NYSE:CTS Q3 2025 Earnings Call Transcript

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Claire | Conference Call Coordinator:

earnings call. My name is Claire and I will be coordinating your call today. During the presentation, you can register to ask a question by pressing star followed by one on your telephone keypad. If you change your mind, please press star followed by two. I will now hand over to Kieran O'Sullivan to begin. Please go ahead.

Kieran O'Sullivan | Chief Executive Officer:

Good morning and thanks for joining us today. We delivered a quarter of strong double digit growth in our diversified end markets with sales up 22% versus the prior year period. Diversified sales for the quarter were 59% of overall company revenue. We also expanded gross margin by 66 basis points and had solid operating cash flow. Secondly, our SideQuest team was awarded a sole source naval defense contract with an initial value of $5 million and the potential to add additional platform awards within the next 12 months. Finally, in transportation, we had a strong quarter with winds of 130 million and added a new braking sensor application.

Ashish | Chief Financial Officer:

Ashish will take us through the safe harbor statement. Ashish? 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 with today's earnings press release and supplemental slide presentation, which can be found in the investors section of the CTS website. I will now turn the discussion over to our CEO, Kieran O'Sullivan.

Kieran O'Sullivan | Chief Executive Officer:

Thank you, Ashish. We finished the third quarter with sales of 143 million, up 8% from 132 million in the third quarter of 2024. For the quarter, diversified end market sales, including sales to medical, aerospace and defense, and industrial end markets were up 22%. Transportation sales were down 7% from the same period last year. Diversified end market sales were 59% of overall company revenue in the quarter, up from 52% in the third quarter of last year. Our book-to-bill ratio for the third quarter was slightly above 1 in comparison to the third quarter of 2024, where we were marginally below 1. Bookings for our diversified end markets were up double digits in industrial and defense, and an increase in the high single digits in medical on a year-over-year basis. We expect stronger medical bookings in the last quarter, especially for therapeutic products. Third quarter adjusted diluted earnings were 60 cents per share, down from 61 cents in the third quarter of 2024, primarily due to an unfavorable impact from the recent US tax legislation. Ashish will add further color on this and on our financial performance later in today's call. In the medical end market, third quarter sales were up 22% compared to the same period in 2024. Bookings in the quarter were up 8% compared to the prior year period. We are excited about the prospects for growth in minimally invasive applications where our products help deliver enhanced ultrasound images, and make it easier for medical professionals to detect artery restrictions. Our teams are engaged on next-generation product development to further enhance diagnostic capability with our customers. We are proud to highlight that our products support solutions that help save lives. Additionally, our products enable medication delivery for treatment of infected areas, aid blood analysis and flow, cancer treatments, and are incorporated in pacemakers and cochlear implants. Our therapeutic products enhance skin aesthetics and, in combination with other medical procedures, help improve skin tightness. During the third quarter, we had multiple wins for diagnostic ultrasound and had wins for therapeutics, pacemakers, and a win for an ophthalmology application. We are also developing samples for Doppler ultrasound for a vascular flow application. In addition, we added two new customers for diagnostic ultrasound. Demand remains strong for therapeutic products, and we expect increased volumes in 2026. Over time, we expect the volume increases in portable ultrasound diagnostics and therapeutics will continue to enhance our growth profile as well as expansion to new applications. Aerospace and defense sales in the third quarter were up 23% from the third quarter of 2024. SideQuest revenues in the third quarter increased to 8.8 million, and we expect to maintain this momentum through the balance of this year. Bookings in the third quarter were up 29% from the prior year period as we maintain a healthy backlog, and we expect solid bookings in the last quarter of this year. Our strategy is focused on moving from a component supplier to a supplier of sensors, transducers, and subsystems and is further validated by a recent naval award. We received multiple orders in the quarter for sonar applications. The order mentioned in my opening comments for the SideQuest business is for a naval munition application, and we expect additional platform awards as we move forward. SideQuest continues to drive a strong pipeline of opportunities. In the industrial market, we continue to see a steady recovery with OEMs as well as a stronger recovery with distribution customers. Sales in the third quarter were up 9% sequentially and up 21% compared to the prior year period, underscoring our expectation of a continued recovery. Bookings in the quarter were up 29% from the same period last year. We were successful with multiple wins in the quarter for industrial printing, EMC, temperature sensing wins for pool and spa, and the wind for an industrial heat pump application. We added one new customer in the quarter for position sensing. Demand across industrial end market is expected to remain healthy for the balance of 2025. The mega trends of automation, connectivity and efficiency enhance our longer term growth prospects. Transportation sales were 58.5 million in the third quarter, down approximately 7% from the same period last year, due to softness for commercial vehicle products. In the third quarter, we had awards across various product groups, including accelerator module wins with OEMs in Europe, South America, and China. Total book business was approximately $1 billion at the end of the quarter. We had various wins for passive safety and chassis ride height sensors across several regions. We added a new product to the portfolio for brake sensing, securing a business award with a North American OEM. This further strengthens our long-term capability to expand our footwell presence. We also had a large win in commercial vehicles for smart actuators with an existing customer. Additionally, during the quarter, we released our COBRIS technology, a new platform for electric motor control. This technology eliminates the need for three discrete current sensors and the position sensor, allowing for a simplified design, weight reduction, and more precise control. The near-term growth rates for ICE versus EVs and hybrids are less of a concern for us, given our light vehicle products are mostly agnostic to the drivetrain technology. The trend towards increasing demand for hybrids with extended range capabilities remains robust. Interest in our e-brake product, offering weight and cost advantages, continues across OEMs at a slower pace, as certain OEMs recalibrate EV investments and launch dates. we remain confident in the longer-term growth prospects for our e-brake and other footwell products. These, along with existing and new sensor applications, will increase our ability to grow content. For our diversified end markets, subject to the uncertain tariff environment, demand in the medical market is expected to remain mixed with strength in therapeutics and softness in diagnostic ultrasound. In aerospace and defense, revenue is expected to grow giving the timing of orders and momentum from the side quest acquisition. Industrial and distribution sales are expected to improve. Longer term, we expect our material formulations, supported by three leading technologies and their derivatives, to continue to drive our growth in key high-quality end markets in line with our diversification strategy. Across transportation markets, Production volumes are expected to remain soft given the tariff impact and demand from customers. The North American light vehicle market is expected to be in the 15 million unit range. European production is forecasted in the 16 million unit range. China volumes are expected to be in the 30 million unit range. We are carefully monitoring for any potential impact from supply chain issues related to rare earth, aluminum, and semiconductors, although we are not seeing any immediate impact. Electric vehicle penetration rates have softened in some regions, while hybrid adoption continues to improve. There was a notable demand increase for EVs in September with the elimination of the vehicle subsidy for the North American market. We anticipate general softness in commercial vehicle demand in the fourth quarter. Shipments of our new commercial vehicle actuator continue to ramp as we prepare for 2026 where we will implement further product enhancements. As I mentioned in previous calls, revenue from the SideQuest acquisition will introduce some seasonality where the timing of revenue may be influenced by the approval of funding by the US government. As reported, we saw an increase in revenue for SideQuest in the third quarter and expect to maintain this positive momentum through the end of this year. We continue to closely monitor and evaluate the tariff and geopolitical environment while focusing on agility and adapting to cost and price adjustments in close collaboration with our customers and suppliers. Assuming the continuation of current market conditions, we are narrowing our guidance for sales in the range of $535 to $545 million and adjusted diluted EPS to be in the range of $2.20 to $2.25. Now we'll turn it over to Ashish, who will walk us through our financial results in more detail.

Ashish | Chief Financial Officer:

Ashish. Thank you, Kiran. Sales in the third quarter were $143 million, up 6% sequentially and up 8% from last year. Sales to diversified end markets increased 22% year over year. SyQuest sales were $8.8 million during the quarter. As Kiran has highlighted, We expect the momentum to continue for sales from SyQuest in the fourth quarter. Sales to transportation customers were down 7% from the third quarter of last year due to the softness in sales related to commercial vehicle products. Foreign currency changes had a favorable impact on sales of approximately $1 million. Our adjusted gross margin was 38.9% in the third quarter, up 66 basis points compared to the third quarter of 2024 and up 12 basis points compared to the second quarter of 2025. Our global teams continue to focus on operational execution to deliver margin improvements. Tariffs had a minimal impact on profitability in the third quarter, and we continue to work closely with customers and suppliers to manage the impact. Adjusted EBITDA was 23.8% in the quarter. This is an improvement of 86 basis points sequentially and a reduction of 55 basis points compared to the third quarter of 2024. Earnings were 46 cents per diluted share for the third quarter. The third quarter results include a $4.2 million increase in reserve related to EPA's cost reimbursement claim for a prior environmental matter. Adjusted earnings were 60 cents per diluted share compared to $0.57 in the second quarter of 2025 and $0.61 in the third quarter of 2024. We had an unfavorable impact on our tax rate from changes in the mix of earnings. And in addition, the recent US tax legislation changes had an adverse impact of approximately $0.03 on adjusted earnings per diluted share for the third quarter. Moving to cash generation and the balance sheet, we generated $29 million in operating cash flow in the third quarter, compared to 35 million in the third quarter of 2024. Year to date, we have generated $73 million in operating cash flow. Our balance sheet remains strong with a cash balance of $110 million at the end of the quarter. Our long-term debt balance was $91 million leaving us good liquidity to support strategic acquisitions. During the quarter, we repurchased 400,000 shares of CTS stock for approximately $17 million. In total, we returned $44 million to shareholders through dividends and share buybacks in the three quarters of 2025. We have $21 million remaining under our current share repurchase program. Our focus remains on strong cash generation and appropriate capital allocation, and we continue to support organic growth, strategic acquisitions, and returning cash to shareholders. This concludes our prepared comments. We would like to open the line for questions at this time.

Claire | Conference Call Coordinator:

Thank you. To ask a question, please press star followed by 1 on your telephone keypad now. If you change your mind, please press star followed by two. When preparing to ask your question, please ensure your device is unmuted locally. Our first question comes from John from Zodotti Company. Your line is now open. Please go ahead.

John | Analyst, Zodotti Company:

Good morning, guys, and thanks for taking the questions. I'd like to start with the guidance. It seems to me that you raised the midpoint on your revenue guidance, but lowered the midpoint on the EPS guidance. Now, I recognize that you've been suggesting it would be the low end of that EPS, but I guess I'm surprised at the dynamic of raising the revenue in light of that. Can you just walk us through what's going on there?

Kieran O'Sullivan | Chief Executive Officer:

Yeah, John. So, from a top-line perspective, we feel good about the direction we're going there. As I mentioned in the prepared comments, the four-quarter has some Headwinds on CV, but overall, we've got good progress in industrial, nice momentum in aerospace and defense, strength in therapeutics, and then some things we're monitoring on the diagnostic side. So that's it on the top line. And then on the bottom line, primarily, as Ashish mentioned in his prepared comments, there's the tax impact, and Ashish, you probably want to comment on that.

Ashish | Chief Financial Officer:

Yeah, so John, there are a couple of things that are having an adverse impact on our tax rate. Number one, the mix of earnings. And then the second piece, which is more pronounced, is the tax legislation. Given the mix of earnings we have, it actually has an adverse impact on our overall tax rate. So you saw that impacting our Q3 earnings in a meaningful way. And then that impact is expected to continue, obviously, smaller into Q4 as well.

John | Analyst, Zodotti Company:

Okay, understood. And Kieran, you just mentioned the CV market, so that begs the question, what are your transportation customers signaling about the 2026 production rates?

Kieran O'Sullivan | Chief Executive Officer:

John, for 2026, it's kind of a bit of a mixed market out there. You hear some OEMs, especially on the light vehicle side, talking more positive, some talking a little bit negative. So It's a very mixed story. What I would tell you is on the light vehicle side in this quarter, excluding Cummins, our large customer and CV, we saw a small incremental increase in low single digits. And we had solid bookings in the quarter, so we feel really good about the bookings and where we're going. So the market is going to be a bit mixed until next year from everything we hear on transportation, but feel very good about what we're doing in medical, aerospace and defense and industrial.

John | Analyst, Zodotti Company:

Agreed. Can I just maybe touch on the end markets as a whole? Because the gross margin improvement was nice to see. And I'm actually kind of curious, and maybe you can help me frame this better. But if you kind of rank your end markets on the gross margin contribution, or should we be thinking about it on the operating margin contribution? Um, how would you, I know you're not gonna give the actual margin profile, but how would you rank them? So as we can see the change on the go forward basis, we can think about the impact of profitability.

Ashish | Chief Financial Officer:

So John, um, we earn good margins on our diversified and markets pretty obviously. Um, I don't know if I would split the margins by end markets in terms of profile. They, they are pretty decent on the diversified side. medical, industrial, aerospace and defense. We are doing reasonably good margins on all of those. Transportation is obviously behind in terms of comparison, but we earn good margins on the transportation side as well.

Kieran O'Sullivan | Chief Executive Officer:

And John, the other thing I would comment on is you can see that you talked about the improvement in gross margin. Our diversification percentage is going up quarter and quarter as well. So I think that's what you're going to see is positive momentum there.

John | Analyst, Zodotti Company:

Yeah. Yeah. I was just, I mean, I guess I'm kind of curious as how much, I don't know, medical has a more of an impact versus say aerospace and defense. You know, I would, I would guess that industrial would be third in that ranking, but that would be me just guessing.

Ashish | Chief Financial Officer:

So John, it's a little bit more, I would say split by product line. You know, the margin profile on different product lines has, a different level in pretty much all the end markets. So, you know, for example, when you look at our piezo product lines, we have single crystal in there, tapecast and bulk, and the margin profile varies. So single crystal would be slightly higher margins than the other two. In frequency, we'll have a different level of margin, which is higher. And then so that that It's not so much where we are seeing distribution by end market as we are seeing distribution by product lines.

John | Analyst, Zodotti Company:

Thank you, Shishir. I appreciate that clarity, and I'll get back into Q&A if somebody else has a question. Thanks.

Ashish | Chief Financial Officer:

Great. Thanks, John.

Claire | Conference Call Coordinator:

Thank you. Our next question comes from Hendy Susanto from Gabelli Funds. Your line is now open. Please go ahead.

Hendy Susanto | Analyst, Gabelli Funds:

Good morning, Kiran and Ashish. Thank you for taking the questions. Good morning, Hendy. First question is for Ashish, the tax impact, the adverse tax impact, will it go away in 2026?

Ashish | Chief Financial Officer:

So, Hindi, we'll obviously be looking at areas that we can drive improvements. The specific change from the tax legislation that will continue to have a slight adverse impact But we'll continue looking at other areas of opportunity in terms of tax efficiency as we've always done. So I would expect at this point, the 2026 to be similar tax rate as 2025, but we'll continue working on it.

Hendy Susanto | Analyst, Gabelli Funds:

I see. And would you be able to spell out what tax rate estimate we should use for our model?

Ashish | Chief Financial Officer:

Yeah, so we are in the low 20% range right now. And we are talking about 21% to 23% type of ballpark on a go-forward basis.

Hendy Susanto | Analyst, Gabelli Funds:

Yeah. And then this question is for Kiran. Kiran, this morning, NXP Semiconductor reported it's September quarter. I know that it's an apple and orange comparison. They do say that Tier 1 inventory burn is getting closer and closer to be completed. How should we view the expectation that inventories in your channel for transportation is somewhat close to representing the end market demand, and then at some point they will need to build more inventories internally? How should we view that notion?

Kieran O'Sullivan | Chief Executive Officer:

Yeah, I didn't see the NXP data, but what I would look at, Hendi, is if you look at the days of supply on hand, it's probably trending on the light vehicle side around 50 days, which seems pretty normal. I wouldn't be concerned about it at all. There is obviously some further softness in the commercial vehicle market, and that's one where We're watching more closely, but not on the light vehicle side.

Hendy Susanto | Analyst, Gabelli Funds:

I see. And then looking back at SideQuest acquisitions and then your expectation, given we have insight into the quarterly revenue run rate for the last five quarters, would you be able to give some puts and takes and whether or not the company's revenue contribution meets or exceeds your target for this year?

Kieran O'Sullivan | Chief Executive Officer:

Yeah, so, Hendi, if I look at it quarter by quarter, we've always said the first half is going to have some seasonality, whether it's heavier in the second half, and that's what we're seeing now. So we've seen a step up in revenues from Q2 to Q3. And we expect that step up to continue. We will see some seasonality next year as well, first half, second half, due to government funding. And we're very pleased with the pipeline of opportunities. And we called out an award today in the Commons, sole sourced for a new platform with the first 5 million. And we expect other awards in the next 12 months and over the next several years as well. So we feel really good about that, and we want to build on that momentum.

Hendy Susanto | Analyst, Gabelli Funds:

Got it. One last question for us is the operating expense line. The SG&A is somewhat meaningfully larger this quarter. I know that you mentioned that's a $4.2 million increase in reserve. Is that the main reason of the increase in OPEX?

Ashish | Chief Financial Officer:

Yes, so, Hendi, that is by far the largest. We also have a year-over-year increase in equity-based compensation as, you know, going through the year, sometimes you have to make adjustments based on expected performance. And last year's number had a relatively larger reduction. So that is also causing the year-over-year comparison to look a little bit unfavorable in Q3 of 2025. Got it.

Hendy Susanto | Analyst, Gabelli Funds:

Thank you, Kiran. Thank you, Anish.

Ashish | Chief Financial Officer:

Thanks, Hendrik. I'm Hendrik.

Claire | Conference Call Coordinator:

Thank you. We now have a follow-up question from John Frinzap. Your line is now open. Please go ahead.

John | Analyst, Zodotti Company:

Yeah. I'm kind of curious about your comments on the industrial end markets. It seems like, to me, it seems like you're more positive than you've been in quite some time. Is that the case, or am I just reading too much into it?

Kieran O'Sullivan | Chief Executive Officer:

No, John. I think when we look at all the diversified end markets, we feel pretty good. And if I start with industrial, which you mentioned, we've seen a 9% sequential improvement, over 20% year-on-year. We've seen a strong increase in distribution-related sales. So we feel very good about the trend there. And then I also mentioned on medical, we expect bookings to increase in the fourth quarter, and the very same on aerospace and defense. So across the diversified markets and with industrial right up there, it feels very good.

John | Analyst, Zodotti Company:

And just on the medical, when you think bookings will increase, do you think the diagnostic side of the business will be coming back, or do you think that will remain weak on a go-forward basis?

Kieran O'Sullivan | Chief Executive Officer:

And the diagnostic side is a little weaker, but it's still solid overall, and we expect it will improve probably more so next year. But we've got strong momentum on therapeutics, and we feel that's going to continue not just in the fourth quarter, but in the next year as well, John.

John | Analyst, Zodotti Company:

Got it. And can you kind of walk me through how you're successfully navigating tariffs? A lot of companies I cover... anticipate a delay in being able to recover pricing from the customer base. But you seem to be doing extremely well. Can you talk about what's going on there?

Ashish | Chief Financial Officer:

So, John, we've talked about this in the past where a lot of what we do in Asia stays in Asia. What we do in Europe stays in Europe. And what we do in North America stays in North America. It's not 100% that way, but largely it is that way. And that helps us mitigate cross-border flows, which is where you see the impact of tariffs. That's a big portion of it. The other is where we do have tariff impact. We are working very closely with suppliers, with our customers to find ways to mitigate, but then also pass the cost on to our customers as we work through the impact. And so far, we've been able to manage well. We have talked about USMCA. That's where our exposure would increase if USMCA were to go away and it doesn't get replaced with something suitable. But, you know, other than that, we've been able to manage pretty well.

John | Analyst, Zodotti Company:

Very good. I guess one last question. The fire at the Ford aluminum supplier, does that have any impact on your company at all?

Kieran O'Sullivan | Chief Executive Officer:

John Novellis, that's the aluminum supplier, and then there's Nexperia on the chips. We haven't seen any direct impact, but it's something we're monitoring as we go through the fourth quarter. So nothing to report at this point.

John | Analyst, Zodotti Company:

Okay. Thanks for taking my follow-up, guys, and keep up the good work.

Kieran O'Sullivan | Chief Executive Officer:

All right. Thank you. Thank you.

Claire | Conference Call Coordinator:

Thank you. As a reminder, to ask a question, please press star followed by one on your telephone keypad now. We currently have no further questions, so I'll hand back to Kieran for any closing remarks.

Kieran O'Sullivan | Chief Executive Officer:

Thank you, Claire, and thank you all for your time today. Despite the challenges of tariffs, geopolitical and economic pressures, diversification remains a strategic priority to drive growth and margin expansion. In addition, we are expanding in vehicle powertrain agnostic solutions. We look forward to updating you on our full year 2025 performance in February of 2026, Thank you again. This concludes our call.

Claire | Conference Call Coordinator:

This concludes today's call. Thank you for joining. You may now all disconnect your lines.