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CTS Corp. (CTS)

Q3 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello, everyone, and welcome to the CTS Q3 2022 Earnings Call. My name is Seb and I will be the operator for your call today. There will be the opportunity to ask a question on today's call. [Operator Instructions]

I will now hand the floor over to Kieran O'Sullivan, CEO of to begin. Please go ahead.

Kieran M. O'Sullivan

Chairman, President, Chief Executive Officer & Director, CTS Corp.

Thanks, Seb. Good morning and welcome everyone to our third quarter 2022 earnings call. We delivered another strong quarter and reported solid financial results that were propelled forward by our strategic focus on diversification. Sales in the third quarter were \$152 million, up approximately 24% compared to the third quarter of 2021. Third quarter adjusted gross margin was 36.6%, down 70 basis points from 37.3% in the third quarter of last year. Adjusted EBITDA margin of 22.3% was up 60 basis points from 21.7% in the same period in 2021. Third quarter adjusted earnings per diluted share of \$0.62 were up 34%, from \$0.46 in the third quarter of 2021.

Non-transportation sales accounted for approximately 48% of our overall revenue as we continue to advance our diversification strategy. Electrification progress was solid as we added six EV platform wins in the quarter and expanded our total available market with new electrification products. Last quarter, we completed the Ferroperm acquisition. The business is performing well, work in progress to consolidate the two facilities in Denmark.

We are already seeing potential customer wins in North America using Ferroperm proprietary material formulations. We expect the acquisition 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 O'Sullivan.

Kieran M. O'Sullivan

Chairman, President, Chief Executive Officer & Director, CTS Corp.

Thank you, Ashish. We achieved strong results this quarter with sales increasing 24% to a \$152 million versus the third quarter of 2021. Organic sales growth was 17%. Our recent acquisitions Tier 1 Ferroperm added nearly \$9 million in sales during the quarter and the businesses are performing well. Demand was solid across medical and defense markets with mixed demand across the industrial markets, where we saw softness in consumer facing products linked to computing and entertainment, which make up a smaller part of our portfolio. We also saw a slowdown in pool and spa for temperature sensing products. Demand for transportation products was robust despite semiconductor supply issues that continue to be a challenge primarily with one supplier. 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 third quarter was 36.6% down 70 basis points from 37.3% for the same period last year. We continue to operate in a very dynamic environment as we are impacted by commodity prices, supply chain headwinds and other macro challenges, which are pressuring margins. In addition, we are now seeing increasing energy costs for our facilities, which is especially evident in our European locations. We continue to partner with our customers to offset or share cost increases. We are moving forward to consolidate our two Denmark locations and we expect the process to be substantially completed by the end of June 2023.

We are also gaining momentum with our CTS operating system, which continues – with continuous improvement projects supporting margin performance. Adjusted EBITDA margin of 22.3% was up 60 basis points from 21.7% in the third quarter of 2021. Third quarter adjusted earnings per diluted share of \$0.62 were up almost 34% from \$0.46 in the same period last year.

As a company, we remain focused on driving profitable growth through diversification and leveraging our capabilities in the electrification of mobility to enhance the quality of our earnings. Solid transportation, electrification, medical and defense wins, drove new business awards in the quarter to \$159 million. We remain confident in our robust pipeline of opportunities and see good momentum for awards in the coming quarters as we expand our portfolio of products. By continuing to focus on growth and diversification, we added five new customers in the quarter, two in industrial, one in electrification and two in defense. Additionally, we were awarded several new sample contracts and funded [ph] pre-development (00:05:58) awards in key strategic areas of our business.

Our material formulations continue to drive our performance in key high growth end markets. Customers view our leading edge technologies, deep industry experience and vertical integration over several end markets as key differentiators, helping us deliver long term value. Our in-house knowhow and proprietary processes, along with the competencies across three leading PAs of ceramic technologies, are a key competitive advantage, enabling us to develop new material formulations such as textured and led free.

In addition, with our global foundry footprint, we are well positioned to support our customers. With the completion of the Ferroperm acquisition, we enhanced our medical product portfolio offerings as well as industrial and defense capabilities. In the industrial market, demand for micro-actuators used in industrial printing applications were down marginally from prior quarters. Across temperature sensing hot and cold applications, we continue to see good momentum with awards for HVAC and demand for industrial appliances.

We saw a slowdown in the pool and spa area for temperature sensing products down from the pandemic record peak. We added two new customers in industrial applications, one for nano-positioning and another for an EMC application in rail transportation. While distribution sales were up year-over-year, sales were down low-single digits sequentially, which we expected after the higher demand periods we have seen for several successive quarters.

Across medical, we see continued momentum and long term growth opportunities building. Our targeted business development efforts continue to deliver, resulting in an expanding customer base. We were awarded two new pre-development ultrasound contracts, one for application and drug delivery for liver ablation, and another for minimally invasive surgery. We continue to see solid growth across multiple customers for our traditional medical ultrasound products.

More recently, we displaced a competitor through advances with our single crystal ultrasound capabilities. The sample qualification for a handheld medical ultrasound that we discussed in the last quarter is proceeding as planned with our customer expecting completion of the FDA approval process in the next six months. The precision insulin pump application, previously discussed, gained customer approval and we expect the first shipments to begin early in 2023.

Further, we received multiple temperature sensing awards from existing customers ranging from incubator to critical freezer monitoring and disposable applications. We also had a new temperature sensing win for application in heart and liver transplant equipment support.

In aerospace and defense, we remain confident in the long term prospects for this market, driven by the geopolitical environment and our enhanced capabilities with new material formulations. We continue to see solid growth in sonar and guided torpedo applications where several contracts were renewed. And we are now engaged more cohesively in the European defense market with the capabilities of the Ferroperm team.

For unmanned underwater vehicles, we received a new customer contract for a single crystal product and expect to build on this win to advance our growth momentum in new defense applications. We were awarded a preproduction contract for a multilayer munitions application with a Tier 1 defense contractor and had a design win with a new customer for an RF filter product with application in tactical radar. Our temperature portfolio continued to support our growth with repeat orders across several customers and a new order for low orbit satellite application.

Finally, we had wins with two Tier 1s, one for a high precision frequency product and the second for a thermal application. We've continued to advance our M&A strategy which is focused on expanding our geographic reach, diversification of our end market profile and increasing the broadness of our products and customer base. This is becoming more visible with the recent Ferroperm acquisition, where we now have the capability to develop and deliver both diagnostic and therapeutic products. We continue to focus on complementary materials, sensor and transducer acquisition opportunities to increase our non-transportation growth, while at the same time seeking to expand the portfolio of electrification products for broader mobility applications.

Strengthening our M&A pipeline of opportunities to meet our overall growth target remains a priority. With a strong balance sheet and cash position, we have the capability to make a meaningful impact on our inorganic growth initiatives. As already mentioned, our goal remains to accelerate inorganic revenue growth by deploying capital in a disciplined way to expand our range of technologies, products, customers and geographic reach. We believe this strategy continues to bear fruit as we are seeing the diversification of our business progressing with third quarter sales at approximately 48% of our total revenue in non-transportation markets and the overall enhancement of the quality of earnings.

Our acquisitions of QTI, SSI and TEWA demonstrates the execution of our strategic plan and track record of thoughtfully expanding ceramic technology to support diversification, while at the same time, leveraging our ceramic expertise to build and scale our temperature sensing platform. 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 as our team continues to develop our pipeline of prospects.

In transportation, we continued to perform in an environment, where OEMs and Tier 1 suppliers are navigating challenging supply issues. We continue to see robust demand in commercial vehicles and while headwinds are already visible with a slowdown in freight, aged fleet still require replacement and are increasing backlogs. We expect this replacement demand to extend into 2023. We are seeing some challenging supply constraints on semiconductor parts that may temporarily impact our revenues in the fourth quarter and into the first quarter of 2023.

On the light vehicle front, volume growth remains a challenge, given the supply side issues across the industry. We also remain cautious on light vehicle demand going forward, due more to weakness in consumer sentiment and supply disruptions and view demand trending flat going into the end of this year and into next 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 range is approximately 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.

Key drivers of our ability to attain this goal will be our ability to transfer our legacy accelerator module and sensor products to electric and hybrid vehicle applications, and new products being added to the portfolio. We were selected by a North American OEM and funded for pre-development of an eBrake module. In addition, our new current sensing product will begin shipment in the fourth quarter of 2023 to support a European premium platform. More recently, we began shipments of Chassis sensing product for an easy platform in North America. Overall, we're making solid progress towards our goal to achieve greater than 25% of our light vehicle sales from EV platforms.

Our value proposition in transportation has been built on our expertise in designing and packaging, position sensing for safety, critical and harsh environments where our teams have developed deep industry experience. In the quarter, we had six EV platform wins across existing customers, covering several products in our portfolio. For Chassis ride height sensing, we had wins with a North American OEM and added a new EV customer in Asia. We also had accelerator module wins for EV application with three existing customers. For passive safety sensors we had an award with a North American Tier 1. Finally outside EV for commercial vehicle application, we had strong wins for existing and new actuator products.

Looking ahead, we currently see good demand in medical and defense markets with some softness in industrial and distribution where we see some increased inventory levels. We expect to see continued benefit from our recent acquisitions. Momentum is solid with the Ferroperm acquisition and the excitement and momentum in our

temperature platform continues to build. Mobility demand currently remains solid. In the light vehicle market, the [ph] loss of vehicle builds (00:15:50) so far this year have been driven primarily by COVID-19 lockdowns with an impact of over 1 million reduced units. And the semiconductor shortage impacting production volumes negatively by 3 million to 4 million units this year. We remain cautious and order demand going forward, given recent customer sentiment and higher interest rates. We expect incremental volume gains in the years ahead due to the recent recessionary volumes in transportation markets.

We expect US light vehicle production to be in the 13.5 million to 14 million unit range this year. European production has been revised down and is now forecasted in the 15 million to 16 million unit range. The Chinese market is expected to be flat this year in the 24.5 million to 25 million unit range. Commercial vehicle demand, as previously mentioned, remains robust. However, as I mentioned earlier, we expect some challenges in the commercial vehicle market due to a temporary issue with a semiconductor supplier, which is likely to unfavorably impact our revenues in the next two quarters.

Overall, we expect some softness in the short-term, driven by macroeconomic factors such as inflation, high interest rates and the geopolitical challenges. Despite the near-term economic headwinds, we feel confident in the long-term prospects for the business driven by our strategic focus on diversification, electrification and our strong balance sheet. Our teams are creatively navigating the current environment to ensure supply for our customers, while at the same time maintaining a strong focus on strengthening our go-to-market capabilities and adding new customers globally. We were able to maintain operations this past quarter while ensuring a safe working environment for employees as we experienced continued lockdowns in the Asian market.

As always, we are monitoring the macro environment very closely and remain concerned by recent developments. I am pleased to say in this very challenging environment, our teams are working and adapting with speed and agility to support our customers, demonstrating the strength of our underlying culture, leadership and core values. Then in terms of the financial outlook for the full year 2022, our guidance is now for sales to be in the range of \$585 million to \$595 million. Adjusted earnings per share are expected to be in the range of \$2.40 to \$2.55.

Now let's turn it over to Ashish, who will walk us through our financial results in more detail. Ashish?

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

Thank you, Kieran. Third quarter sales were \$152 million, up 24% compared to the third quarter of 2021 and up 5% sequentially from the second quarter of 2022. Foreign currency exchange rates impacted revenue unfavorably by approximately \$4.1 million in the quarter, as the euro and Chinese renminbi depreciated versus the US dollar. Most of this impact was related to sales in the transportation market. Sales to non-transportation end markets increased 22.5% year-over-year, supported by another quarter of double digit growth in the industrial and medical end markets.

Our two acquisitions added \$8.6 million in sales during the quarter. Sales through transportation customers increased 25.7% compared to the third quarter of 2021 and increased 4.9% sequentially, driven by the robustness in demand, which Kieran mentioned. Our adjusted gross margin was 36.6% in the third quarter, down 70 basis points compared to the third quarter of 2021 and up 50 basis points compared to the second quarter of 2022. Ongoing commodity inflation and supply chain headwinds pressured margins during the quarter. We are also seeing increases in energy and labor costs. We have been able to partially mitigate these impacts through pricing and operational improvements across our organization.

Due to the significant movement in exchange rates, we saw an unfavorable impact of slightly more than \$1 million on gross margin. We have realized \$0.19 of savings to-date from our 2020 restructuring program. As previously communicated, we still expect to achieve the lower end of the \$0.22 to \$0.26 of savings by 2023, as we balance growth with the completion of some of the restructuring projects. We reported earnings of \$0.37 per diluted share in the third quarter. Adjusted earnings for the third quarter were \$0.62 per diluted share, compared to \$0.46 per diluted share at the same time last year and \$0.62 per diluted share in the prior quarter.

Moving on to cash generation and the balance sheet, we generated \$60.4 million in operating cash flow for the third quarter of 2022. Included in this number is approximately \$34 million that we received during the quarter as part of the surplus cash from termination of our US pension plan. Approximately, \$7 million of this cash gets used for excise tax payments in the fourth quarter.

Controllable working capital as a percentage of sales was 15.6% at the end of the third quarter of 2022. We are carefully watching our working capital, especially inventory levels across different parts of our business as a key area to improve efficiency. Strong cash generation and maintaining a healthy balance sheet is an important priority for us to support the continued focus on organic growth and strategic acquisition.

During the quarter, we repurchased approximately 52,000 shares of CTS stock, totaling \$1.8 million. In total, this year we have returned over \$17 million to shareholders through dividends and buybacks. We ended the third quarter with a cash balance of \$148 million and our long term debt balance was \$85 million. Our debt to capitalization ratio was at 14.8% at the end of the third quarter, compared to 9.9% at the end of Q3 of 2021.

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 comes from Joshua Buchalter from Cowen. Please go ahead.

Joshua Buchalter

Analyst, Cowen Inc.

Q

Hey, guys. Thanks for taking my question and congrats on the solid results. The guidance implies a sequential decline in the fourth quarter and I totally recognize the prudent conservatism in much of your commentary. But anything you can share on expectations by end market, in particular, auto reaccelerated in the third quarter. So, I'm wondering is that – do you feel that's related directly to end demand or is it more GM called out completing some vehicles that had been partially [ph] completed unlocked (00:23:27) last quarter? Is it sort of that dynamic or do you feel like you're shipping to end demand more comfortably? Thank you.

Kieran M. O'Sullivan

Chairman, President, Chief Executive Officer & Director, CTS Corp.

A

Hey, Joshua, good morning and thanks for your question and a few things. Obviously, we had a strong third quarter, but in my prepared comments, I mentioned that we were having challenges with a semiconductor supplier impacting our commercial vehicle volumes and that's something that's going to impact us temporarily both in the fourth quarter and the first quarter of next year and then should be corrected. So that's mid-single digits in value we would think. And then we're just watching the softness in the industrial market. We've seen

some strength and some softness and trying to balance that out. So, other end markets are seem to be doing well.

Joshua Buchalter

Analyst, Cowen Inc.

Q

Thank you for that. And then, I know you mentioned a bunch of inflationary cost pressures, but your margins were still hung in pretty nicely. Any changes to, I guess, your ability to pass on costs – rising input cost to customers? [ph] Or any really (00:24:33) tone changes at your customers that we should be aware of in light of what's objectively some weakening macro data points and softer industrial demand? Thanks and congrats on the results again.

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

A

Josh, the pricing environment we've talked about in the past, it's always a tough discussion. The first round is tough. The second round is tougher by far. That's what we are seeing. We continue having those discussions. We are able to get some pricing, obviously not enough to offset all of our cost increases, but we're finding a reasonable balance of sharing that burden between us and our customers and maintaining long-term relationships.

No significant change to that environment. But as you pointed out, as the macroeconomic situation gets more challenging, it is possible that we might start facing some of those pressures and we are keeping a very close eye on that. Our goal will be to also obtain material cost savings to help balance that equation. So I would look at those as mutually going together in terms of price pressures and material cost improvements.

Kieran M. O'Sullivan

Chairman, President, Chief Executive Officer & Director, CTS Corp.

A

And Joshua, just one point to add, we've got a long way to go on the material deflation from where we were two years ago. So it's still quite a bit of pressure we're carrying.

Joshua Buchalter

Analyst, Cowen Inc.

Q

No. Thank you, and then if I could squeeze one more in. Ashish, toward the end of the prepared remarks you mentioned, you're sort of taking a close look at inventory, levels have been roughly stable the last several quarters. But is roughly in the 50 or 60 days range sort of where you feel comfortable and where you'll be managing the business the next several quarters in this environment. Thank you.

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

A

Yeah. I mean the inventory levels have gone up and we are managing that. Our biggest concern is that if there is a slower demand environment, we don't want to be sitting on a lot of excess inventory and we are continuing to manage that through our – throughout our supply chain also keeping track of the inventory levels at our customers and at our suppliers. So not a huge area of concern, we just don't want to be sitting on a lot of excess inventory if we go into a slower environment.

Joshua Buchalter

Analyst, Cowen Inc.

Q

Got it. Thanks, Ashish. Thanks, Kieran.

Kieran M. O'Sullivan

Chairman, President, Chief Executive Officer & Director, CTS Corp.

Thank you.

A

Operator: Our next question comes from John Franzreb from Sidoti. Please go ahead.

John E. Franzreb

Analyst, Sidoti & Company, LLC

Good morning, guys, and thanks for taking the questions. Kieran, I want to start with something you said in the beginning of your prepared remarks about energy cost in Europe. Could you talk a little bit about how that's maybe kind of been embedded into your guidance right now for the fourth quarter versus how you're thinking about it a quarter ago and maybe how we should be thinking about it into the first quarter also?

Q

Kieran M. O'Sullivan

Chairman, President, Chief Executive Officer & Director, CTS Corp.

John, I would say, the materiality of it currently is on the lower end, really it's more of an issue going into next year where we see the bigger challenge on that with our operations in Czech Republic and Denmark and some other areas as well. But more of an issue going into next year than this year, some impact, but not – the more significant issue is next year.

A

John E. Franzreb

Analyst, Sidoti & Company, LLC

Okay. And you talk a little bit about the goal to hit 25% of sales in EV market. I'm curious, as you're starting to see this transition materialize and become a greater part of your revenue profile. Are you seeing increased dollar content on EV vehicles versus ICE or are you seeing better margin profile or neither?

Q

Kieran M. O'Sullivan

Chairman, President, Chief Executive Officer & Director, CTS Corp.

I would say, John, as we – with EV we see an opportunity to increase the content. I mentioned in the prepared remarks that we had been funded for a pre-development of an eBrake product. So that's obviously not a production win yet, but doing the engineering work on this, and that's a market of maybe some \$600 million, \$700 million, so being a player in that market is going to add content significantly for us going forward. But we've got to turn that pre-development into a win to get that content there. And we like the new EV products that we're bringing to the market. And they've got – we've got to be competitive, of course, but we don't see it changing our profile dramatically.

A

John E. Franzreb

Analyst, Sidoti & Company, LLC

Got it. Got it. And I might have missed this, but what was the transportation sales as a percent of the total volume in the third quarter?

Q

Kieran M. O'Sullivan

Chairman, President, Chief Executive Officer & Director, CTS Corp.

Ashish, [indiscernible] (00:29:43)?

A

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

It would be approximately 52%.

A

John E. Franzreb

Analyst, Sidoti & Company, LLC

Okay. So it's kind of flat compared to the previous quarter.

Q

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

Yeah.

A

John E. Franzreb

Analyst, Sidoti & Company, LLC

And one last thing, you talked about the opportunity [ph] cost of chips (00:29:57) being about 3 million to 4 million units. I'm guessing you're thinking that that's the North American number or you're putting that as a global number. And when's your best guess Kieran of when that kind of eases out?

Q

Kieran M. O'Sullivan

Chairman, President, Chief Executive Officer & Director, CTS Corp.

Yeah. John, the chip number is probably more of a global number and I think it ranges somewhere from 3 million to about 4.2 million or 4.3 million this year that will be the final kind of trend rate it's going. And so we see that improving as we go into next year, but probably still a challenge through the first quarter. Because I did highlight again on the commercial vehicle front, we have a supply issue there that impacts us in the fourth and first quarters of – the next two quarters.

A

John E. Franzreb

Analyst, Sidoti & Company, LLC

Okay. And then [indiscernible] (00:30:50) I'm going to squeeze one more in. Regarding, Ashish, the 2020 restructuring program that you've gotten \$0.19 from year-to-date, the timing of realizing the balance of that savings of \$0.22 to \$0.26, albeit at the low end, is that going to be first half of 2023, second half of 2023, mid? What are your thoughts there?

Q

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

John, we are really looking at the demand environment in terms of how quickly we can move. So if things are a little bit softer in the first part of 2023, then I would expect us to move more quickly.

A

John E. Franzreb

Analyst, Sidoti & Company, LLC

Okay.

Q

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

A

If the demand environment continues to remain robust, then it might slip a little bit later on, but I would expect by Q3 timeframe we should be done with those transitions that we were targeting as part of the 2020 plan.

John E. Franzreb

Analyst, Sidoti & Company, LLC

Okay. Thanks, guys. I appreciate you taking my questions.

Kieran M. O'Sullivan

Chairman, President, Chief Executive Officer & Director, CTS Corp.

Thanks, John.

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

Thank you John.

Operator: Our next question is from Justin Long at Stephens. Please go ahead.

Yeah. Good morning, everyone. This is [ph] Brady (00:32:01) on for Justin. I know there's a lot of crosscurrents and some uncertainties in the macro environment right now. But if you were to kind of look across your end markets and think about the outlook for 2023, where do you kind of see is the up arrows and the down arrows at this point in time?

Kieran M. O'Sullivan

Chairman, President, Chief Executive Officer & Director, CTS Corp.

Yeah. We feel good about medical. We feel good about certain parts of industrial and aero and defense is trending in a good direction, but it's probably at a slower pace. And then on the transportation side, it's pretty mixed, where we – I said in my prepared remarks that we see it flattening a little bit. There have been supply chain issues that I mentioned already, but it's really we see that more of an issue with the consumer than supply chain longer term in 2023 with the higher interest rates. And we think that's going to be a bit more challenging. You're flat to up single digits would be very good.

Okay. Awesome. And then maybe if I could just get one follow-up in here. Could you talk a little bit about the level of activity in the acquisition pipeline versus a quarter ago? Have you seen any easing of valuation multiples given the uncertain macro environment?

Kieran M. O'Sullivan

Chairman, President, Chief Executive Officer & Director, CTS Corp.

Well, we're actively working the pipeline. We've got a strong balance sheet and it's a key part of our growth trajectory, as well as organic growth. We haven't seen a softening in multiples, but we would expect the softening in multiples going forward.

Q

Okay. That's helpful. Thanks, guys.

Kieran M. O'Sullivan

Chairman, President, Chief Executive Officer & Director, CTS Corp.

Thank you.

A

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

Thank you.

A

Operator: Our next question comes from Hendi Susanto from Gabelli Funds. Hendi, please go ahead.

Hendi Susanto

Analyst, Gabelli Funds LLC

Good morning, Kieran and Ashish.

Q

Kieran M. O'Sullivan

Chairman, President, Chief Executive Officer & Director, CTS Corp.

Morning, Hendi.

A

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

Hi, Hendi.

A

Hendi Susanto

Analyst, Gabelli Funds LLC

First questions. So, Kieran, how much visibility and ability to adjust when it comes to managing softness in industrials and potentially significant improvement in supply chain constraint in automotive after Q1 next year. I think what I would like to know is in industrials, I think there are some inventories in the channels and that they're also like end customer demands and then the two may not move in – at the same level, let's say. So I'm wondering, like how much visibility and then how you can adjust one way or another.

Q

Kieran M. O'Sullivan

Chairman, President, Chief Executive Officer & Director, CTS Corp.

Yeah. So Hendi, as I mentioned, we've seen some increasing inventories in certain parts of industrial and distribution as well. And on the transportation side, inventory levels continue to be low. We haven't seen big problems in medical or aero and defense at this point in time. And then in terms of adjusting, I would say two things. Number one, when we were hit by COVID back in 2020 and our automotive volumes went down by about 50%, we were able to flex pretty quickly and still maintained a profitable trajectory for the company. And I think you know that we're a pretty disciplined management team. We would have scenarios already prepared for how we would respond to a dip of 10% or greater in the market. So just expect us to be disciplined on that as we go forward.

A

Hendi Susanto

Analyst, Gabelli Funds LLC

Q

I see. And then how much visibility, Kieran, in terms of, let's say, like how many weeks you have visibility toward customer demand and fulfillment?

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

A

It varies across the different customers and the different applications, but it varies from several weeks up to three months. But you always got to be careful in this type of environment, where demand corrections happen and demand gets pushed out. We haven't seen much of that, but it's something that we're concerned about and watching.

Hendi Susanto

Analyst, Gabelli Funds LLC

Q

I see. And then second question for Ashish. Ashish, would you be able to share the breakdown of revenue contribution from TEWA and then Ferroperm?

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

A

Hendi, let me take a look at that and I'll come back to you. Obviously, the contribution from Ferroperm is larger. I'm expecting it's in the \$5 million to \$6 million range and the balance coming from TEWA. But I can get back to you on the more precise numbers.

Hendi Susanto

Analyst, Gabelli Funds LLC

Q

I see. Yeah. And then last question from me. If I look at CapEx, I'm wondering whether CapEx will be back on loaded in Q4, considering that you have spent like \$9.3 million in the first nine months and I believe that CapEx will be higher than that, let's say, like a normalized run rate?

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

A

Yeah. So from a cash flow standpoint, there are a couple of things. The Q4 CapEx will – is expected to be slightly higher Hendi, and I'm wording it that way, because we generally say we will spend and then we don't end up spending quite that much, because generally the business leaders are very prudent about their CapEx spending. The other thing to watch for which I mentioned in the prepared remarks also is the cash that we got back from the pension plan. We will be paying \$7 million out of that for excise taxes. So that also unfavorably impact the fourth quarter cash flow.

Hendi Susanto

Analyst, Gabelli Funds LLC

Q

That's very helpful. Thank you so much, Ashish. Thank you, Kieran.

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

A

Thanks, Hendi.

Ashish Agrawal

Vice President & Chief Financial Officer, CTS Corp.

Thank you, Hendi.

A

Operator: [Operator Instructions] We have no further questions on the call, so I will hand the floor back to Kieran.

Kieran M. O'Sullivan

Chairman, President, Chief Executive Officer & Director, CTS Corp.

Thanks, Seb, and thank you for joining us today, everyone. I want to thank our global teams for their dedicated efforts in driving strong execution and operational efficiency. I'd like to reiterate that CTS is well-positioned for the future, and I'm confident that our diversification strategy, bolstered by our recent M&A activities and the breadth of our geographic footprint, will enable CTS' trajectory of profitable growth while we navigate current macroeconomic uncertainty. We have a strong team aligned around common goals that continues to advance the business for long-term value creation for our shareholders and for all our constituents. Thank you. This concludes our call.

Operator: Thank you for dialing into today's conference call. You may now disconnect your lines.

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