CPI INTERNATIONAL HOLDING CORP.

Q1 2017 FINANCIAL RESULTS CONFERENCE CALL
February 8, 2017
11:00 a.m. ET

Operator: Good day everyone and welcome to the CPI International First Quarter 2017 Financial Results conference call. My name is Bryan and I will be your conference coordinator for today's call. At this time our participants are in listen only mode. We will be facilitating a question and answer session at the end of today's call.

If you require assistance at any time during the call, please press star, followed by zero and a coordinator will be happy to assist you. As a reminder, this call is being recorded for replay purposes. I will now turn the call over to Amanda Mogin, director of investor relations of CPI International. Please proceed.

Amanda Mogin: Thank you, Bryan. Good morning and welcome to the CPI International conference call to discuss the first quarter of fiscal 2017. The agenda for our call is as follows: First Joe Caldarelli, our Chief Executive Officer, will discuss our first quarter order sales and business conditions in our three largest markets. Next Joel Littman, our chief financial officer, will discuss our key profitability and liquidity metrics for the quarter. Joe will then discuss our current expectations for the remainder of fiscal 2017. And lastly, Bob Fickett, our president and Chief Operation Officer, will join us for the question and answer session at the end of our prepared remarks.

Before we proceed, however there are some administrative details to cover. Please bear in mind that today's presentation includes forward looking statements within the meaning of the Securities and Exchange Act of 1934. These statements are based on our best view of our markets and business as we see them today as well as on certain assumptions, and actual results can change as market conditions change. Please interpret these statements in that light.

Additional information regarding risks and uncertainties related to our business are included in the Safe Harbor statement in yesterday's press release and in our filings with the Securities and Exchange Commission. Today's presentation under Securities and Exchange Commission rules also includes non-GAAP financial measures related to EBITDA and cash flow.

A presentation of the most directly comparable GAAP measures and s reconciliation of each of these non-GAAP financial measures to the most directly comparable GAAP measures are available in yesterday's press release, which has been posted to our website. Interested parties can access the press release by going to www.CPII.com and opening the press release entitled "CPI International Announces First Quarter 2017 Financial Results." I will now turn the call over to Joe Caldarelli to discuss CPI's first quarter performance.

Joe Caldarelli: Thank you. Good morning. Following a strong finish to fiscal 2016, our performance in Q1 of fiscal '17 was consistent with the guidance we issued in December. As expected, our sales and profit rose in comparison to the year ago quarter. Overall demand for our products remains steady and conditions in the medical market have improved. Our backlog remains healthy and we continue to generate cash.

In Q1, CPI booked orders totaling 104 million, a 14 percent decrease from the 120 million we booked in the year ago quarter. This decrease was primarily due to the timing of large programs in the defense and communications markets that resulted in lower orders in those markets. Orders in our medical business improved as conditions within the market have improved.

Sales in Q1 totaled 115 million, increasing four percent from the 111 million we shipped in the same quarter of fiscal 16. Sales increased in the medical and communications markets but decreased in the defense market due to the completion of one sizable radome program.

As of the end of Q1, our backlog remained healthy at 316 million. As anticipated, our book to bill ratio was a little soft in Q1 but we expect it to strengthen as the year progresses. In fact, in the first several weeks of Q2, we booked a number of multi-million dollar orders, several of which had originally been expected in Q1. That will improve this metric going forward. This orders spanned multiple -- these orders spanned multiple divisions of CPI and multiple end markets and they included orders for amplifiers, antennas and high-power VED products.

In the defense market, we booked 35.6 million in orders in Q1, a $3 million decrease from the amount booked in the year ago quarter. This decrease is more than explained by the timing of a large order for our largest defense program, the Aegis radar system. As you may recall, in 2016, our Econco Division, which has historically provided rebuilt power grid devices for the Aegis radar systems, booked a $9 million multiyear order to provide new power grid devices for these systems. This multiyear order was the largest single order ever received in Econco 50 year history and was not expected to repeat in the recent quarter.

This decrease in Q1 Aegis orders was purely a timing issue. Our long-term Aegis business remains stable and secure. Orders to support a variety of other defense programs including other domestic radar systems partially offset this decrease.

Sales in the defense market totaled 36.7 million, decreasing 3.2 million from last year's quarter. As with orders, this decrease was entirely attributable to one program.

In the second half of fiscal '16, CPI Radant Technologies division completed a large multiyear program for which it provided multiple times -- types of radomes for military aircraft. The absence of this program in the most recent quarter resulted in the decrease in defense sales.

Overall, CPI's defense business remains healthy and demand remains steady. We are still seeing some program delays that may impact the timing of orders but they are manageable. The defense market remains a solid recurring business for CPI.

Our communications market also remains healthy but we faced a tough Q1 comparison for orders. This is a dynamic market characterized by sizeable programs that may need substantial upgrades or numerous earth stations only every few years.

Last year's first quarter set a company record both for the highest level of total communications orders and the highest level of military communications, or milcom, orders booked in a quarter. In particular, in last year's first quarter, we received significant orders for a number of foreign commercial satcom programs as well as a number of sizeable milcom orders for shipboard, TCDL and sustainment programs.

In comparison to last year's record levels, in Q1 of '17, our communications orders were in line with our average quarterly orders level for the past two years. In other words, at 47.7 million, our Q1 communications orders were consistent with expectations but not exceptional like last year. The decrease was primarily the result of the coincidental occurrence of several large programs in last year's first quarter.

Our communications sales totaled 51.6 million in Q1, increasing by 5.8 million and driven by strong orders received in previous quarters. Our milcom sales increased during the quarter, primarily due to higher sales of advanced TCDL antenna products from our Malibu Division and higher sales of certain aircraft radomes from our Radant Technologies Division.

We have seen no fundamental changes to the communications market. In fact, some of CPI's most promising growth opportunities are within this market. We are confident our communications business will continue to perform well in fiscal '17.

In the medical market, conditions have improved compared to last year. As you may recall, some of our foreign customers within this market faced challenging economic conditions that hampered their demand in fiscal '16.

We told you on our Q4 call that we expected 2016 to be the floor for our medical business and that it would grow going forward. That has proven true in Q1, as we have seen higher demand from foreign customers, particularly in Asia, for our medical emission products. As a result, we recorded double-digit percentage increases in both our orders and sales in this market during the quarter.

Our Q1 medical orders increased by 17 percent to 12.7 million. This increase was due to higher orders for x-ray imaging products, primarily for foreign customers.

Our Q1 medical sales increased by 14 percent to 18.4 million. This increase was similarly due to higher sales of x-ray imaging products to foreign customers. Sales of radiation therapy products increased as well.

Within our medical market, our radiation therapy business remains stable, and we believe that the external challenges that reduced demand for our medical imaging customers have settled. As discussed on last quarter's call, the introduction of new medical imaging products in 2017 will also drive our forward momentum within this market.

As you have seen, fiscal ’17 is off to a good start and demand for CPI products remains healthy. In markets where we saw decrease in orders or sales, those were due to the occurrence of large programs last year.

I would now like to turn the call over to Joel to discuss our financial performance during the quarter.

Joel Littman: Thanks, Joe.

Good morning. As always, the definitions and reconciliations of the non-GAAP metrics that I will discuss in my remarks this morning are available on the financial tables of the press release we issued yesterday afternoon.

I will start today’s discussion with our key measures of profitability, net income and adjusted EBITDA. In comparison to the year ago quarter, both of these profitability measures increased due to the positive impact of the higher sales levels in the first quarter of fiscal 2017.

CPI’s net income in the most recent quarter totaled approximately 200,000, an increase of 1.4 million from last year’s first quarter net loss of 1.2 million. The increase in net income is primarily due to the increase in sales volume.

The first quarter of fiscal 2017 also benefited from the absence of acquisition related expenses that were incurred in the first quarter of fiscal 2016 in conjunction with the purchase of ASC Signal Corporation in September 2015.

Our adjusted EBITDA totaled 18.6 million, or 16.3 percent of sales, in the most recent quarter, an increase of 2.3 million as compared to the 16.3 million, or 14.7 percent of sales, recorded in last year’s quarter. Again, this increase was primarily due to the positive effect of higher sales volume in this year’s quarter.

Our adjusted EBITDA margin was consistent with our stated guidance of mid to high teens. We expect our adjusted EBITDA margins to strengthen as the year progresses.

Let’s turn now to our liquidity metrics. CPI continued to generate healthy, positive cash flows during the quarter.

As of the end of the first quarter, CPI's cash and cash equivalents totaled 44.3 million, as compared to 50.2 million at the end of fiscal 2016. The decrease in these amounts was due two payments made during the first quarter that were related to our debt.

Under the terms of our credit agreement, we are required to make an excess cash flow payment at the conclusion of each fiscal year, as defined in the agreement. Following a successful 2016, we made a 9.9 million excess cash flow pre-payment during this year's first quarter to the holders of the term loan.

The other large payment we made in the first quarter was related to the bridge financing commitment letter that we entered into with UBS in December. As we discussed on last quarter's call, UBS has committed, subject to conditions in the letter, to provide CPI with up to 245 million in bridge financing that we can use to refinance our senior notes and our second lien term loan, if we are unable to refinance our senior notes through other means in the next several months. In the first quarter we made 2.5 million in payments related to the signing of this agreement.

Excluding these two debt related payments, our cash interest- our cash increased 6.7 million in the first quarter of fiscal 2017.

CPI generated 30.9 million in cash flow from operating activities in the 12 month period ended December 30. During that period, we also generated free cash flow of 24.6 million and adjusted free cash flow of 26.4 million. Our operating cash flow and adjusted free cash flow for the recent 12 month period continued to exceed our annual guidance of more than 28 million and 22 million, respectively.

As you can see, CPI remains profitable and healthy, with significant financial resources at our disposal.

At this time, we can provide no update to our December discussion regarding our plans to refinance our debt. We remain confident that we will be able to repay or refinance our senior notes this year, either through financing provided by UBS under the terms of the bridge financing commitment letter or through another source of funds.

I will now turn the call back over to Joe to discuss our expectations for the remainder of the fiscal year.

Joe Caldarelli: Thanks, Joel.

Our performance in Q1 represented an improvement from last year's quarter, as we expected. At this point in time, the rest of the fiscal year looks to be in line with the guidance we gave in December. Our market conditions are essentially unchanged, with the exception of the anticipated improvement of conditions in the medical market. We continue to expect to gain positive momentum as the year progresses, with performance in the second half of the year that outpaces the first half.

This concludes our prepared remarks today. We appreciate your time and attention this morning. Operator, please open up the call for questions.

Operator: Certainly. Ladies and gentlemen, if you have a question at this time, please press star and then the one key on your telephone keypad. If a question has been answered or you wish to remove yourself from the queue, please press the pound key. One moment for questions.

Once again, if you have a question at this time, please press star and then the number one key on your telephone keypad. If a question has been answered, or you wish to remove yourself from the queue, please press the pound key.

I am showing no further questions. I would now like to turn the call back to Joe Caldarelli for any further remarks.

Joe Caldarelli: We thank you very much for listening to us this morning, and we look forward to talking to you again in May, thank you.

Operator: Ladies and gentlemen, thank you for doing today's conference. This concludes today's program. You may all disconnect. Everyone have a great day.

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