializes in the design and manufacture of high-performance piezoceramic components for use in complex and demanding medical, industrial, and aerospace applications. This acquisition expands our capabilities and geographic reach of our piezoceramic product portfolio. Ferroperm is recognized for its high quality and innovative technology.

Based in Denmark, Ferroperm has established a strong customer base across Europe and in North America. Ferroperm is located within a short distance of our existing ceramics business in Denmark, and we are already evaluating potential plans to consolidate operations into the Ferroperm facility. We are delighted to welcome this talented team to CTS.

In the industrial market, demand for our micro-actuators for use in industrial printing applications remains solid, driven by online demand. Across temperature sensing, hot and cold applications, we continue to see good momentum with awards for HVAC and strong demand for industrial appliances as consumers return to service industries. We secured wins with two new customers for temperature applications and coffee machines and high-end blender products. Though lower, demand for pool and spa applications remains at reasonable levels. We gained awards in Europe for flow sensing applications and expect revenue from previously shipped samples for combined flow and temperature to begin in 2023.

Wins with the RF product line were good in industrial communications and IT applications with wins in three regions. We delivered RF samples for a new 5G application for a Japanese customer and added a new Asian customer for a semiconductor equipment application.

In Japan, we received an initial order for an industrial welding application. We also secured frequency product wins, and demand was solid for our switch product used in industrial applications, computing and entertainment equipment. Distribution sales were a little tempered, which we expected after the higher periods we have seen for several successive quarters.

Across medical, we are seeing increasing momentum and long-term growth opportunities building off our first quarter performance. Our targeted business development efforts continue to deliver, resulting in an expanding customer base. We had wins with sleep apnea applications across several customers. We continue to see solid growth across multiple customers for our traditional medical ultrasound products. And we shipped samples to a potential new customer for a cardiac application, which removes plaque buildup in blood vessels.

We had an additional win for a cataract surgical application that extends through 2023. The sample qualification for a handheld medical ultrasound that we discussed last quarter is now in the FDA approval process, which is expected to take between six to nine months to complete. The precision insulin pump application samples previously discussed are expected to gain approval for the first quarter of 2023.

Further, we received multiple temperature sensing awards from existing customers, ranging from incubator to critical freezer monitoring and disposable applications, and added two new customers, one for a temperature cycling application, and another for an application used in body aesthetics. We also received an award with an existing customer for an application in immunoassay equipment.

In aerospace and defense, we continue to remain confident in the long-term prospects for this market, driven by the geopolitical environment as we improve our capabilities with new material formulations. We continue to experience good growth in sonar and guided torpedo applications, and we expect to gain more traction in the European defense market with the addition of Ferroperm.

For unmanned underwater vehicles, we continue to develop sample product with a Tier 1 defense customer and expect initial small volume production between late this year and early 2023. In aura filter applications, we experienced some near-term softening due to program transitions, but expect to grow with new applications next year. We were also awarded the precision harsh temperature application for a space vehicle and were also awarded extensions on existing timing products.

We continue to advance our M&A strategy, which is focused on expanding our geographic reach, adding momentum to our end market profile and increasing the richness of our customer base. As I mentioned earlier, during the quarter, we successfully completed the acquisition of Ferroperm. The addition of Ferroperm strengthens our medical product portfolio by complementing our existing medical imaging products with therapeutic products. Through this acquisition, we also gain industrial and defense product capabilities and new customers.

As we have discussed before, our long-term strategic plan is focused on diversifying our end market profile. We plan to achieve this by expanding our range of technologies, products, customers, and geographic reach to accelerate the revenue growth of our non-transportation business, while also strategically growing our transportation business. We believe this strategy continues to bear fruit as we are seeing the diversification of our business and enhancing our quality of earnings despite the challenging macro-economic factors we are facing.

The Ferroperm acquisition advances these efforts by supporting the growth of our non-transportation revenue with the potential of expanding this portion of the business beyond 50% of total revenues. We remain focused on continuing to strengthen our M&A pipeline of opportunities to meet our overall growth target. Our track record of thoughtfully expanding ceramic technology to support diversification, while at the same time leveraging our expertise to build and scale the temperature sensing platform through the acquisitions of QTI, SSI and now TEWA demonstrates the execution of our strategic plan.

Adding technology that will enhance our EV offering also remains a priority. We continue to focus on acquisition targets in the range of up to \$50 million a year in sales. But we remain open to the right larger opportunities that will advance our long-term strategy.

Our team continues to develop our pipeline of prospects. Appropriately deploying capital in line with our allocation framework is important and we've maintained a healthy balance sheet which enables us to maintain flexibility to drive organic growth and make strategic acquisitions while returning capital to shareholders. To that end, in the quarter, we repurchased approximately \$7.7 million of CTS stock.

In transportation, we continue to perform in an environment for OEMs and Tier 1 suppliers saw sales declines in the quarter. We currently see robust demand in commercial vehicles, which we expect to extend into 2023.

On the light vehicle side, while the sales softness remains given the supply side challenges across the industry, our positioning from a product and geographic standpoint has propelled us forward. We remain cautious on light vehicle demand more from a consumer weakness sentiment than supply disruptions and view demand trending flat for this year. However, longer term, we see the need for a growth cycle given the recession level industry volumes of recent years.

We continue to focus on strengthening our light vehicle sensor portfolio, especially around EV platforms. Today, electric vehicle revenue ranges in the high-single digits as a percentage of our total light vehicle revenue. Our goal is to have greater than 25% of our light vehicle revenue coming from EV platforms by 2025. This goal is supported by our ability to transfer our legacy accelerator module and sensor products to electric and hybrid vehicle applications.

This past quarter, the level of EV wins as a percentage of transportation wins was up, given the lag in some prior quarters, as OEMs focused more on supply challenges. We are also developing new products to integrate into existing and future EV architectures such as our eBrake product, which has been prototyped and represents a future growth opportunity similar in magnitude to the existing accelerator module market. In addition, we are getting traction with our current sensor products and are working on potential position sensing products for EV motor application.

Our value proposition in transportation has been built on packaging, position sensing for safety, critical and harsh environments for our teams to develop deep industry experience. For chassis ride height sensing, we had wins with North American and Chinese OEMs. For passive safety sensors, we had two large Tier 1 wins across Europe and North America, the largest one for an EV application. We had a brake sensor win with a Chinese EV application and a legacy NOx sensor award for a European customer.

We also had a second win for our EV current sensing product with a North American Tier 1 customer. Across the accelerator module products, we had multiple wins, three with Asian OEMs and additional wins with European and North American OEMs. In addition, three of the accelerator awards were for EV platforms. In the quarter, a total of 10 of the awards were for EV applications.

Looking ahead and recognizing the macro uncertainty, we currently see good demand in industrial markets and strengthen the medical market with some softness in defense as we transition programs. We expect to see continued benefit from our recent acquisitions. Channel inventories are back to more normal levels. Backlogs are flattening, while demand currently remains stable. However, we expect market demand may soften throughout the balance of the year.

In transportation, the cumulative loss of vehicle builds so far this year has been driven primarily by two factors. COVID-19 had an impact of over 1 million units and the semiconductor shortage impacted closer to 2 million units or more based on the trend we are seeing, which we feel is likely to end above 3 million units for the year.

As I mentioned earlier, we are cautious in order build rates for this year and expect production volumes to grow in the low-single digits versus the prior year with incremental gains in the years ahead despite a recessionary environment. We expect US light vehicle production to be in the 13 million to 14.5 million unit level. European production has been revised down since the start of the Ukraine war and is now forecasted in the 15 million to 16 million unit range this year. The Chinese market is expected to be flat this year in the 24 million to 25 million unit range. Commercial vehicle demand remains solid.

Overall, we feel confident in the long-term prospects for the business. Our teams are creatively navigating the current environment to ensure supply for our customers. We were able to maintain operations this past quarter while ensuring a safe work environment for our employees during the Asian lockdowns. All our plants remain fully operational. Some industrial and automotive customers continue to confirm demand into 2023.

As always, we are monitoring the macro environment very closely. I'm pleased to say in this very challenging environment, our teams are working and adapting with speed and agility to support our customers.

In terms of the financial outlook for the full year 2022, our updated guidance, including the Ferroperm acquisition, is for sales to be in the range of \$570 million to \$800 million – sorry, to \$600 million, up from the previous range of \$550 million to \$580 million. Adjusted earnings per share are now expected to be in the range of \$2.40 to \$2.55 compared to the previous range of \$2.20 to \$2.45.

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

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

Thank you, Kieran. Second quarter sales were \$145 million, up 11.9% compared to the second quarter of 2021 and down 2% sequentially from the first quarter of 2022. Foreign currency exchange rates impacted revenue unfavorably by approximately \$2.2 million.

Sales to non-transportation end markets increased 21.1% year-over-year, supported by another quarter of double-digit growth in the industrial and medical end markets. Excluding sales from TEWA acquisition, sales to non-transportation end markets were up 14.1% year-over-year. Sales to transportation customers increased 4.4% compared to the second quarter of 2021.

We have continued to see momentum in our smart actuator product, which primarily go into commercial vehicle applications. Sales to the transportation end market decreased 5.6% sequentially, due to lower market volumes caused by supply constraints and COVID-related shutdowns. Our adjusted gross margin was 36.1% in the quarter, down 70 basis points compared to the second quarter of 2021, and down 110 basis points compared to the first quarter of 2022.

Inflationary factors and supply chain headwinds pressured margins during the quarter, which we were able to partially offset through pricing and operational improvements across our organization. Foreign currency exchange rates also impacted gross margin unfavorably by approximately 0.5 percentage point. We have realized \$0.19 of savings to-date from our previously announced restructuring program. As previously communicated, we are on-target to achieve the lower-end of the \$0.22 to \$0.26 of savings. However, some of these projects will extend into 2023, as we balance growth with the completion of the projects.

We reported earnings of \$0.39 per diluted share for the second quarter. Adjusted earnings for the second quarter were \$0.62 per diluted share compared to \$0.52 per diluted share for the same period last year and \$0.67 per diluted share in the prior quarter.

Moving on to cash generation and the balance sheet. We generated \$16.1 million in operating cash flow for the second quarter of 2022. Cash flow was impacted by the movement in foreign currency exchange rates. Controllable working capital was at 17.7%, higher than the first quarter, primarily due to the addition of the balance sheet from our Ferroperm acquisition. We remain focused on ongoing cash generation and a healthy balance sheet that have enabled our focus on organic growth and strategic acquisitions.

We repurchased approximately 216,000 shares of CTS stock during the quarter, totaling \$7.7 million. In total, we returned approximately \$9 million to the shareholders in the second quarter and \$14 million year-to-date through dividends and buybacks. We ended the second quarter with a cash balance of \$98.7 million as of June 30, 2022,

and our long-term debt balance was \$91 million. The debt to capitalization ratio was at 15.8% at the end of the second quarter compared to 9.9% at the end of the prior-year period.

During the second quarter, we funded our Ferroperm acquisition partly with cash outside the US and the balance through our existing credit facility. Our leverage and cash position allow us to continue evaluating further strategic acquisitions.

This concludes our prepared comments. We would like to open the line for questions at this time.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question today comes from the line of Justin Long from Stephens. Please go ahead. Your line is now open.

Justin Long

Analyst, Stephens, Inc.

Thanks and good morning.

Q

Kieran M. O'Sullivan

President, Chief Executive Officer & Chairman, CTS Corp.

Good morning, Justin.

A

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

Hi, Justin.

A

Justin Long

Analyst, Stephens, Inc.

To start, I wanted to ask about the updated guidance. Is there any way you could ballpark how much of the increase was driven by the acquisition versus upside in the business from an organic basis?

Q

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

So, Justin, in terms of sales, we talked about the acquisition delivering in the low- to mid-\$20 million range. So, that'll give you a rough idea of how much to expect in the second half of the year. \$10 million to \$11 million is how we are thinking about it. And the EPS, we are not counting on much accretion at this point. Most of it, we are expecting in 2023.

A

Justin Long

Analyst, Stephens, Inc.

Got it. So, that EPS raise at the midpoint, I think was around \$0.15. Is there a little bit more color you can provide on the key drivers to that upside?

Q

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

A

So, the biggest one is our continued improved confidence in the revenue expectation from our core business. And we have also been continuing to work on offsetting the cost pressures with pricing and operational improvements like we talked about. So, those are what are contributing to our improved confidence around the EPS numbers.

Justin Long

Analyst, Stephens, Inc.

Q

Got it. And last one on the guidance, looking at the implied EPS guidance for the second half of the year, is there anything you can share on your expectation for the quarterly cadence of EPS? Do you feel like it will be relatively even in 3Q, in 4Q? Or is there anything or any reason to expect one quarter to be stronger than the other?

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

A

Hey. I think the best way to answer that is, as we see at the moment, we're off to a reasonable start in Q3, we don't have the same level of visibility yet into Q4 is probably the best way to answer that, Justin.

Justin Long

Analyst, Stephens, Inc.

Q

Okay. Got it. And last question for me. Obviously, there's – there are a lot more headlines around the economy and economic concerns. If I kind of reflect back on when the pandemic initially hit in 2020, I felt like you moved pretty quickly to adjust the cost structure lower. If some of the recession headlines become a reality, can you talk about how quickly you can adjust the cost structure moving into next year? And maybe just from a high level, I'm curious what kind of economic environment you're planning for as we look into 2023.

Kieran M. O'Sullivan

President, Chief Executive Officer & Chairman, CTS Corp.

A

So Justin, two points on that. In our prepared remarks, we said we expect some softness in the second half of the year. Obviously, the degree of that is not clear yet. And if you look back to the COVID period, when we had to respond to a pretty down market where we saw huge drops even in transportation, we remained positive. We adapted our cost structure pretty much within a quarter and had things moving. And we tried to do that very thoughtfully, so that we're improving the long-term prospects of the business as well.

Justin Long

Analyst, Stephens, Inc.

Q

Okay. I'll leave it there. Thanks for the time.

Kieran M. O'Sullivan

President, Chief Executive Officer & Chairman, CTS Corp.

A

Thanks, Justin.

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

A

Thank you.

Operator: Thank you. The next question today comes from the line of John Franzreb from Sidoti. Please go ahead. Your line is now open.

John E. Franzreb

Analyst, Sidoti & Co. LLC

Q

Hi. Good morning, Kieran and Ashish. Thanks for taking the questions.

Kieran M. O'Sullivan

President, Chief Executive Officer & Chairman, CTS Corp.

A

Good morning, John

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

A

Hi. John

John E. Franzreb

Analyst, Sidoti & Co. LLC

Q

Kieran, I just – I want to start with – you had previously voiced some concerns about supply chain issues, really calling it a Whac-A-Mole kind of a situation. Can you give us an update of the supply chain issues that you're facing in the company? Are they behind you at this point? Any kind of color would be appreciated.

Kieran M. O'Sullivan

President, Chief Executive Officer & Chairman, CTS Corp.

A

Yeah. John, I would say for the most part in the non-transportation markets, we're doing pretty well. That doesn't mean we don't have issues, but we're still managing through that pretty well. On the transportation side, it has improved and is improving. And we still have one or two watches on the semiconductor side, but several have improved. So we expect a little better second half. I think more of our concern in transportation as we look forward beyond supply chain is just where the consumer is with inflation, and will that bring any softness to demand as well.

John E. Franzreb

Analyst, Sidoti & Co. LLC

Q

Got it. And regarding Ferroperm, can you talk a little bit about the piezo technology that they bought? Is it materially different than what you were doing, or is it a scenario where you just access to new markets and new customers was the bigger driver of the acquisition?

Kieran M. O'Sullivan

President, Chief Executive Officer & Chairman, CTS Corp.

A

Yeah. The technology, John, is very similar to what we're doing at the moment, but it allows us to scale with new products and new customers. As an example, we said therapeutics, so we're into pacemakers, we're into skin care and other applications and in that area, but we really like it. And it also gives us capability in industrial applications and aerospace and defense for high temp applications.

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

A

John, they have a good technology team. They have good powder formulations which will add to our portfolio of ceramic compounds that we can offer that are suitable for different applications. So, that's really what we gain out of the acquisition in addition to that in the European markets.

Kieran M. O'Sullivan

President, Chief Executive Officer & Chairman, CTS Corp.

A

And John, we expect it to help us penetrate the defense markets in Europe even more.

John E. Franzreb

Analyst, Sidoti & Co. LLC

Q

Right. So, when you talk about the potential non-transportation-related businesses potentially being above the 50% threshold, and I'm looking at temperature sensing portfolio versus piezo portfolio, which would be the most significant driver of reaching that kind of a threshold of greater than 50%?

Kieran M. O'Sullivan

President, Chief Executive Officer & Chairman, CTS Corp.

A

John, both product areas are pretty important to us, and we're moving in several end markets with each of those. And I would tell you, if we look today, we're probably closer to a 48/52 split, so that's before Ferroperm. So, we see ourselves crossing that bridge in the future.

John E. Franzreb

Analyst, Sidoti & Co. LLC

Q

Got it. And just one last thing. I think, Kieran, I heard you say that the inventory levels at the customer level is close to equilibrium now. Is that the case? There's no inventory stocking going on? People worried about supply chain issues that you need to worry about?

Kieran M. O'Sullivan

President, Chief Executive Officer & Chairman, CTS Corp.

A

John, when I was talking about inventory, it was more for the distribution side of the business, which is now approximately 10% of our sales. I'm just saying it's getting back to more normal levels.

John E. Franzreb

Analyst, Sidoti & Co. LLC

Q

And if you look at it in a broader sense, the balance of the – your customer base and the inventory equilibrium?

Kieran M. O'Sullivan

President, Chief Executive Officer & Chairman, CTS Corp.

A

Transportation side, we're not seeing any inventory issues. And in the other markets, we're doing pretty well. No big issues to flag at this point in time.

John E. Franzreb

Analyst, Sidoti & Co. LLC

Q

Great. Great. All right. Thanks for taking my questions. I'll get back into queue.

Kieran M. O'Sullivan

President, Chief Executive Officer & Chairman, CTS Corp.

Thanks, John.

A

Operator: Thank you. The last question today comes from the line of Joshua Buchalter from Cowen. Please go ahead. Your line is now open.

Joshua Buchalter

Analyst, Cowen & Co. LLC

Hey, guys. Thanks for taking my question and congrats on another solid quarter. I want to follow up on some of Justin's question from earlier. The guidance sort of implies a flat second half versus the first half despite tailwind from Ferroperm and TEWA. I understand you pointed us to some weakness, but could you walk us through some of the assumptions that are baked into the guidance? In particular, I'm asking because bookings were again above \$170 million this quarter. So, it doesn't seem like you're seeing a material slowdown in demand yet. But I was wondering where you're taking a potentially more conservative approach. Thank you.

Q

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

Yeah. Josh, there are several parts to your question. First of all, the bookings. Kieran pointed out in his call that a lot of the strength in the booking compared to the first quarter came from the transportation market, where we don't recognize sales from those bookings for a period of time, typically two to three years. The demand environment, we are expecting stable compared to Q2, Q1 for the transportation with potential to increase. But again, there's that question mark of does the consumer demand start softening because of higher interest rates?

And in the rest of the end markets, we are concerned about potential softening as we go towards the end of the year. So, that's sort of the backdrop that we are looking at in terms of end market dynamics.

A

Joshua Buchalter

Analyst, Cowen & Co. LLC

That's helpful. Thank you. And then, on the inventory line, I know on books picked up sequentially, but you also closed Ferroperm on June 30, I believe. Is there a way to back out how much of the inventory increase was due to just closing the deal and the inventory step up versus what you are – what happened organically with prior CTS? Thank you.

Q

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

Yeah. So our working capital would be about 1.5 points lower without the Ferroperm acquisition.

A

Joshua Buchalter

Analyst, Cowen & Co. LLC

Got it. Thank you. Last one for me. I saw in the deck you called out, the target of greater than 25% of transport from EVs in 2025. And then, longer term, the – I guess it was like 25% of your SAM being from EVs. Is there any benchmarks we can view, as you know, how that business is tracking today for some of the applications like current sensors and e-brakes? Or is that more of a second half of the decade before it becomes material? Thanks and congrats again.

Q

Kieran M. O'Sullivan

President, Chief Executive Officer & Chairman, CTS Corp.

A

Great. Thanks. Just on that question, well, some of the wins in EV and some of the growth in EV today is from legacy product. And we mentioned in the prepared remarks that on the EV side, our first wins on new products are with current sensing where we've had to it. So you're going to see that grow incrementally. And obviously, past 2025, we'd expect that to accelerate.

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

A

Yeah. The – on the eBrake product, Josh, we would expect revenue only in the second half of the decade beyond 2025.

Joshua Buchalter

Analyst, Cowen & Co. LLC

Q

Makes sense. Thanks, guys. I'll get back in the queue.

Operator: Thank you. [Operator Instructions] The next question today comes from Hendi Susanto from Gabelli Fund. Please go ahead. Your line is now open.

Hendi Susanto

Analyst, Gabelli Funds LLC

Q

Good morning, Kieran and Ashish.

Kieran M. O'Sullivan

President, Chief Executive Officer & Chairman, CTS Corp.

A

Good morning, Hendi.

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

A

Hi, Hendi.

Hendi Susanto

Analyst, Gabelli Funds LLC

Q

Yeah. My first question on Ferroperm. I think you indicated that accretion will be in 2023. May I inquire like how much operating expense dollars come from Ferroperm, let's say, in the second half for 2022? And given your comment that acquisitions will be in 2023, does that imply that the operating profitability is somewhat comparable to your corporate CTS level?

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

A

So, Hendi, in the initial period of the acquisition, we will be incurring some incremental expenses. So, without going into the details of operating expense levels, the overall profitability of the business will be accretive to CTS. So the gross margins will help us from a mix standpoint. And as we work through the initial integration period, then that's when we start expecting accretion as we get towards the end of this year early next year.

Kieran M. O'Sullivan

President, Chief Executive Officer & Chairman, CTS Corp.

A

And, Hendi, the quality of the earnings is something we liked about the business.

Hendi Susanto

Analyst, Gabelli Funds LLC

Q

Okay. And then, I think on the more optimism, a more optimistic side, may I know what the top end of the sales guidance imply, Kieran?

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

A

So on the high-end, we would be looking at either no softening in the other end markets to maybe very marginal softening and transportation remaining strong to slightly growing. And you could take the inverse of that on the lower end where the markets on the other non-transportation side are softening as we expect and transportation is stable. So that's kind of the how we are thinking about the guidance range.

Hendi Susanto

Analyst, Gabelli Funds LLC

Q

Yeah. And then, with regards of the goal of like more than 25% of revenue in light vehicle sensors come from EV, should we expect the EV customer base by 2025 represents your existing customer base or should we expect it may look different than your legacy customer base, Kieran?

Kieran M. O'Sullivan

President, Chief Executive Officer & Chairman, CTS Corp.

A

It will have some legacy, but also some new customers and actually we've been adding some new customers in that space already, Hendi. So it'll definitely change.

Hendi Susanto

Analyst, Gabelli Funds LLC

Q

Okay, yeah. Thank you so much, Kieran. Thank you, Ashish.

Kieran M. O'Sullivan

President, Chief Executive Officer & Chairman, CTS Corp.

A

Thank you.

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

A

Thank you.

Operator: Thank you. There are no additional questions waiting at this time. Mr. O'Sullivan, I'll turn the call back over to you.

Kieran M. O'Sullivan

President, Chief Executive Officer & Chairman, CTS Corp.

Thanks, Bailey. And thank you again for joining us today. I also want to thank our global teams for their dedicated efforts in driving strong execution and operational efficiency. I'm confident that our diversification strategy, bolstered by our recent M&A activities and the breadth of our geographic footprint, will position us for profitable growth while navigating the macro uncertainty we all face.

I'd like to reiterate that CTS is well positioned for future growth. We have a strong team aligned around common goals that continues to advance the business for long-term value creation for our shareholders. Thank you. This concludes our call.

Operator: Thank you for your participation. You may now disconnect your line.

Disclaimer

The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2022 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.