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Telit Communications PLC

2018 Half Year Financial Results Conference Call

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CORPORATE PARTICIPANTS

Yosi Fait, *Chief Executive Officer*

Yariv Dafna, *Finance Director and Chief Corporate Development Officer*

Adrian Duffield, *Shir Stopper, Investor Relations*

CONFERENCE CALL PARTICIPANTS

Eliot Penn, *Ibex Investors*

PRESENTATION

Operator:

Greetings, and welcome to the Telit 2018 Half Year Financial Results Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Adrian Duffield. Please go ahead, Mr. Duffield.

Adrian Duffield:

Thank you, Operator, and thank you for joining the Telit Communications 2018 First Half Financial Results Conference Call. The call is being hosted by Yosi Fait, the Chief Executive, and Yariv Dafna, Chief Financial. Following the prepared statements by the Management Team, we will open the call to the question-and-answer session. An updated company presentation, including the financial results, is now available, should you wish, on the Corporate IR website.

I'd like to remind all listeners that the comments made today will contain forward-looking statements. The Management Team may make additional forward-looking statements in response to your questions. Such written and oral disclosures are made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995.

The results presented today include results on a non-GAAP basis. A full reconciliation table of non-GAAP results to IFRS measures is in the half year results press release published this morning.

With that, I'd like to hand over the call to Yosi Fait. Yosi, please go ahead.

Yosi Fait:

Thank you, Adrian, and thank you all for dialing in. Good afternoon and good morning to our European and U.S. investors and analysts.

I would like to start by welcoming Telit's new Chairman of the Board, Mr. Paolo Dal Pino, that joined us a few days ago. Paolo has held a number of executive, operational and financial roles across a range of multi-national businesses, including industrial, as well as financial and telecom industries. We are welcoming Paolo and we are sure he will be a great contributor to the Board. Paulo will be leading the drive to strengthen and solidify the composition of Telit's Board.

Today, we announced our half year results, the first set of results following the turnaround plan. This is a good opportunity to share with you our progress and strategic outlook.

At the end of 2017, we adopted a turnaround plan which included the following main objectives: increase our focus on industrial IoT products and services and integrating our IoT solutions capabilities; return to double-digit revenue growth; stabilization of gross margin; cost optimization and focus on cash generation. I am happy to report that in the first half we achieved a significant progress in our turnaround plan and the set of results are evident to this progress.

We focused our efforts on the Company's core business, the industrial IoT products, services and solutions. This includes the sale of the Automotive Division for $105 million, which we expect to close towards the end of the year.

In order to improve our focus, we also have changed our organization and completed recently a full integration of our Product and Services Teams under a single structure. The integrated business structure will enable us: to better define and develop innovative products required for the market; to focus much more on synergies from leveraging the combination of our modules, cellular, GNSS and short range, and the IoT platform and portal, gaining differentiation and innovation through these synergies and to better utilize our sales force; as well as generally become more efficient.

We are back to double-digit growth in total revenues and IoT cloud and connectivity revenues. Following the completion of the LTE IoT products certifications, we were able to achieve in the first half growth of 13.6% in total revenues and 16.2% growth in IoT cloud and connectivity revenues. We also see better traction in the market, more design wins, including customers with significant IoT projects and better services level to our customers.

Stabilizing of gross margins and improving them was a major objective of the plan. Despite a stressed component market, we have been able to stop the sharp decline in gross margins we faced in H2 2017, and improve it by more than 2%. This was done through several actions, including optimization of product bill of material and manufacturing costs.

As part of our turnaround plan, we acknowledged that gross margin will stabilize at the lower level than we saw in the last few years. Therefore, we initiated a cost optimization plan which included analyzing return on investment on our products and activities and rationalizing our investments on the different product lines and activities.

Our plan is to cut this year about $10 million from our cash op ex, in comparison to our 2017 cash op ex. As you see from the set of results, we already achieved during the first half about $4.6 million of cash op ex savings, which helped to decrease the percentage of R&D, sales and marketing, and general and administrative expenses out of revenues.

Another very important parameter of our plan is to reduce the number of R&D sites to improve both operational and financial efficiencies. We had 11 in 2017, and we have closed two already. Once the Automotive business is sold, we will only have six R&D sites.

One final point. We defined last year a new KPI, profit in cash. This is the Adjusted EBITDA less R&D capitalization less cap ex. This will also increase our focus on cash generation. In the first half of the year, we were still negative, but with significant improvement versus 2017. With further progress of our plan, we expect additional improvements in H2.

To summarize, we were able to create over the last two decades real expertise in the industrial IoT space, both in the module business, connectivity and platforms space. Alongside with our plan to maintain and further develop our leading position in the module space, now is the time to streamline all these pieces together, to allow fast go to market for our customers and enable the digital transformation of enterprises through end-to-end IoT solutions. I am confident that our planned double-digit growth for 2017, together with our determination to achieve all the objectives in our turnaround plan, will lead us to positive results and positive profit in cash in H2 2018, with further improvements in the following years.

Before I hand over to Yariv Dafna, Telit's Finance Director, I wish to thank Telit's employees, Management and Board members for their commitment to Telit during the last 12 months and supporting the success of our turnaround plan.

Now, let's move to Yariv to present our 2018 half year results.

Yariv Dafna:

Thank you, Yosi, and good morning and afternoon, everyone. I'm very pleased to present our financial results for the first half of '18. The results are in line with our expectations and along with the turnaround plan as was reviewed before by Yosi.

We achieved double-digit revenue growth, from $177.6 million in H1 '17 to $201.7 million in H1 '18, an increase of 13.6%. Our IoT cloud and connectivity revenue was $16.5 million, an increase of 16.2% over H1 '17. The growth is a direct outcome of our growing focus at core business that helped to complete the LTE products development and certifications.

Turning to revenue performance by region, in America, revenues up 13.1% to $86,9 million, reflecting the growing demand to our LTE products following the completion of products development and certifications. We are expecting further growth to come from the transition to LTE in this region. In EMEA, revenues increased by 15.2% to $78.5 million. This strong growth was fueled by the strong performance of our Automotive business in this region. In APAC, revenues increased by 11.1% to $36.2 million, a significant improvement after the decline we faced in 2017. Our performance was still slightly behind our expectations, as we are still impacted by a delay in the ramp-up of a big project that negatively impacted our overall performance in this region.

Moving to gross profit and margin, we generated gross profit of $67.8 million, in comparison to $69.6 million last year. During the first half, we have been able to stabilize the gross margin and even improve it from its H2 2017 level. Gross margin was 33.6%, down from 39.2% of the first half of '17, but up from the 31.5% of second half of '17.

As Yosi mentioned, we adopted last year the profit in cash as performance measure. In H1 '18, we saw an improvement in the loss in cash that was $5.7 million, in comparison to a loss of $9.8 million last year. This improvement was mainly supported by a decrease in our cash op ex from $74.7 million in H1 '17 to $70.1 million in H1 '18. According to our plan, we expect to further increase our cash op ex saving to an annual level of $10 million, in comparison to 2017, and we expect a further improvement in our profit in cash in the second half of the year.

Let me now review the operating expenses.

Our gross R&D expenses decreased slightly to $34.7 million, or 17.2% of revenues, in comparison to 19.9% of revenues last year, reflecting mainly the reorganization of our short-range business, including the closure of the two R&D centres. The capitalized R&D costs decreased by $4.2 million, from $17.9 million in H1 ’17 to $13.7 million in H1 ’18. As a percentage of gross R&D, the capitalization sharply decreased from 50.6% in H1 ’17 to 39.4% in first half ’18. The capitalized R&D costs in H1 this year are mainly related to the development of additional high category LTE products for both industrial and automotive, and low categories, including CAT-M1 and NB-IoT, for industrial IoT.

During H1 ’18, we booked a non-cash impairment of $2.4 million of capitalized development assets as a result of integration of a new software that made an old development redundant.

Selling and marketing expenses also decreased to $33 million, or 16.3% from revenue, down from $35.1 million, or 19.8% from revenue, last year.

G&A expenses decreased to $13.2 million, or 6.5% from revenue, down from $14.4 million, or 8.1% from revenue, last year.

The pressure on costs are a key part of our cost optimization plan and, in total, we achieved $4.6 million in cash op ex savings.

Let me now move to the adjusted results. We measure our profitability based on adjusted figures in order to eliminate non-recurring expenses and share-based charges. The adjusted figures also exclude exceptional items, like restructuring costs, impairment of assets and amortization of acquired intangible assets.

Our Adjusted EBITDA decreased to $12.5 million, versus $14.7 million in H1 ’17, reflecting mainly the decline in the gross margin and the lower R&D capitalization, offset by a lower cash op ex, as mentioned earlier. The decrease of $1.8 million in gross profit, together with less $4.2 million in capitalization of R&D, led to a negative Adjusted EBIT of $0.6 million, in comparison to profit of $1.6 million last year. The operating loss was $9.8 million, versus a loss of $4.8 million in H1 ’17, impacted by the said decline in gross profit and $3.2 million increase in non-recurring and exceptional expenses.

I will move now to review the main cash flow and balance sheet items.

Cash flow from operating activity was $21.1 million, a huge swing and improvement of $24.4 million from the cash used in operating activities of $3.3 million last year. A significant part of the improvement came from better optimization of our working capital, including the inventory management.

Cash flow used in investing activity was halved to $18.1 million, compared to $36.2 million during H1 ’17. The decrease was mainly due to a decrease in the amount spent on acquisition and on R&D capitalization.

Cash used in financing activity was $6.6 million, compared to $42.1 million generated in H1 ’17. The H1 ’17 figure includes $49.7 million coming from the fundraising of last year.

Net debt for the period was $25 million, a decrease of $5.2 million from the end of ’17. The decrease was the result of an improvement in the cash from operating and investing activities.

To summarize our results, we are pleased with the progress so far and keep being very focused on executing our turnaround plan, including reaching profit in cash and completing the sale of the Automotive business. With our continuous efforts to implement our strategy, we plan to further develop our leading position in the industrial IoT market, while keep improving our financial results.

Thank you all for joining us today and I will now transfer the call back to the Operator for Q&A session.

Operator:

Thank you. We will now be conducting a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star key. One moment, please, while we poll for questions.

Once again, that is star, one if you would like to ask a question. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star key. One moment, please, while we continue polling for questions.

Our first question comes from the line of Eliot Penn with Ibex Investors. Please proceed with your question.

Eliot Penn:

Hi, guys, and congrats on the progress, great to see the turnaround taking place. I wanted to know if you would comment on what it is that you're seeing that leads you to believe that the Automotive business will be sold by the end of the year. What are kind of the things that you're able to comment on that bring you to that conclusion? Thanks.

Yosi Fait:

Yariv will take this question, Eliot.

Yariv Dafna:

Hi, Eliot. The deal we signed with TUS International is coming from a very strategic view and it take us quite a lot of time until we come to the point that we signed that deal. The only reason why it takes a few months is the fact that they need to have an audited financial statement and they need to include it in a circular, which is going to be out and dispatched to the shareholders by the end of October, and that's why it will take until the year end to complete the transaction. We are in constant discussions with these guys. They visit the offices. We are working on the reorganization and I have no reason to think that there will be no closing of this transaction.

Eliot Penn:

That's helpful, thank you, and if I can ask one more, just your thoughts in general on the currency of the balance sheet, especially in light of the new covenants, how are you feeling about that?

Yariv Dafna:

We are good with the covenants so far and we are, of course, monitoring very closely, and we don't have any reason to be concerned at this point of time.

Eliot Penn:

Okay, also great to hear, Again, I offer congratulations once again on all the improvements. I'm looking forward to seeing that trend continue. Thanks.

Yosi Fait:

Thank you, Eliot.

Operator:

Thank you. Once again, as a final reminder, if you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star key. One moment, please, while we poll for more questions.

Thank you. There are no further questions at this time. Thank you for your time and your participation on today's call. You may now disconnect your lines and have a wonderful day.