ATC TECHNOLOGY CORP

Moderator: Mary Ryan
February 10, 2010
9:00 am CT

Operator: Good day everyone and welcome to the ATC Technology Corporation fourth quarter and year-end 2009 results and 2010 guidance webcast. Today's conference is being recorded.

At this time, I would like to turn the conference over to Mary Ryan. Please go ahead.

Mary Ryan: Good morning. Thank you for joining us. With me today are Todd Peters, our President and CEO and John Pinkerton, our CFO.

Please turn to slide 2. Our agenda for today includes a brief overview of the company's fourth quarter and full year 2009 results, as well as the report on each segment's performance and new business opportunities presented by Todd.

The financial review will be presented by John. Todd will then present our 2010 guidance. At the end of Todd's comments, we will open the floor for questions to our pre-approved list of analyst, money managers and institutional holders.

Please turn to slide 3. Before we go to the substance of our call today, I would like to point out that many of our comments are considered to be forward looking statements under the Federal Securities laws.

These forward looking statements generally include all statements other than statements of historical fact including statements that are predictive that depend upon or refer to future events or conditions, or that concern future financial performance or position including future revenues, expenses, earnings, growth rates or margins.

You are reminded that forward looking statements are subject to numerous risks and uncertainties that could cause future results to differ materially from those stated or implied by our comments today. Those risks and uncertainties are fully described in our 2008 annual report on Form 10-K and other SEC filings.

Please turn to slide 4. For those of you who are unfamiliar with the ATC story, this slide presents a brief description of each of our businesses.

Please turn to slide 5. At this time, I would like to turn the call over to our President and CEO, Todd Peters.

Todd Peters: Thank you, Mary. Good morning. I would like to thank all of you who have joined us on the call today. My comments will cover the following four topics.

First, I will provide a brief overview of the company's 2009 fourth quarter and year end results. Second, I will highlight the factors that impacted each of our business segments. Third, I will provide a summary of our new business opportunities in each segment and fourth, after John presents additional financial detail related to our performance for 2009 I will discuss our strategy and guidance for 2010.

Please turn to slide 6 for the company’s fourth quarter and year end performance. As I reflect on 2009, simply stated I am proud of everything our team has been able to accomplish. All things considered we successfully executed on many of the goals and strategic initiatives we laid out for 2009.

In spite of economic headwinds that continue to challenge the US economy, our logistics business remains resilient.

I believe this is a testimony to both the excellent work of our employees as well as the strong ongoing relationships that we have built with our customers.

As a company we held our ground in 2009 by focusing on and controlling the fourth things we could definitively impact. First, we solidly executed across our operations.

Second, in a disciplined fashion we realized $18 million in cost reductions as we simultaneously continued making investments and improving our operations and expanding our services.

Third our operational flexibility enabled the successful launches of new business and fourth we continued to focus on cash flow and enhance our already strong liquidity position.

So 2009 wasn’t all about operational performance, I am glad to report that we had an outstanding year in business development as we secured an impressive $100 million in annualized new business across both segments.

These wins were generated for both new and existing customers to whom we expanded our service offerings during the year. In the fourth quarter alone we won $42 million of new logistics business.

These late 2009 logistics wins will help us get off to a solid start in 2010. The timing of these wins represents a significant shift by many companies to start making improvements in their supply chain after a year of hunkering down and maintaining the status quo.

These wins clearly highlight my optimism for our future growth prospects. Now let's look at the fourth quarter. Results were in line with our expectations and essentially flat compared to the fourth quarter of 2008 with revenues decreasing less than 1%, so $125.3 million as compared to $26.4 million last year.

On an adjusted basis for the fourth quarter we reported earnings per diluted share of 50 cents equivalent to the 50 cents for 2008. I am very proud of our 2009 performance given two primary factors.

First, we faced a high level of economic uncertainty at the beginning of 2009 as was reflected in our initial adjusted earnings guidance of $1.80 to $2.20 per diluted share. And second we are faced with a difficult challenge in our drive train business with the loss of the Honda transmission remanufacturing business.

For the full year 2009 revenues were $485 million, down 8.6% compared to 2008 with logistics down 2.3% and drive train down 21.1%.

For the full year on an adjusted basis, earnings per diluted share were $2.15 as compared to $1.91 for 2008. We ended the year with $73.8 million in cash and no debt.

In the face of a challenging economic environment, it is fair to say that we finished 2009 with a slightly better performance than our initial expectations.

Now let's review performance for the logistics business so please turn to slide 7. Our logistics segment delivered another outstanding quarter with revenue of $93.4 million, up 6.4% compared to last year's fourth quarter.

Principle factors driving this performance included the contribution of a new test and repair program with a leading handset OEM and a 37.6% increase in revenue with TomTom to coincide with the holiday selling season. This was partially offset by an 8.3% decline in revenue with AT&T primarily related to mobile device return volumes.

For the year our logistics revenue was down a nominal 2.3% to $345.3 million. Full year revenue with AT&T was $234.5 million, up $7.9 million or 3.5% as wireless held steady and we experienced growth with DSL resulting from the launch of services in 2008.

Full year revenue with TomTom was $52.8 million, down $20.6 million due to a difficult comparison to 2008 when we engaged in our ramp up of services and system bill of TomTom's finished fixed inventory for their retail channels.

During the year, we also expanded our service offering with existing customers by launching transpiration management and FTZ capabilities. These capabilities were well received. I'm pleased to share the news that we won $79 million of annualized new logistics business with just under 50% of that launched and realized in 2009.

Forty two million of the $79 million was won during the fourth quarter of 2009 and these programs will launch in early 2010.

During each quarter of 2009, we achieved solid merger performance which was largely attributable to cost improvements, a favorable mix of services as well as a solid execution and timing on our new business launches with both existing and new customers.

Now let's take a closer look at the drive train segment, so please turn to slide 8. Fourth quarter revenue came in at expected levels, down 17.4% from the fourth quarter last year, lead by the reduction in revenues with Honda.

We fell short of break even profit expectations primarily due to the slower launch of our engine programs as one of our customers used the opportunity to review and improve the production requirements utilized by the former supplier.

For the full year, the drive train story is much the same with revenues down 21.1%. Throughout 2009 we shared with you our disappointment at the loss of the Honda remanufacturing transmission business and overall softness in our base volumes and the corresponding challenges these present for us.

As demonstrated throughout the year, we did not hesitate to the take the steps necessary to further restructure the business to enable it to be modestly profitable.

Going forward, our goal will remain to deliver low single digit margins with a strong focus on cash flow generation. I expect to see a return to modest profitability during the second quarter as we continue to launch our engine programs. Now to our new business pipelines for both segments please turn to slide 9.

Our new business pipelines represent a snapshot of qualified opportunities with both existing and new customers. Not surprisingly, these pipelines fluctuate as customers award, modify or withdraw opportunities for any number of reasons.

As you can see from the left hand side of the slide, for the logistics business we currently have a robust pipeline of $197 million of annual revenue opportunities across 13 customers.

This is after having won $79 million of new business in 2009. Of the 13 over half are with potential new customers. I am very pleased to tell you that our new business pipeline reflects opportunities we have never seen before.

Driven by two factors that work behind the scenes, first going into 2010 there is more momentum as companies that we have been developing relationships with over the last few years are now moving ahead with their outsourcing plans and choosing us to help improve the supply chains.

Second, during the year, we strengthened our new business development team, now seven strong, representing various industry backgrounds.

The team is actively engaged and is gaining additional traction and bringing new opportunities with both existing new customers. They continue to do an excellent job of elevating the ATC brand in the marketplace.

And as a result we are being sought out to submit a wider range of RFPs than we have seen in the past. And the next six months, we set decisions on opportunities with 8 of the potential 13 customers.

Looking at the right side of the slide for drive train, we currently have $55 million in new business opportunities across 11 customers representing a balanced product offering.

We did win $21 million in annualized new business in drive train during 2009 including the addition of remanufactured engines to our North American product portfolio.

Our recently announced transmission remanufacturing program with Suzuki will launch during this current quarter.

At this time, I'd like to turn the call over to John and he will present additional financial details for 2009. Please turn to slide 10.

John Pinkerton: Thank you, Todd. Today, I will share with you our results of operations for 21009 including our cash flow and net debt highlights.

Please turn to slide 11. As Todd mentioned, net sales decreased 8.6%. Four primary factors contributed to the decline. First is the impact of Honda's decision to in source production of remanufactured transmissions.

Honda revenues decreased $17 million or 33%. Additionally as you know we continue to experience reduced demand for remanufactured drive train products across our entire customer base due to reductions in the size of in warranty vehicle fleets, general improvements in quality and persistent macro economic factors.

The second contributing factor is lower sales to TomTom related to a reduction in their in channel inventories compared to 2008.

The third factor relates to the completion in early 2008 of two small discontinued programs in our logistics segment. And finally sales decreased in part due to scheduled price concessions in our logistics segment granted in connection with previous contract renewals.

These factors were partially offset by the launch and expansion of new programs in our logistics segment including a test and repair program for a leading handset OEM and to a lesser extent, new engine programs in our drive train segment.

For 2009 I am pleased to report operating income of $26.5 million compared to an operating loss of $25 million in 2008. The results of both periods reflect good will impairment and restructuring charges in our drive train business due to a significant downshift in that business, especially during the past two years.

Excluding these charges, adjusted operating income of $68.6 million for 2009 increased nearly 8% from $63.8 million in 2008. This translates to a 200 basis point increase in adjusted operating margin to 14.1% and reflects solid operating performance, the efficient launch of significant new business and logistics and the realization of cost reductions in both segments

The good news continued with income from continuing operations of $11.7 million or 59 cents per diluted share, increasing from a loss of $22.7 million or $1.09 per share in 2008.

As I mentioned previously the results of both periods reflect goodwill impairment and restructuring charges. Additionally 2009 reflects a non-cash charge to record valuation allowances against certain foreign deferred tax assets as we have assessed their future recoverability as unlikely.

Excluding these charges, adjusted income from continuing operations of $42.7 million or $2.15 per diluted share increased 6% from $40.2 million or $1.91 per diluted share in 2008.

These changes were driven primarily by the same factors impacting operating income. Please turn to slide 12. As has been our legacy, we continue to generate substantial pre-cash flow.

Our adjusted cash flow from operations of $62 million increased $9 million compared to 2008. This solid performance reflects an 18% improvement in our inventory metrics.

Partially offset by an increase in accounts receivable due to the timing of revenue within the quarter, capital spending for 2009 a modest $8.6 million reflects the timing of new business wins and is split roughly 50/50 between logistics and drive train.

This compares to $11.3 million in 2008. The resulting free cash flow of $54 million includes a $5 million positive contribution from our drive train segment, despite the difficult operating environment and restructuring expenditures.

Cash provided from financing activities reflects proceeds from option exercises and no stock repurchases compared to last year when we repurchased 50 million of our outstanding stock.

We do not anticipate making any stock repurchases in 2010. We ended the year in an enviable liquidity position with $73.8 million of cash on hand and zero debt.

During the quarter, we repaid in full the $70 million Q1 preemptive draw on our credit facility. Additionally we have $149 million of borrowing capacity on our credit facility which we intend to renew or replace before March of 2011.

At this point, I would like to turn it back over to Todd.

Todd Peters: Thank you, John. Please turn to slide 13 for our 2010 outlook. As we enter 2010, I am optimistic that the worst is behind us. What gives me the confidence to say this?

As we review our recent wins and new business opportunities, companies are increasingly looking to improve the supply chains by collaborating with experts that combine cost savings, efficiency, consistent execution and overall customer care to the table.

While we won't win all the opportunities that surface, we will win our fair share of new business. With that said, I will try to add some perspective and offer my views to how we see 2010 unfolding for our business.

Wireless devices pure and simple are must haves. Even during the 2009 economic meltdown, demand for AT&T's wide array of product offerings remained resilient and we expect that to continue in 2010 as AT&T continues to launch new products and platforms.

We believe we are well positioned to assist AT&T with their supply chain needs. TomTom remains number two in the GPS market in the US and we expect them to maintain their share. I do believe that smart phones and dedicated personal navigation devices will co-exist during our 2010 to 2012 planning horizon.

One of our recent new logistics customer wins, a custom repair services contract with a leading OEM could become a 10% revenue customer in 2010. This represents another classic example of us starting small with a customer, proving our mettle and then having our customer ask us to do more. This speaks volumes about our quality and service.

We have $252 million in combined new business opportunities and our business development teams are intensely focused on delivering revenue growth and diversification in both segments.

Spring boarding from our $42 million in annualized new business wins during the fourth quarter we are aggressively pushing the wide range of opportunities in our pipeline.

Our management team is focused on delivering results and managing costs with the savings expected to be $15 to $20 million range this year. And finally at year end we had $73.8 million in cash and no debt, position us strongly for 2010.

With that background, this leads to my discussion of our 2010 guidance. Admittedly our guidance range is broad initially, although it takes into account all known business factors as of this date.

There remain many vagaries in the current economic environment that we cannot control but that could impact our business. As is our practice we will narrow guidance throughout the year as we gain further clarity on those factors that will drive our performance.

Our 2010 full year revenue guidance is $515 to $550 million, an increase of 6 to 13% from 2009. This translates to earnings per diluted share from continuing operations of $2.13 to $2.45.

The range from low to high in large measure reflects the timing, size, scale and scope of significant new business wins, the impact of contractor renewals and contribution from cost reductions.

Our new business growth will drive investment and working capital and facilities and as a result we expect to generate $20 to $28 million of free cash flow.

Our logistics revenue guidance is $400 to $430 million, an increase of 16 to 25% with segment profit of $67 to $74 million or margins of approximately 15 to 17%.

Our guidance for margins reflects continued success of cost reductions offset by infrastructure and launch costs associated with recent and anticipated new business wins and the anticipated impact of contract renewal.

Our drive train revenue guidance is $115 to $120 million, down from the $139 million of 2009 with segment profits of $2 to $5 million.

As we have previously indicated we expect to achieve low single digit profit margins. In all candor, our primary focus for the drive train business will be to maximize cash flow generation.

We expect to generate over $10 million of free cash flow from this segment in 2010, including the liquidation of $4 million of working capital related to the Honda program.

The five key drivers of our performance in 2010 include the successful launch of all new business won in 2009, successfully converting pipeline opportunities into new business wins, achieving low single digit margins in drive train, the realization of savings from cost reduction initiatives and the anticipated impact of contract renewal.

Our guidance does not contemplate additional significant macro economic or regulatory ((inaudible)) of 2010 that could disrupt our business.

Strategically looking at the 2010 to 2012 horizon, we expect logistics sales to increase organically greater than 10% per year with margins in the 15 to 16% range.

And looking at our growth opportunities and logistics we will continue to focus on the consumer electronics market and more specifically we will focus on four key channels: wireless; broadband and cable operators; product OEMs; retailers and insurance and extended warranty providers.

While I am enthusiastic about our organic growth we continue to analyze acquisitions opportunities to augment our logistics business.

We are focusing on business that have enterprise values of $150 million or less and more specifically we are focusing on smaller tuck in or bolt on acquisitions that are concentrated in products and services that are adjacent to what we currently do.

I would like to thank you for your time today and we are now available to answer your questions. So Dana?

Operator: Thank you. The question and answer session will be conducted electronically. If you would like to ask a question today, please do so by pressing the star key followed by the digit 1 on your touchtone telephone. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Once again, that's star 1 to ask a question.

And we'll come first to Craig Kennison with Robert W. Baird.

Craig Kennison: Good morning and congratulations everybody.

Todd Peters: Thank you.

Craig Kennison: Todd, you had mentioned that you had added to your business development team, I think the number is seven. Can you tell me where that was historically? And then maybe give me a little more background on the backgrounds of these people?

Todd Peters: Yes, historically we had operated with about three business development people and we expanded it to seven and they're dispersed geographically. And they're from a wide range, they come from the transportation industry, they come from the traditional 3PL, industrial and the test and repair markets. So what we've done is added a nice mix of backgrounds across our enterprise.

Craig Kennison: Have you seen - you know that's a pretty big strategic decision on your part, have you seen the impact yet on the pipeline or is that more to come?

Todd Peters: Well I think we saw a little bit of both. I think late in the year we started to see the impact on the pipeline. I was just at (CE US) and met with our business development team and some win action, some customer event and I'm very confident that this team is going to continue to deliver, bringing new opportunities to the table.

Craig Kennison: And in the past you had provided sort of win rate guidance for your pipeline. Do you expect that to be about the same or will that change given your new team structure?

Todd Peters: Well I don't know if the win rate will change yet, that's to be determined but I expect to win more which will - you know with seven people strong I expect to have more opportunities on the table. It will be determined if the win rate will change.

Craig Kennison: And maybe just lastly on this topic, could you explain sort of how incentive structures work for this team?

Todd Peters: It's - without going into any competitive information I mean Craig it's typical salary and incentive. There are variable compensation related to bringing in the business.

Craig Kennison: Okay, that's great. And then shifting gears to TomTom, it seemed to ramp aggressively in the fourth quarter, I imagine that's mostly seasonality. How should we think about the growth trajectory of that particular business?

Todd Peters: Yes, that's really for TomTom to say, they report later this month. You're right in saying that it was a seasonal impact and it was more concentrated in Q4 this year.

As I said in my remarks I believe that TomTom has grown to the number two market position in the US, I expect them to maintain that. I expect there to be in the 2010 horizon definitely a continued place for personal navigation devices given where they're used in the 220 million vehicle population and I think our base business we have low single digit buying growth contemplated.

Craig Kennison: That's helpful. And just how would you generally comment on the broader GPS market given you know you can get an app on an iPhone that would have a lot of that functionality. Is - what are your longer term expectations for the broader market there?

Todd Peters: Yes, that's a great question. I think that again going back to 220 million vehicle population, not everybody owns a smart phone and not every car has got in dash DVD.

You know you buy those, the vehicle is new, the dealership is getting work from a $2000 to $3000 plus add on and then if you look at the install base of mobile devices, not everybody has a smart phone that has that capability. So I think there's - during our planning horizon I still see P&Ds as a part of the landscape.

Craig Kennison: Okay thank you and then a couple more questions if I may. With logistics guidance, appears to imply some margin compression in that business, is that a true statement? Is that a function of some new business wins or something else?

Todd Peters: It's a function of everything I laid out. It's the function of new business wins and on the longer term horizon it's about where I think margins will be vis-à-vis new business in a competitive environment, consider the impact of our cost reduction activities and it considers impact of contract renewal. So it's all of those factors have been baked in if you will to the way we think about our margin guidance.

Craig Kennison: Okay, and then lastly, thank you Todd, on the SG&A front John I think it was around $12 million in the third and fourth quarter which was down from earlier in the year and then last year. Is that the right run rate you think going forward or is there more room on either side of that?

John Pinkerton: Well the reason it's down is it reflects the cost reductions largely from the consolidation of our drive train business into one facility. So I'd say that's probably a more reasonable run rate going forward.

Craig Kennison: Okay, thank you John, that's helpful. Congratulations everybody.

Todd Peters: Thanks.

Operator: And we'll go next to Torin Eastburn with CJS Securities.

Torin Eastburn: Good morning.

Todd Peters: Good morning.

Torin Eastburn: I was first hoping you could maybe if possible provide any more detail on AT&T just kind of what drove less returns this quarter or more returns last quarter?

Todd Peters: Yes, thanks for the question Torin. You know if you think about the economy that we were in, in fourth quarter, I can't pin it on any one thing. I think the consumers with the money they had to spend were more thoughtful about what they were buying and I think we saw less returns related to buyer's remorse.

Torin Eastburn: Okay, makes sense. And in logistics, your pipeline grew quite a bit this quarter. It looks like a lot of it was from wireless. Can you say how much of that is AT&T and how much is other carriers?

Todd Peters: I cannot.

Torin Eastburn: Okay. For your cash flow guidance for the year obviously it's a bit below net income. How much of that is going to be capital expenditures and how much is working capital?

John Pinkerton: Capital expenditures are projected to be $13 to $15 million for 2010 and the balance is primarily working capital investment to support the growth in logistics business.

Torin Eastburn: Okay. And Todd you mentioned acquisitions. Do you feel like you're close on announcing anything?

Todd Peters: We don't comment while were in process, I'll tell you that we are actively engaged in reviewing opportunities. But that doesn't answer your question directly.

Torin Eastburn: No, that's fine. I understand. And last thing, traditionally you've filed the 10-Q and the 8-K concurrently but you didn't this quarter. Is that something we should expect to continue?

John Pinkerton: We expect to file I believe it's the last (link) day in February.

Todd Peters: So Torin, we typically file our 10-Q the night of the release earnings, the 10-K is traditionally typically filed about two weeks after our year end record. So we're exactly on our cadence.

Torin Eastburn: I got it, thank you.

Operator: And we'll go next to Gary Prestopino with Barrington Research.

Gary Prestopino: Hi, good morning everyone.

Todd Peters: How are you doing Gary?

Gary Prestopino: Hey Todd, could you just go through - you gave some stats or some growth metrics for logistics? And I couldn't write them down for 2010 through 2012, I couldn't write - could you just go through those again?

Todd Peters: Yes, what we said Gary were logistics the outlook over planning horizon through 2012 was we expect organically our logistics business to grow at least at 10%.

Gary Prestopino: That's top line, right?

Todd Peters: Top line and for 2010 we expect our logistics business to grow 16 to 25%.

Gary Prestopino: Okay. That's fine. And then in terms of drive train, when will - do you think that all of these, the Chrysler and Subaru programs will be fully up and running? Is that a Q2 event?

Todd Peters: By the end of Q2 that should coincide with us returning to modest profitability. That's - by the end of Q2 we're hopeful that that's the time frame.

Gary Prestopino: Okay and then in terms of contract renewals, what contracts are up for renewal this year? Can you share that with us?

Todd Peters: Yes, the most significant one is AT&T which was subject to renew at the end of this year.

Gary Prestopino: Is that the forward or reverse?

Todd Peters: That's both.

Gary Prestopino: Okay, so that's both, okay. So that...

Todd Peters: And we have other contracts are subject to renewal, our new test repair opportunity we're currently doing a purchase order and we expect that to convert into a contract this year.

Gary Prestopino: Okay. All right and -- okay.

Todd Peters: And that would be - and the last one is Ford, we're negotiating, as you know that contract expired at the end of '09 and we're continuing to supply product.

Gary Prestopino: Okay. All right, thank you.

Operator: And as a reminder if you would like to ask a question today, please press star 1. We'll go next to Morris Ajzenman with Griffin Securities.

Morris Ajzenman: Hi guys. My two questions have really been asked but just kind of a fill in here on the free cash flow number please. Depreciation and amortization, is it going to be about $13 million or so this year in 2010?

John Pinkerton: One second. Yes, D&A should be about $13 million.

Morris Ajzenman: Okay, so basically it's going to be kind of close to CapEx so that the net income of mid point of $45 million and the mid point of cash flow of $25 million, therefore you're going to have a working capital use of about $20 million to round out the number there, is that a fair number to kind of put into sort of a projection?

Todd Peters: Well we think about the working capital being closer to $25 million.

Morris Ajzenman: About $25 million, okay. And clearly it's a fall out of - a good reason a pick up in hopefully new business trends in the logistics and funding that through 2010.

Todd Peters: That's correct.

Morris Ajzenman: All right, that's it, thank you.

Todd Peters: Thank you Morris.

Operator: And we'll take a follow up question from Gary Prestopino with Barrington Research.

Gary Prestopino: Yes, just a quick question, that new test and repair program that was part of in logistics, that was part of the wins a couple of quarters ago. Todd is that correct?

Todd Peters: Yes, that's correct.

Gary Prestopino: That one of these had the potential to be a fairly large customers and it looks like it may still materialize.

Todd Peters: Yes, we announced - that was one of the wins we announced in 2009, I believe it was in the second quarter. That business has continued to grow and that customer could become a 10% customer in 2010.

Gary Prestopino: Can you tell us what industry that's in?

Todd Peters: All I can say it's a leading handset OEM.

Gary Prestopino: Okay, okay. That's fine, thank you.

Todd Peters: Yes.

Operator: And with no further questions in the queue, I'd like to turn the conference back over to Mr. Todd Peters for any additional or closing remarks.

Todd Peters: Thank you, Dana. I'd like to thank all of you for your questions and as always thank you for your continued interest in ATC. I look forward to a prosperous 2010 and updating you on our progress throughout. Bye.

Operator: That does conclude today's presentation; we thank you for your participation.

END