Zacks Small-Cap Research

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CTS Corporation (CTS-NYSE)

CTS: - First Quarter of the New CTS Shows an Improved Business Model- Revs up 35% and Adjusted EPS up 39%

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	08/24/2009
Current Price (2/10/2014)	$17.71
Target Price	**$20.00**

OUTLOOK

By selling off its low-margin stagnant EMS business in October 2013, and using that cash to pay down debt, CTS Corporation (CTS) is emerging as a more focused higher margin, higher growth business in the components and sensors market. Its automotive business (65% of sales) is benefiting from the robust car market.

It is finding new opportunities for its sensor portfolio in the automotive market, growth in piezo ceramic technologies for industrial hard drives and design wins in ClearPlex technology for electronic filtering, all of which should drive growth in 2015 and beyond.

SUMMARY DATA

52-Week High	**$20.63**
52-Week Low	**$9.69**
One-Year Return (%)	**80.34**
Beta	**2.16**
Average Daily Volume (sh)	**81,110**
Shares Outstanding (mil)	**34**
Market Capitalization ($mil)	**$597**
Short Interest Ratio (days)	**2.64**
Institutional Ownership (%)	**86**
Insider Ownership (%)	**5**
Annual Cash Dividend	**$0.16**
Dividend Yield (%)	**0.90**
5-Yr. Historical Growth Rates	
Sales (%)	**0.4**
Earnings Per Share (%)	**11.9**
Dividend (%)	**5.5**
P/E using TTM EPS	**23.0**
P/E using 2014 Estimate	**19.9**
P/E using 2014 Estimate	**21.3**
Zacks Rank	**3**

Risk Level	**Below Avg.**
Type of Stock	**Small-Blend**
Industry	**Elec-Misc Comp**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2012	147 A	154 A	137 A	76 R	305 R
2013	98 R	105 R	104 R	102 A	410 A
2014	102 E	106 E	108 E	114 E	430 E
2015					465 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2012	$0.07 A	$0.18 A	$0.20 A	$0.18 A	$0.64 A
2013	$0.14 A	$0.20 A	$0.24 A	$0.25 A	$0.82 A
2014	$0.16 E	$0.22 E	$0.24 E	$0.35 E	$0.97 E
2015					$1.10 E

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WHAT'S NEW

CTS Reports First Clean Quarter After Huge Divestiture

On February 6, 2014, CTS Corporation, the designer and manufacturer of electronic components and sensors primarily sold to the automotive industry, reported financial results for its fourth quarter and year, ended December 31, 2013 on a continuous operations basis.

This quarter was the first full quarter since the divestiture of its EMS division (on October 2, 2012 for $75 million in cash), which had contributed $154 million sales in the first nine months of 2013. As a result the company reported revenues on a continuing operations basis and 2012 revenue numbers were restated significantly downward.

Revenues in the quarter were $102 million versus a restated $76 million last year, up 35%. Adjusted EPS, taking out all one-time expenses was reported as $0.25 versus $0.18 up 39%. Of the incremental $26 million in sales, $15 million was from the purchase of D&R Technologies (automotive sensors) in December 2012, while the rest was internal growth primarily in piezoelectric ceramic and automotive products.

The fourth quarter EPS as reported contained $0.34 of one-time charges: $0.23 for the divestiture, $0.08 for restructuring and $0.03 for the change in CEO. The company is not yet finished with realigning its global footprint and investors should expect more restructuring charges some time in 2014 at the time actions are taken. The company plans to continue to consolidate manufacturing in best cost locations.

Gross margin for the quarter and the year were virtually flat with a year ago at 30%. We have not seen Q3 restated gross margins from Q3 2012. The big improvement in earnings however, was the ability of the company to keep the dollars spent on SG&A and R&D flat despite the 35% increase in sales. This grew operating income (ex-one time charges) to a profit of $7.5 million (or 7%) from a loss of $0.6 million. Net interest is now near zero as the sale of EMS, which generated $75 million in cash, offset much of the net interest expense. Going forward we expect that line item to be comprised mostly of currency translation rather than interest expense.

CTS secured new orders of $78 million in the quarter. Broken down, $52.5 million came from sensors and $25.7 million from electronic components.

The full year numbers were compared against a restated 2012 taking out the EMS division. For the full year, revenues were up 34% to $410 million. Operating expenses on the other hand were only up 11% leading to a much-improved profit. Adjusted EPS for the year was a healthy $0.82 versus $0.64 the year before.

The pre-tax margin for the company before one-time charges was 6.9%, up significantly from the restated 2.5% reported for last year. The tax rate for the year was 89% impacted by restructuring and repatriation of cash.

CTS Corporation's cash and equivalents for the year ended December 31, 2013, was $124 million, up from $97 million in Q3. More importantly, long-term debt was reduced to $75 million from $129 million at the end of Q3, as the proceeds from the divesture were placed into the company's revolving loan.

Cash flow from operations improved to $38 million for the year compared to $32 million 2012, up 19%, Free cash flow was $24 million. Capital expenditures were $14 similar to the $13.5 million spent last year.

On November 11, 2013 CTS appointed Ashish Agrawal as Vice President and CFO replacing Tom Kroll who is retiring in March. Mr. Agrawal joined CTS in June 2011 as VP, Treasury and Corporate Development and came from Dometic Corporation where he spent four years as SVP and CFO. He also had 13 years experience at General Electric. He is a key executive is this extreme financial makeover and has had excellent results so far. Other new appointments were Anthony Urban as VP and General Manager of CTS' sensors and mechatronics business. He previously was President of D&R Technologies which was acquired by CTS in December 2012. Also added was Robert J. Patton as VP, General Counsel and Secretary. Both have extensive experience in the automotive market.

INVESTMENT THESIS

- The components and sensors are now the sole business at CTS and these products enjoy better margins and higher growth potential than the previous combined company. The increased earnings growth should expand the company's multiple and its valuation.

- With over 65% of revenues now sold to the light vehicle industry, the company could benefit by new investors looking for exposure to new car sales without picking a specific manufacturer, while having an overweight exposure to the Asian carmakers.

- Given the drastic restructuring and conservative outlook, the company could exceed earnings estimates as it takes actions to improve its global footprint and rationalize operations and tax rates.

- The company has upside that is not priced into the stock by the introduction of a number of new products that could gain traction in the coming year. Particularly in:

    - Piezo ceramics, that are being used on high-end hard drives to read data faster and more accurately.

    - Smart actuators, that combine software and hardware in complicated mechatronics for simplified consolidated auto parts resulting in lower parts and labor costs for customers.

    - CleanPlex technology that may be designed into small base stations used in building out cellular telecom networks. They are used to filter electronic signals and are smaller and more energy efficient than parts currently in use.

CTS Just became a Higher Margin Company

CTS Corporation (CTS) designs, manufactures, assembles, and sells electronic components and sensors worldwide. It has found new customers and markets for existing products. It designs and manufactures:

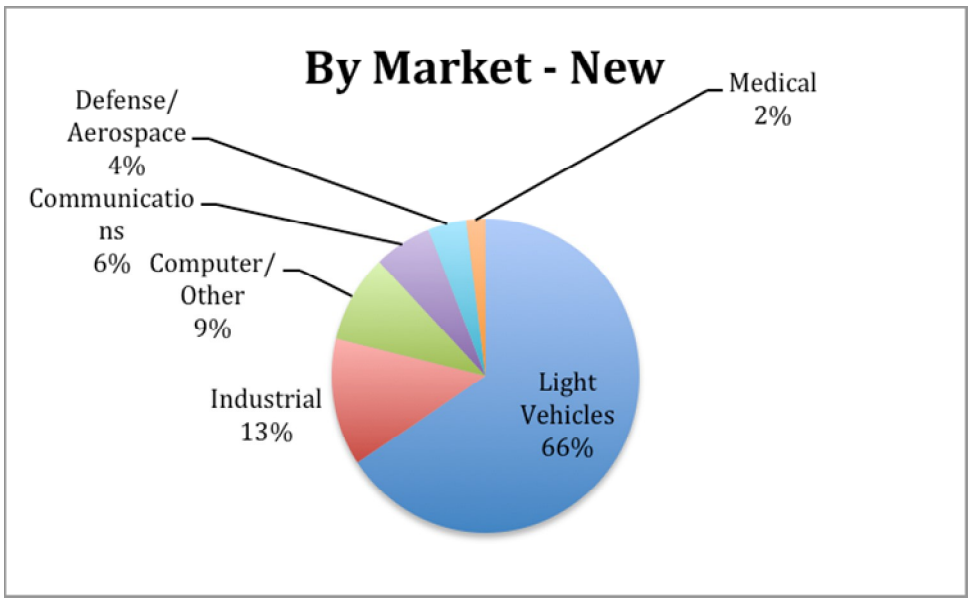
- an extensive line of vehicle sensors and actuators used in powertrain, safety, fuel and emissions control systems;

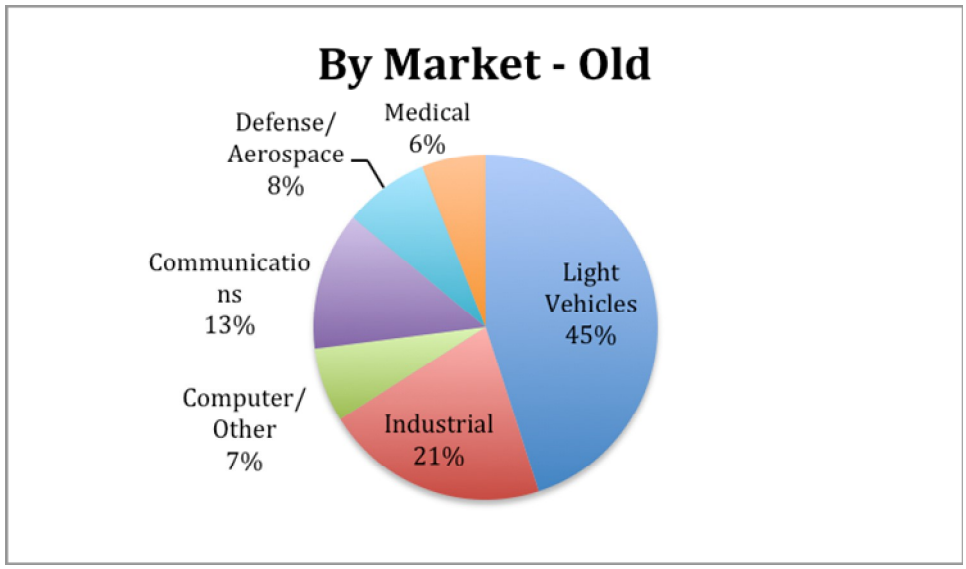
- ceramic and crystal-based engineered electronic components used primarily in wireless communications infrastructure equipment;

- piezoelectric materials, heat management and resistive-based components used in medical, defense and aerospace, computer, consumer and industrial equipment applications.

On October 3, 2013, Benchmark Electronics, Inc. acquired its Electronics Manufacturing Solutions (EMS) business for $75 million in cash. This segment drove down company margins as well as growth potential and the company has used the cash generated from the sale to pay down debt and reduce interest expense.

CTS Markets Before and After Divestiture:





VALUATION

Compared to other companies in its industry, CTS appears fairly valued to undervalued compared to an average on a basis of PE to growth and enterprise value as well as on a cash flow basis. The share price has increased in value in the past twelve months due primarily to the restructuring efforts that are forecasted to increase the company's cash flow by over 50% in the 2014 calendar year. As a result, although the company looks rich on a trailing basis, on a forecasted basis the company trades in line with its peers. We believe estimates for the company are conservative and that the stock could appreciate as these projections are surpassed as the year progresses.

Looking forward to 2015, we expect the stock could appreciate another 12% in the next nine months as investors begin to focus on 2015. At current multiples we expect the stock to move up from $18 today to over $20 by year-end 2014.

Feb 10, 2014

Comps Valuation Data ($ in millions)

	Cal 2014E Revenue	LTM EBIDA Margin	5-Yr Hist. CAGR	Cal '14 P/E	P/E/G	EV/2014E Sales	EV/TTM Cash Flow
OSIS	$ 934	15.3%	26.0%	16.5	0.6	1.3	9.1
MEI	$ 793	11.2%	18.5%	14.5	0.8	1.4	16.1
SYNA	$ 922	20.1%	10.7%	15.2	1.4	1.8	10.1
SAMN	$ 6,000	4.6%	5.1%	9.6	1.9	0.3	6.4
Mean	$ 2,162	12.8%	15.1%	13.9	1.2	1.2	10.4
Median	$ 928	13.3%	14.6%	14.8	1.1	1.4	9.6
CTS	$ 430	8.8%	2.3%	19.1	8.5	1.2	15.0

PROJECTED INCOME STATEMENT

Q1 Sales and Earnings Growth Should be Slower

After a huge ramp in Q4 2013, the March quarter should show slower growth versus a restated 2013. We are looking for revenues of $102 million up from $98 million in 2013 or 3% using restated revenues. No other quarterly numbers are available on a restated basis until the 10K is filed. On the earnings model we have shaded the quarters that will be restated in the future. Those shaded areas show results with the discontinued operations and as a result the quarters will not add to the year.

Using a 31% tax rate, we are looking for EPS of $0.16 versus a previously reported $0.14. The company's growth should accelerate throughout the year and be back end weighted as new products ramp.

Modest Sales Growth is Expected But Margins Should Greatly Improve

Despite the 20% internal growth rate in Q4 2013, management expects full-year 2014 sales to show growth of only 4-6% or a range of $426-434 million and to be back half weighted as new product offerings kick in. We are forecasting sales of $430 million versus a restated $409 million in 2013.

While CTS expects only modest sales growth in 2014, the real story is an improvement in operating margins. Sales in 2014 should improve in the second half of the year as sales to hard drive manufacturers return to more normal levels. Gross margin is expected to improve as new products ramp and old products are further fine-tuned. We are forecasting an improvement from 29.6% in 2013 to 32.1% for the full year 2014. SG&A should see the vast improvement in 2014 as facilities are better aligned with the current and future customer base. As a percent of sales we are forecasting 15.1% in 2014 from 17.1% in 2013. R&D is expected to remain steady, as the company believes that new products are its future and there are many more applications for the technologies they already have expertise in.

Interest expense should be nil this year due to the addition of cash from the divesture and only currency fluctuations should affect this line item.

As a result of all these moving parts, we expect pretax income to go from 6.9% to 11.2% in 2014. Taxes are expected to be about 31% as the geographic mix of earnings changes from 2013. Earnings by quarter should be back-end weighted as the cost savings from restructuring has more effect as the year progresses and revenues in the HDD market improve. We forecast an EPS of $0.97 for the year ending December 31,2014.

Sales Should Accelerate in 2015

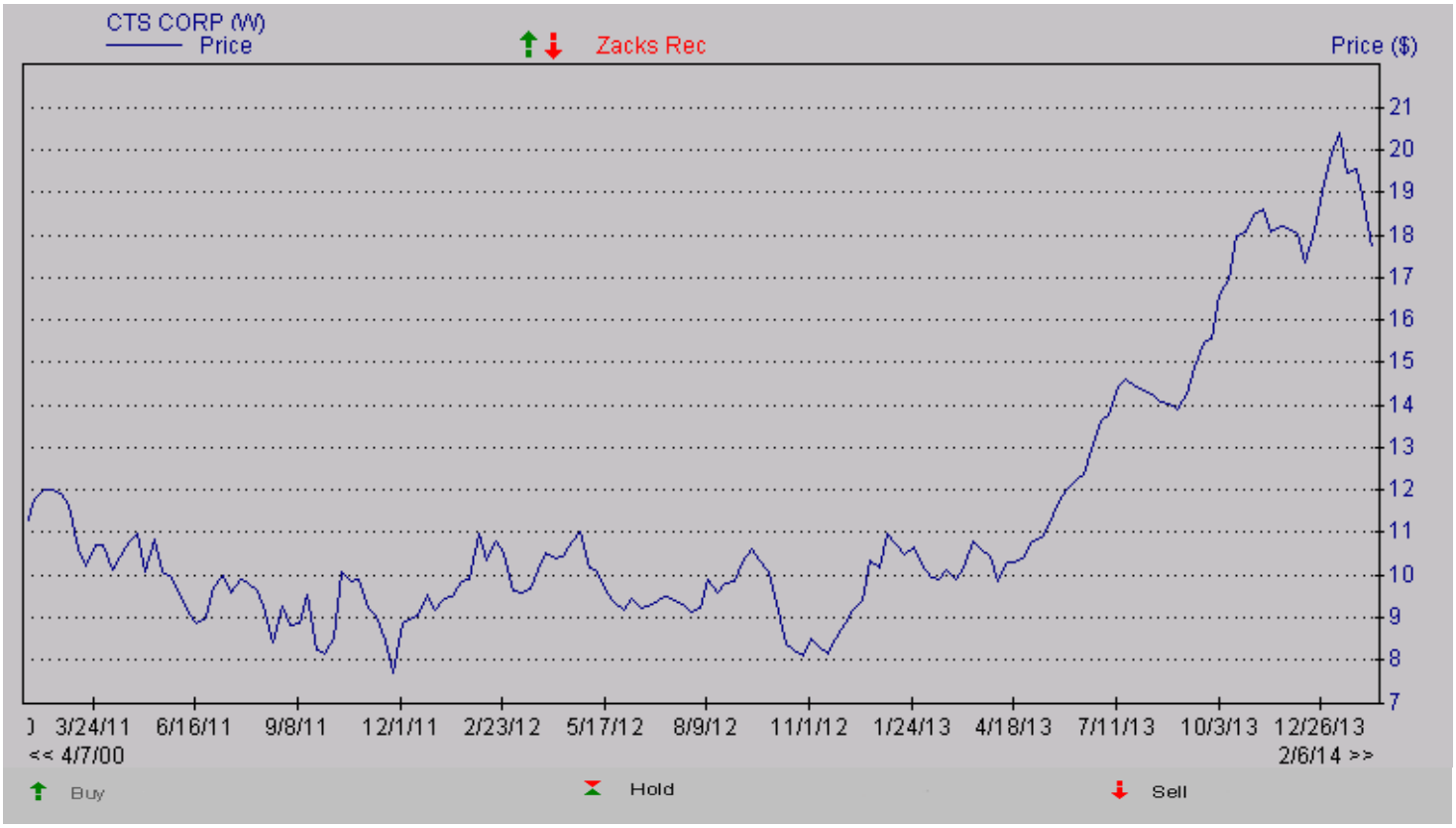
As new product design in kick into gear and the revamp of the company is stabilized. We believe the newly revitalized company could grow sales 8% to $460 million and increase pretax income and cash flow over 12%. We expect an EPS of $1.10 versus $0.97 in 2014.

CTS Corp.
Income Statement

	Dec Q4 12	March Q1 13R	June Q2 13R	Sept Q3 13R	Dec Q4 13	March Q1 14E	June Q2 14E	Sept Q3 14E	Dec Q4 14E	As Reported 2010	As Reported 2011	Restated 2012	Restated 2013	2014E	2015E
REVENUE															
Net Revenue (restated)	$75.7	$98.1	$105.4	$103.6	$102.4	$102.0	$106.0	$108.0	$114.0	$552.6	$588.5	$304.5	$409.5	$430.0	$465.0
Yr-to-yr Gr.		NA	NA	NA	35%	4%	1%	4%	11%	11%	6%	-48%	34%	5%	8%
OPERATING EXPENSES															
Cost of goods sold	53.3	118.3	116.1	122.0	72.2	71.5	73.0	74.0	$73.5	432.7	478.7	213.0	288.1	292.0	315.0
Gross Margin	22.4	(20.2)	(10.7)	(18.4)	30.2	30.5	33.0	34.0	40.5	119.9	109.8	91.5	121.4	138.0	150.0
% of Sales	29.6%	-20.6%	-10.1%	-17.8%	29.5%	29.9%	31.1%	31.5%	35.5%	21.7%	18.7%	30.1%	29.6%	32.1%	32.3%
SG&A	17.7	21.4	20.7	20.8	17.2	16.8	16.2	16.0	$16.0	69.8	69.3	63.1	69.9	65.0	69.0
R&D	5.3	6.3	5.8	5.7	5.5	5.6	6.0	6.3	$7.1	18.3	20.0	20.9	23.2	25.0	27.0
One-time charges	(8.4)	0.6	7.2	1.0	2.3	0.0	0.0	0.0	$0.0	1.4	(7.3)	(6.9)	10.5	0.0	0.0
Tot Operating Exp.	14.6	28.2	33.8	27.4	25.1	22.4	22.2	22.3	23.1	89.6	82.0	77.1	103.6	90.0	96.0
Operating Income	7.7	(48.5)	(44.4)	(45.9)	5.1	8.1	10.8	11.7	17.4	30.3	27.8	14.4	17.8	48.0	54.0
Yr-to-yr Gr.															
Oper Inc B4 One-time	(0.6)	(47.9)	(37.2)	(44.9)	7.5	8.1	10.8	11.7	17.4			7.5	28.3	48.0	54.0
Pre-tax margin												2.5%	6.9%	11.2%	11.6%
Net Interest	(0.3)	(0.5)	(0.6)	(0.4)	0.0	0.0	0.0	0.0	0.0	0.2	1.1	(0.8)	(1.5)	0.0	0.0
Other income	0.4	0.3	(0.3)	0.7	1.4	0.0	0.0	0.0	0.0			0.2	1.7	0.0	0.0
Pretax Income	7.8	(48.7)	(45.4)	(45.6)	6.5	8.1	10.8	11.7	17.4	30.5	28.9	13.8	18.1	48.0	54.0
Taxes	1.9	(0.8)	12.1	3.6	1.8	2.5	3.3	3.6	5.4	6.0	5.4	1.0	16.1	14.9	16.7
Tax Rate	24.4%	1.7%	-26.7%	-7.8%	27.9%	31.0%	31.0%	31.0%	31.0%	19.6%	18.6%	6.9%	88.8%	31.0%	31.0%
Net Income Cont. Ops.	5.9	(47.8)	(57.5)	(49.1)	4.7	5.6	7.5	8.1	12.0	24.5	23.6	12.9	2.0	33.1	37.3
Yr-to-yr Gr.	0.2%	-908.4%	-1841.8%	-930.4%	-21.1%				156.6%						
EPS-Basic	$0.18	($1.43)	($1.71)	-$1.46	$0.14	$0.17	$0.22	$0.24	$0.36	$0.72	$0.69	$0.38	$0.06	$0.99	$1.12
EPS-Fully dil.	$0.17	($1.40)	($1.71)	-$1.43	$0.14	$0.16	$0.22	$0.24	$0.35	$0.70	$0.67	$0.37	$0.06	$0.97	$1.10
Yr-to-yr Gr.															
EPS-Adjusted	0.18	0.14	20.0%	24.0%	0.25	$0.16	$0.22	$0.24	$0.35	$0.70	$0.67	$0.64	$0.84	$0.97	$1.10
Yr-to-yr Gr.	NA	100.0%	11.1%	20.0%	38.9%	16.8%	8.9%	-1.6%	71.4%				NA	15.9%	12.6%
Share Out	33.6	33.5	33.6	33.7	33.6	33.5	33.5	33.5	33.5	34.1	34.3	33.9	33.6	33.5	33.4
Fully diluted shares	34.3	34.2	33.6	34.3	34.3	34.2	34.2	34.2	34.2	34.8	35.0	34.5	34.0	34.0	34.0
Yr-to-yr Gr.		-1.6%	-1.3%	-0.4%	0.0%	-1.6%	0.5%	-0.8%		3.0%	0.5%	-1.4%	-1.5%	0.0%	0.0%

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