Zacks Equity Research

October 28, 2010
Ken Nagy, CFA

www.zacks.com
111 North Canal Street, Chicago, IL 60606

CTS Corporation (CTS-NYSE)

CTS: Solid Quarter- Design Wins Ramping- Outperform

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	08/24/2009
Current Price (10/27/10)	$10.53
Six- Month Target Price	**$12.00**

OUTLOOK

CTS Corporation designs, manufactures, assembles, and sells electronic components and sensors worldwide. On October 28, 2010 the firm presented September quarter results. Design wins were strong as CTS won seven new automotive sensors and actuator programs in the third quarter of 2010, including a light commercial vehicle diesel engine program in India. The firm also recorded 58 new wireless infrastructure design wins compared to 52 in the third quarter of last year. Most of the design wins were in 3G and 4G wireless applications, and approximately 16% were for defense and aerospace applications.

SUMMARY DATA

52-Week High	**$11.77**
52-Week Low	**$7.05**
One-Year Return (%)	**16.85**
Beta	**2.06**
Average Daily Volume (sh)	**163,133**
Shares Outstanding (mil)	**34**
Market Capitalization ($mil)	**$360**
Short Interest Ratio (days)	**9.89**
Institutional Ownership (%)	**96**
Insider Ownership (%)	**4**
Annual Cash Dividend	**$0.12**
Dividend Yield (%)	**1.14**
5-Yr. Historical Growth Rates	
Sales (%)	**-3.5**
Earnings Per Share (%)	**-9.9**
Dividend (%)	**0.0**
P/E using TTM EPS	**15.3**
P/E using 2010 Estimate	**16.0**
P/E using 2011 Estimate	**13.9**
Zacks Rank	**4**

Risk Level	**Above Avg.,**
Type of Stock	**Small-Value**
Industry	**Elec-Misc Compn**
Zacks Rank in Industry	**26 of 47**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2008	173 A	186 A	170 A	163 A	692 A
2009	118 A	120 A	127 A	134 A	499 A
2010	129 A	139 A	139 A	150 E	557 E
2011	155 A	158 E	162 E	170 E	645 E

Earnings per Share
(EPS is operating earnings before non recurring items)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2008	$0.18 A	$0.27 A	$0.16 A	$0.15 A	$0.77 A
2009	-$0.03 A	$0.06 A	$0.13 A	$0.19 A	$0.35 A
2010	$0.13 A	$0.17 A	$0.20 A	$0.15 E	$0.65 E
2011	$0.17 A	$0.17 E	$0.18 E	$0.19 E	$0.71 E

Zacks Projected EPS Growth Rate - Next 5 Years % **15**

© Copyright 2010, Zacks Investment Research. All Rights Reserved.

WHAT'S NEW

On October 26th 2010 CTS announced results for the third quarter of fiscal year 2010 ending September 2010. Revenue for the period was $139.4 million up 0.4% sequentially from $138.9 million and up 10.1% year over year.

Components and Sensors segment sales increased 29% from the same period last year, reflecting both improved global economic conditions and new product introductions. Third quarter 2010 sales of sensor and actuator products increased 20% from the same period last year, primarily from growth in global light vehicle production and new customers and product introductions. Sales of electronic component products increased 44% across most served markets from general improvement in the economy and new product introductions. Components and Sensors segment sales, as a percent of total company sales, increased to 51% from 44% in the third quarter of 2009 helping overall gross margins and operating earnings returns.

EMS sales decreased 4% from the same period last year, but were up 1% sequentially. The year-over-year decrease resulted primarily from weaker sales in the defense and aerospace and medical markets due to lower demand and timing of new programs.

Strong Design Wins

New design wins are the best indicator of future revenue growth. CTS won seven new automotive sensors and actuator programs in the third quarter of 2010, including a light commercial vehicle diesel engine program in India. The firm also established a private limited company in India to further pursue growth opportunities in sensors, electronic components and EMS.

In electronic components CTS recorded 58 new wireless infrastructure design wins compared to 52 in the third quarter of last year. Most of the design wins were in 3G and 4G wireless applications, and approximately 16% were for defense and aerospace applications.

Bringing Estimates Up

Management increased the full-year 2010 diluted earnings per share to a range of $0.60 to $0.65 compared to the previous range of $0.55 to $0.62 per share, and maintained the full-year 2010 sales estimate to an increase of 10%-15% over 2009.

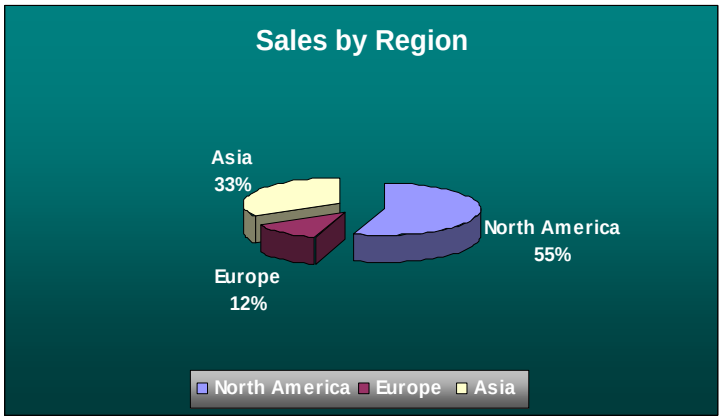
Diversification

CTS has sensor technology and strongly desires to diversify its base, the firm has been going beyond the traditional pedal-modules of position sensors has endeavored to convince its customers that they should be looking at a broader array of sensors from the company. The most recent appraisal CTS did on a brand new sensor application, (albeit with small volumes), was significant because it represented taking its sensing technology to a newer application. The second opportunity is CTS sensors going into diesel engines, which are taking CTS into on-and-off highway diesel engines and trucks. This introduces the firm to commercial applications like construction, mining, and agriculture. Finally in electronic components, CTS employs a similar strategy. The firm is taking its piezoceramic product, which traditionally was only used in ultrasonic medical application, commercial inkjet applications, or energy exploration and applying it to a high-density disc-drive actuation application.

INVESTMENT THESIS

CTS remains well positioned to achieve solid revenue growth and operating leverage as end markets turn around in the long run, given the company's competitive advantage led by innovation and laser-like focus on expense management. The slower growing EMS segment has been exceptionally diversified since 2004 and is a complement to the faster growing Sensors and Actuators and Electronic components business.

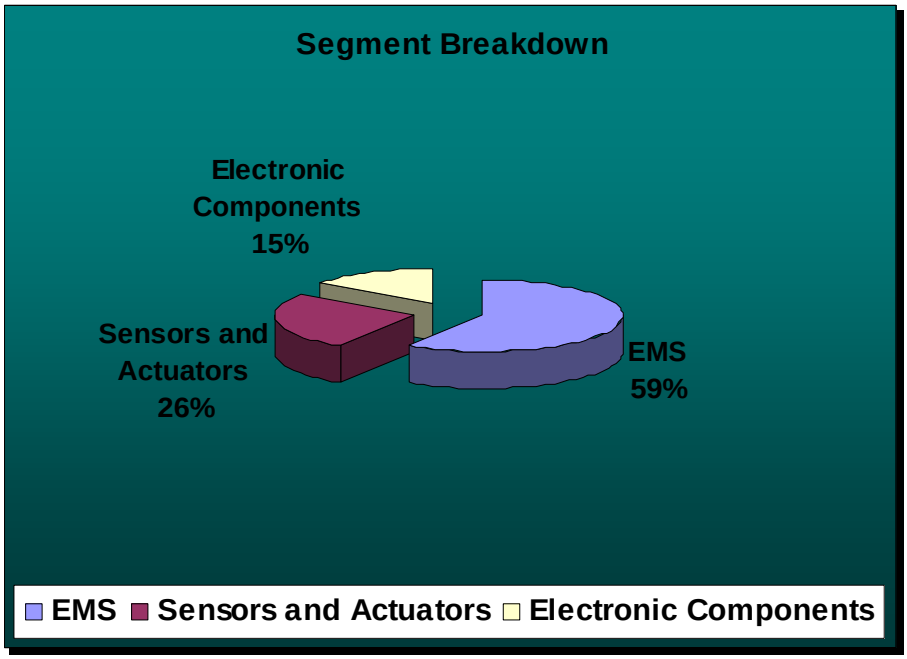
CTS has two reportable segments: Electronics Manufacturing Services (EMS) and Components and Sensors.



Electronics Manufacturing Services (EMS)
EMS includes the higher level assembly of electronic and mechanical components into a finished subassembly or assembly performed under a contract manufacturing agreement with an OEM or other contract manufacturer. The firm also provides full turnkey manufacturing and completion including design, bill-of-material management, logistics, and repair.

Products from the EMS segment are principally sold in the communications, computer, medical, industrial, and defense and aerospace OEM markets. Other smaller markets include OEM customers in consumer electronics, instruments and controls, and networking. Products from the Components and Sensors segment are principally sold in the automotive and communications OEM markets. Other smaller markets include computer, medical, and defense and aerospace.

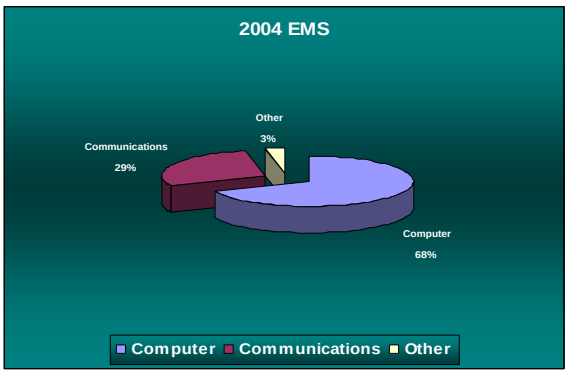
Components and Sensors
Components and sensors are products which perform specific electronic functions for a given product family and are intended for use in customer assemblies. Components and sensors consist principally of automotive sensors and actuators used in commercial or consumer vehicles; electronic components used in communications infrastructure and computer markets; components used in computer and other high-speed applications, switches, resistor networks, and potentiometers used to serve multiple markets; and fabricated piezoelectric materials and substrates used primarily in medical, industrial and defense and aerospace markets.

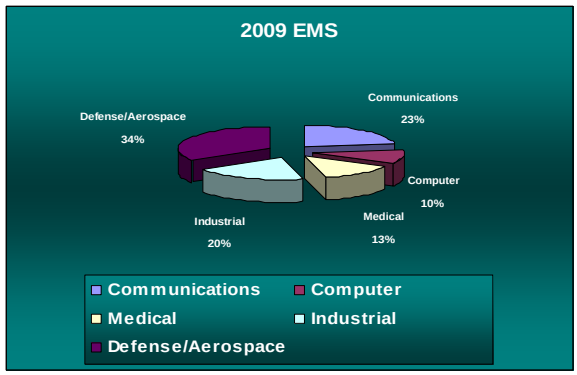


*note Components and Sensors represent one segment

EMS: Niche markets, Diversification and Alternative Energy

The slower growing EMS segment has been exceptionally diversified since 2004 into medical and industrial where margins are higher and cost to enter the market is significant. This will likely produce higher margins and more reliable revenue in what is CTS' largest segment.





Looking at the EMS industry, the economic down turn will increase the chasm between the haves and the have nots. We expect to see industry consolidation and a few firms may exit the business altogether. Despite the lack of visibility into future quarters we feel the winners in the EMS space will benefit from continued OEM outsourcing, and benefit from new opportunities as firms exit the business. EMS Firms with strong footholds in Medical, Defense, and Industrial will outperform firms with more concentration in computer and communications. CTS aims to find customers with complex needs in niche sectors such as defense, aerospace, medical and industrial. This ensures less competition and higher margins.

Sensors and Actuators; Potential in Emissions Regulations
The sensors and Actuators segment has the potential to see double digit sales growth over the next 3-5 years. Green initiatives, the need for increased fuel economy, and market share gains in Automotive provide a positive back drop for the segment.

Driven by tighter emissions regulations that require stricter engine controls, the market for smart actuator technology in commercial and passenger vehicles is growing rapidly and according to CSM Worldwide could grow to the $750 million to $1 billion range by 2010. The firm's target market share is 10%.The smart actuator is used as a key part of a turbocharger system. This initial CTS application will be used on diesel engines for light duty diesel trucks sold in the North American market with production beginning

Electronic Components; Growth in Developed and Emerging Communications
The Electronic Components segment also has the potential for double digit sales growth over the next three to five years. Driven by growth in communications infrastructure, the firm has been increasing market share and winning new customers.

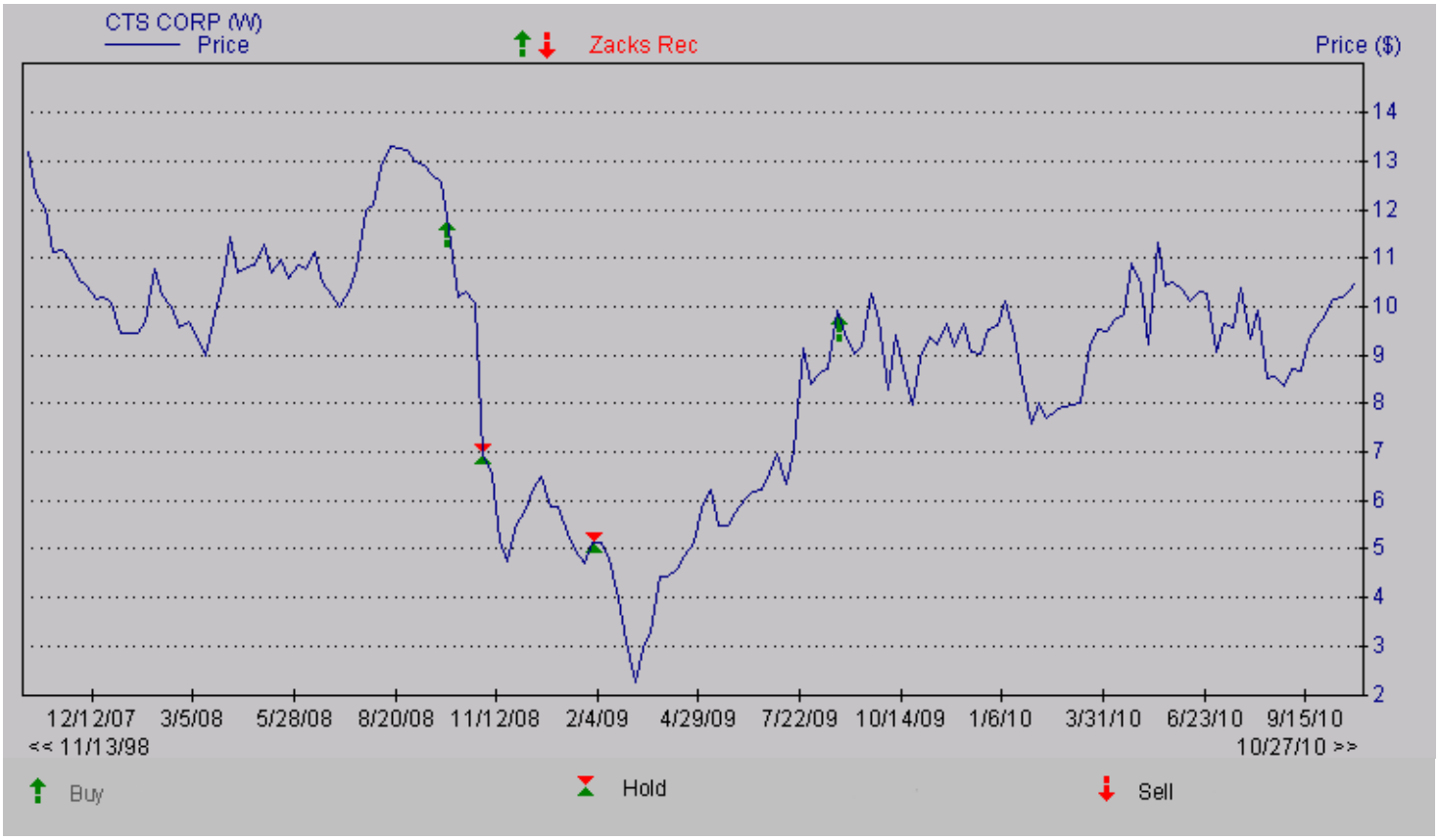
WORLD INTERNET USAGE AND POPULATION STATISTICS						
World Regions	Population (2009 Est.)	Internet Users Dec. 31, 2000	Internet Users Latest Data	Penetration (% Population)	Growth 2000-2009	Users % of Table
Africa	991,002,342	4,514,400	65,903,900	6.70%	1359.90%	3.90%
Asia	3,808,070,503	114,304,000	704,213,930	18.50%	516.10%	42.20%
Europe	803,850,858	105,096,093	402,380,474	50.10%	282.90%	24.20%
Middle East	202,687,005	3,284,800	47,964,146	23.70%	1360.20%	2.90%
North America	340,831,831	108,096,800	251,735,500	73.90%	132.90%	15.10%
Latin America/caribbean	586,662,468	18,068,919	175,834,439	30.00%	873.10%	10.50%
Oceania/Austraila	34,700,201	7,620,480	20,838,019	60.10%	173.40%	1.20%
World Total	**6,767,805,208**	**360,985,492**	**1,668,870,408**	**24.70%**	**362.30%**	**100.00%**

***Source: Internetworldstats.com/howthings work**

In our opinion the internet is still growing and has a relatively low 24.7% penetration rate compared to the population. Especially if one considers Asia which has approximately 56% of the world's population yet remains only 18.5% penetrated. Another trend to consider in assessing the CTS growth rate is the explosion of handheld devices such as IPhones and Blackberries. There are in effect more and more devices being connected and each new connection needs some type of access.

WiMAX has the potential to do to broadband Internet access what cell phones have done to phone access. In the same way that many people have given up their "land lines" in favor of cell phones, WiMAX could replace cable and DSL services, providing universal Internet access just about anywhere you go. WiMAX will also be as painless as WiFi -- turning your computer on will automatically connect you to the closest available WiMAX antenna. The main problems with broadband access are that it is pretty expensive and it doesn't reach all areas. The main problem with WiFi access is that hot spots are very small, so coverage is sparse.

HISTORICAL ZACKS RECOMMENDATIONS



DISCLOSURES

The analysts contributing to this report do not hold any shares of CTS. Zacks EPS and revenue forecasts are not consensus forecasts. Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts' personal views as to the subject securities and issuers. Zacks certifies that no part of the analysts' compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report. Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Because of individual objectives, the report should not be construed as advice designed to meet the particular investment needs of any investor. Any opinions expressed herein are subject to change. This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. Zacks or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time. Zacks uses the following rating system for the securities it covers. **Outperform**- Zacks expects that the subject company will outperform the broader U.S. equity market over the next one to two quarters. **Neutral**- Zacks expects that the company will perform in line with the broader U.S. equity market over the next one to two quarters. **Underperform**- Zacks expects the company will under perform the broader U.S. Equity market over the next one to two quarters. The current distribution of Zacks Ratings is as follows on the 1009 companies covered: Outperform- 14.9%, Neutral- 79.1%, Underperform – 5.7%. Data is as of midnight on the business day immediately prior to this publication.

© Copyright 2010, Zacks Investment Research. All Rights Reserved.