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KE - Q3 2015 Kimball Electronics Inc Earnings Call

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CORPORATE PARTICIPANTS

Don Charron *Kimball Electronics Group LLC - CEO*

Mike Sergesketter *Kimball Electronics Group LLC - CFO*

PRESENTATION

Operator

Good morning, ladies and gentlemen. My name is [Saeed] and I will be your conference call facilitator today. At this time, I would like to welcome everyone to the Kimball electronics third quarter fiscal 2015 financial results conference call.

All lines have been placed on a listen-only mode, to prevent any background noise. After the Kimball speakers' opening remarks, there will be a question and answer period, where Kimball will respond to questions from the analysts. (Operator instructions).

Today's call, May 12th, 2015, will be recorded, and may contain forward-looking statements, as defined under the Private Securities Litigation Reform Act of 1995. This factors that may influence the outcome of forward-looking statements can be seen in Kimball's form 10, declared effective on October 7th, 2014, and today's release.

The panel for today's call is Don Charron, Chairman of the Board and Chief Executive Officer, and Mike Sergesketter, Vice President and Chief Financial Officer of Kimball Electronics. I would now like to turn today's call over to Don Charron. Mr. Charron, you may begin.

Don Charron - *Kimball Electronics Group LLC - CEO*

Thank you, Saeed, and welcome everyone to our third quarter conference call. Our earnings release was issued this morning on the results of our third quarter ended March 31st, 2015. We've also posted a financial summary presentation to accompany this conference call.

The presentation can be found on our investor relations website, within the events and presentations tab, or, if you are listening via the webcast, you can find it in the downloads tab on the webcast portal. I will begin by making a few remarks on the overall quarter, and then I will turn it over to Mike for the financial overview. After that, we will answer any questions that you may have.

The spin-off from Kimball International was completed on October 31st, 2014. Please keep in mind that our third quarter results reflect the first full quarter as a stand-alone public company. Also, while the legal separation was completed on October 31st, 2014, there were still several activities remaining to be completed, to separate the infrastructure, and effectively achieve full separation.

During this period, we had been relying on the parent company for certain services, as outlined by the transitions services agreements included in our form 10 filing with the SEC. We are very pleased to report that we are making great progress, and expect to complete the majority of these spin-related activities by June 30th, 2015, six months ahead of our original schedule.

Our support teams have done a remarkable job staying focused on these spin-related activities, and making sure that they do not impact our operations. Completing these spin-related activities will not only help achieve full separation, but it will also help us lower our cost structure, and offset the added cost of becoming a stand-alone public company.

Overall, we were very pleased with our third quarter results. Solid growth in all four end-market verticals helped us achieve year-over-year double-digit growth for the third consecutive quarter, as well as excellent operating results.

We were particularly pleased with the results our automotive vertical, where stronger than expected sales to the China market helped us more than fill in the hole created by the earlier reported loss of the Johnson Controls business. The final Johnson Controls products were substantially completed last quarter, and we continue to be encouraged by the progress that we are making to replace this business.



While the overall market conditions appear to be mixed, our new business opportunities pipeline remains healthy, and we continue to have good momentum in each of the four end-market verticals we serve.

As I stated in our last call, our business and operations teams are focused on margin improvement, and effective capital utilization. Our lean 6 sigma projects and our global purchasing initiatives helped us exceed our adjusted operating income goal of 4% for the fifth consecutive quarter.

Continued progress in these areas is critical for us to maintain our margins while meeting the cost reduction expectations of our customers. We continue to take advantage of the flexibility provided by our strong balance sheet, making investments that will drive future growth in sales and profits.

New capital to support the European capacity expansion in Romania, as well as the significant new business wins, will in most cases be deployed in advance of the sales growth, and therefore put short-term pressure on our targets that we have set for capital metrics.

Maintaining margin improvement and effective capital utilization will continue to be priorities and focus for us going forward. Now we'll turn it over to Mike to discuss our third quarter results in more detail. We will then open the call to your questions. Mike?

Mike Sergesketter - Kimball Electronics Group LLC - CFO

Thanks, Don. I'll briefly cover our financial highlights for the third quarter, and then as Don mentioned, we'll open the call up for your questions. Starting with the top line, our third quarter net sales were \$206.9 million, an increase of 11% from the prior year third quarter.

And as Don mentioned, this is our third consecutive quarter of year-over-year double-digit growth. Comparing our sales growth by vertical to the same quarter a year ago, our automotive vertical was up 4%, largely on the strength of the China market.

The impact on sales from the Johnson Controls exit was \$17.2 million reduction compared to the same quarter last year, and excluding the Johnson Controls related products, our automotive sales were actually up 44%, again largely on the strength of the China market.

Our medical vertical was up 9% from both increased demand for existing products, and new product awards. Our investor vertical was up 25% over the prior year as we saw strengthening in that market. Our public safety vertical was up 13% compared to a year ago, also from both increased demand for existing products, and new customer awards.

Our gross margin improved 30 basis points during the third quarter compared to a year ago. The improvement resulted primarily from operating leverage due to the higher sales and lower incentive compensation costs, as well as our continued focus on lean 6 sigma projects, and global purchasing initiatives.

Selling and administrative expenses decreased \$1.1 million compared to the prior year third quarter. As a percent of sales, these costs declined 100 basis points compared to the prior year. The main contributors to the change in selling and administration were spin-off costs during the quarter of \$300,000, which was down \$500,000 of Q3 of '14.

Reduced costs related to the elimination of former parent charges and allocations for management fees, IT services, and so forth, which more than offset increased public company costs and compensation costs related to additional team members brought on board to support the Kimball Electronics as a stand-alone public company.

Our other income and expense in the net in the third quarter was an expense of \$900,000 compared to income of \$100,000 in the same quarter last year. Foreign exchange rate losses, which were not fully offset by derivative gains, was the primary driver of the other expense in the third quarter.

The effective tax rate for the third quarter was 27.6%. The effective tax rate was impacted primarily by a higher mix of foreign earnings during the quarter, at lower statutory tax rates, as compared to the U.S. rate, and favorable tax credit adjustments in the U.S.

The prior year Q3 effective tax rate of 21.8% was favorably impacted by a higher mix of foreign earnings at the lower statutory rates, and a foreign-deferred tax asset adjustment. Consolidated net income in the third quarter of fiscal '15 was \$7.2 million, compared to \$6.4 million in the third quarter of last year.

The prior year third quarter included \$700,000 -- or \$400,000 net of tax, of other general income related to proceeds from an antitrust class action suit that alleged the defendant sellers illegally conspired to fix prices of electronic components purchased several years earlier by some of our manufacturing facilities.

Excluding spin-off costs, net income was \$7.5 million for the third quarter, which compares to net income of \$6.7 million in Q3 of last year, when excluding the spin-off costs and the net income from the class action lawsuit.

Diluted earnings per share was \$0.25 in the third quarter of this fiscal year, compared to \$0.22 in the prior year quarter, or \$0.23 last year when excluding the spin-off cost, and the income from the class action lawsuit. Cash and cash equivalents at March 31st, 2015, were \$61.7 million. Cash flow provided by our operations in the third quarter was \$7.7 million.

Capital investments in the third quarter totaled \$6.1 million, primarily for new manufacturing equipment. We presently have no long-term debt as of March 31st, 2015, and our short-term liquidity available represented as cash and cash equivalents plus the unused amount of our credit facilities, totaled \$114.2 million.

Our balance sheet is very strong, and we think we're well-positioned for growth. With that, I'd like to open up today's call for questions from the analysts. Saeed, do we have any analysts with questions in the queue?

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator instructions). I'm showing no questions in queue at this time, sir.

Don Charron - Kimball Electronics Group LLC - CEO

OK, thank you. That brings us to the end of today's call. We appreciate your interest, and look forward to speaking with you on our next call. Thank you, and have a great day.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes our program. You may all disconnect, and have a wonderful day.



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