

**Transcat, Inc.**  
**Fourth Quarter 2009 Earnings Teleconference/Webcast**  
**May 21, 2009**

**Operator:** Greetings and welcome to the Transcat fourth quarter 2009 earnings conference call. It is now my pleasure to introduce your host, Ms. Deborah Pawlowski, Investor Relations for Transcat. Thank you, Ms. Pawlowski, you may begin.

**Deborah Pawlowski:** Thank you and good morning, everyone. We appreciate your joining us today on Transcat's Inc.'s fourth quarter fiscal year 2009 financial results call. On the call, I have with me today Charles Hadeed, President, CEO and Chief Operating Officer of Transcat, and John Zimmer, Vice President of Finance and Chief Financial Officer. They will be reviewing the results of the fourth quarter and fiscal 2009 and progress on the Company's strategy. You should have a copy of the earnings announcement that was released yesterday, and if not, you can access it at the Company's website, [www.transcat.com](http://www.transcat.com).

As you are aware, we may make some forward-looking statements during the formal discussion as well as during the Q&A. These statements apply to future events and are subject to risks and uncertainties, as well as other factors that could cause actual results to differ from what we have stated here today. These risks and uncertainties and other factors are provided in the earnings release, as well as other documents filed by the Company with the Securities and Exchange Commission. These documents can also be found at the Company's website also or at [www.sec.gov](http://www.sec.gov).

So with that, let me turn it over to Charlie.

**Charles Hadeed:** Thank you, Debbie, and good morning, everyone. As most of you know, we are a provider of accredited calibration, parts inspection, production model engineering and repair services and a global distributor of premium brand test and measurement equipment. Our target customers and industries are those who value quality systems and those who operate in regulated environments. This primarily includes the pharmaceutical industry and other FDA-regulated businesses, as well as industrial manufacturing, the energy industry, utilities and the chemical process industry.

Our strategy is to leverage our combined service and product offerings to create a unique and compelling value proposition built upon trust and technical confidence. We intend to capture greater market share in those industries that value product breadth and availability and rely on accredited calibration services to maintain the integrity of their processes.

We are a market leader in the US for sales of test and measurement equipment. In a more normalized economy, we believe we can maintain growth in this segment by expanding our product offerings, increasing our web presence, increasing our market reach with resellers, and capitalizing on our strong relationships with our strategic business partners who manufacture the products that we sell. We also leverage our strength as an expert in test and measurement equipment to expand our Services business, which is our larger, long-term growth opportunity. In our Services segment, our goal is to become the leading US provider of calibration and related services in this highly fragmented industry through organic growth and acquisitions. We believe that times of economic turmoil and challenge, such as we're in today, create an opportunity to spur shifts in market share. As a result, we have maintained our investments and even added to our sales force in this segment over the past year.

Turning to our fourth quarter results, our revenue is stable while profit margins were squeezed as a result of aggressive pricing, reduced point-of-sale rebate income, and sales channel mix. Nonetheless, our operating cash flow allowed us to pay down a sizeable portion of our long-term debt during the quarter.

We began to see sales orders fall off last November and the market has remained soft. Although we are disappointed with the latter half of fiscal 2009, and in particular the fourth quarter, we think that compared with what has been a rough period for many companies, we've held up quite well. This is, in part, because of the industries we serve, the productivity and cost structure improvements we have been implementing over the past few years, and our ability to strategically manage our inventory levels during this downturn without compromising customer service.

Now with that overview, I'll turn it over to John who will provide detail on the quarter and year-to-date financial information and then I'll provide some outlook comments before we open for Q&A.

**John Zimmer:** Thank you, Charlie. Our reported results include those of Westcon Inc., a company that was like a “mini-Transcat,” which we acquired on August 14, 2008. We have completed the integration, including combining Westcon’s operations with Transcat’s lab network and financial systems and, as a result, are reporting only on a consolidated basis. I’ll cover the fourth quarter first and then briefly address trends and events associated with the fiscal year.

For our fourth quarter of fiscal 2009, which ended March 28, 2009, we reported net revenue of \$19 million, which was marginally lower than the \$19.2 million in revenue in fiscal 2008’s fourth quarter. Revenue was split with 64% coming from our Product segment and the rest from the Service segment.

At the segment level, product sales declined 1.4% quarter-over-quarter. We had incremental sales to the wind industry, as a result of the acquisition, and higher sales to resellers. But this was more than offset by the severe weakness in the economy, as existing customers significantly reduced or halted spending. We implemented aggressive pricing strategies to maintain customer retention rates, but volume did not offset the reduced prices.

We have expanded our relationship with resellers to create a broader reach into customers that we would not have had the opportunity to reach. Domestic sales comprised approximately 80% of the total Product segment sales in fiscal 2009, while 7% were to Canadian customers and 12% were to other international markets.

Sales of the Company’s products over our website reached \$1.1 million in the quarter, up more than 37% over the corresponding period in fiscal 2008, as we continue to market our business through our website to both current and prospective customers.

Our Service segment revenue was down slightly to \$6.7 million in the fiscal 2009 fourth quarter. We saw a reduced demand from existing customers because they were not using calibration services, we believe, from lower levels of need. If they are reducing output and people, their calibration

requirements are likewise lower. However, new business development was strong and nearly offset the decline in demand from existing customers.

Gross profit was \$5 million, or 26.6% of net revenue, in the fourth quarter of fiscal 2009, compared with \$5.4 million, or 27.9% of net revenue, in the prior fiscal year fourth quarter. Impacting the quarter-over-quarter comparison was a decrease in Product segment gross margin, partially offset by an improved gross margin in the Service segment. Driving the 310 basis point decline in Product segment gross margin was reduced point-of-sale rebate income, which represented about one-third of the decline, a higher mix of lower margin reseller sales and increased discounting. Historically, sales into Canada have had higher margins, but with an increase in availability of competitive product pricing information on the Internet, margins on product sales into Canada are now trending closer to U.S. product sales margins. The improvement in Service segment gross margin was primarily related to \$200,000 in lower performance-based bonus and profit sharing expense.

Operating income for the fourth quarter of fiscal 2009 was \$900,000, or 4.9% of net revenue, down from \$1.2 million, or 6.2% of net revenue, in the fourth quarter of fiscal 2008. Reduced expenses from a \$600,000 reduction in performance-based compensation, reduced advertising, and other cost controls helped to somewhat offset the reduction in our gross profit.

Product segment operating income was \$500,000 for the quarter, down from the prior year's fourth quarter, with the decline driven by lower gross profit. Our Service segment operating income was \$400,000 in the current quarter, which was up \$100,000 over the prior year's fourth quarter.

Looking at our bottom line, net income for the fourth quarter of fiscal 2009 was down about \$170,000 to \$600,000, and earnings per diluted share were down \$0.03 to \$0.07. Weighted-average diluted shares outstanding increased \$192,000, primarily from shares issued in conjunction with the Westcon acquisition.

For the full fiscal year, revenue was up 7% to \$75.4 million, when compared with the prior fiscal year. In the first half of the year, revenue had been up 12%, pre-acquisition, so the declines in the second-half basically negated first-half gains. We had about seven months of Westcon revenue in the fiscal

year, and of course, their revenue was also impacted. To provide a sense of magnitude, they had \$9.5 million in revenue for their previous fiscal year that ended June 2008.

Fiscal 2009 Product segment sales were \$51.5 million, or 8.3% above fiscal 2008. The reseller channel, where we experienced sales growth of approximately 43% year-over-year, and the Westcon acquisition were the primary drivers for this growth.

Sales of the Company's products over our website were \$3.7 million for fiscal 2009, up 36% over the prior year. Although currently accounting for just over 7% of product sales, we see our website as a means of capturing even greater market share in our Product segment.

Service segment revenue was \$23.9 million in fiscal 2009, up 4.5% when compared with revenue of \$22.9 million in the prior fiscal year. Growth was driven by solid sales to the pharmaceutical industry and some early-in-the-year gains from utilities. Sales to the industrial manufacturing industry were weak throughout the year, as would be expected given the impacts of the recession.

Gross profit was \$18.7 million for the year, a 1.1% improvement. A 6.4% increase of \$342,000 in Service segment gross profit more than offset a \$135,000 decline in the Product segment's gross profit. Much of the increase in Service's gross profit was related to reductions in performance-based management bonus and profit sharing expense.

Operating income for fiscal 2009 was \$2.7 million, or 3.6% of net revenue, a decrease from \$3.3 million, or 4.7% of net revenue in the prior fiscal year. Included in fiscal 2009, operating expenses were approximately \$800,000 in expenses from Westcon and \$300,000 in non-recurring expenses related to its integration. Increases in sales expenses, which were primarily related to increasing sales in our Service segment, were somewhat offset by reductions in performance-based management bonus and profit sharing expense.

Product segment operating income was \$3.4 million at the end of the year, down almost 10% from the prior year. Our Service segment operating income was \$400,000 in the current quarter, which

was up over the prior year's quarter, but comparing year-over-year, we saw our operating loss increase as a result of the significant investments we have made in our sales functions.

For the full fiscal year, net income was \$1.6 million, or \$0.21 per diluted share in fiscal 2009, compared with \$2.4 million, or \$0.32 per diluted share, in fiscal 2008. Fiscal 2008 had the benefit of an \$800,000 reversal of a deferred tax asset valuation allowance. Excluding this item, net income for 2008 would have been \$1.6 million, or \$0.22 per diluted share.

We continue to have solid cash generation from operations, which was \$3.8 million in fiscal 2009. As Charlie mentioned earlier, our long-term debt decreased to \$3.6 million at March 28, 2009, when compared with \$5.3 million at the end of our third quarter. Capital expenditures were \$1.8 million in fiscal 2009, compared with \$1.5 million in fiscal 2008. Capital expenditures in fiscal 2009 were primarily focused on expansion of calibration services capacity and capabilities. We expect capital spending in fiscal 2010 to be about \$1 million. At March 28, 2009, inventory was \$4.9 million, compared with \$5.5 million at the end of the third quarter and \$5.4 million at prior year's end. The decrease in inventory reflects the Company's efforts to manage down its inventory during the current recessionary economy.

That concludes my remarks. Charlie, I will pass it back to you.

**Charles Hadeed:** Thank you, John. Given the current state of the economy, we expect fiscal 2010 sales to be relatively flat or slightly down to start the year, but to end on a stronger note. Impacting our business in fiscal 2010 will be the benefit of a full year of the Westcon business, our expected growth through market share gains in calibration and related services, and our assumption of some improvement in the general economy in the later half of the fiscal year.

As mentioned, we expect the recession to affect Service segment growth early in the year; however, we expect it to strengthen as we move through the year, leveraging a now more experienced sales staff. Over the longer term, it's our goal to expand calibration services at a rate of at least 10% per year.

We expect product sales to have a relatively flat fiscal 2010, with our fourth quarter being the strongest. Our Product segment results reflect broader economic conditions and their impact on our customers. We have and will continue to make prudent investments in this business segment to optimize our performance and service our customers during this challenging period.

Sales to the wind industry should be a greater part of total revenue in fiscal 2010. We have relationships with the major turbine manufacturers, as well as with several major utilities focused on wind energy power generation. We have provided and are continuing to develop services specifically for this industry. This, combined with the government's focus on alternative energy, drives our expectation that we should be able to accelerate growth to this industry during fiscal 2010.

Finally, we continue to make investments in CalTrak, our proprietary customer calibration management software, as well as expanding online marketing of our calibration services.

Operator, you may open the line now for questions.

**Operator:** Thank you. Our first question is from the line of Bill Nicklin with Brown Advisory.

**Bill Nicklin:** Good morning. First off, I'd like to applaud you for building a decent foundation while everybody else is running around trying to survive. I have questions about the energy industry in general. A lot of savants in the industry are saying that the entire infrastructure is going to get billed out from everything from gas distribution systems and power plants right on through the grid. I'd like to get your view on how you're positioning the Company for that, given your traditional presence in that industry?

**Charles Hadeed:** Well, Bill, thanks for your first comment; we appreciate it. Good question. The product side is really going to be to continue to market to them through our catalogue, our channels and expanded Internet and field presence. I'll leave wind for a second. The calibration side is a little less regulated, certainly from our view. Utilities are one of the areas where we saw a reduction in calibration need or willingness to put things off, and a little less structured in terms of their compliance with a steady calibration cycle. The wind energy business, we believe, is going to become a real

opportunity for us to service, not only turbine manufacturers and owner-operators with companies like Nextera and Eberdola. Then there's a third group of service providers that offer services to owner-operators after the turbine manufacturers' warranties have lapsed.

**Bill Nicklin:** On the utilities side, a lot of the independent power producers, in particular, were really worried about rolling over their debt. Then I saw Calpine got some very favorable terms on rolling over some of their debt, so maybe that'll pick up for you.

**Charles Hadeed:** Clearly, what we've seen in the better part of the last five or six months, particularly on the product side of the business, is that a number of companies and utilities, also industrial manufacturing, have been right in there with them, heavily. They have said that they have no budget and are under a few spending holds or, that they have a very limited budget and are going through a much more stringent process of repair, replace, and defer. Obviously, that's had some impact on us. At some point in time, I think it becomes a question of our being on the front end when the cycle swings back up and making sure that we've got the right amount of inventory at the right time to meet customers' needs when their spending re-energizes.

**Bill Nicklin:** What are your observations as far as the condition of your competition?

**Charles Hadeed:** Well, so much of our competition is non-public companies. I think the one strength that we really have is that we're the only major player who is providing both product and calibration services. Because we are uniquely focused on the product side, on test and measurement instrumentation, with a sales force that understands how to sell and provide that application assistance and we have not expanded our product business into a wider, commodity-based warehousing operation. I know that's probably not doing their business justice, but we have a narrow niche, and I think we're probably as well-positioned as anyone in our relationships with our key strategic vendor partners and with customers who know what we have and that we have the ability to help them decide what they need.

**Bill Nicklin:** I've done a little searching around on the Internet on some of those private companies and some of them are much more heavily weighted in the semiconductor industry and other



electronics areas. I would imagine that must hurt a lot more than your customers. So do you think that gives you some earnings power or balance sheet advantage during these tough times? You may be able to leverage when things get better, and particularly, if the energy side does what we suspect it might?

**Charles Hadeed:** I think some of our competitors are stronger on the calibration side, in disciplines where we aren't tremendously focused. Our real core strength is pressure, electrical, temperature and dimensional, although we have some capabilities in the high-end electrical RF fiber optics. I think that we have a very strong balance sheet. We're really pleased with how well we've been able to manage that for quite a while. That's getting us through these times. In fact, having the ability to pay down some of our acquisition debt in the quarter has solidified us in this area. Maybe the strength is from our customers and the fact that they know we're here. They can look at our balance sheet and our performance and know that we'll continue to be here for them as they go through this period and come out of it.

**John Zimmer:** I would just add to that, on the calibration side, that most of our competitors are locally-owned, owner-operated laboratories, and they're not actively marketing their business themselves. They don't have a sales force out there selling their business. What we've seen in our business is the decline in business from our existing customers, which is related to the economy. But we've got a sales force, and we're out there growing the new business and taking market share from competitors. With an owner-operated business and an existing customer base, I would imagine that they're seeing the same phenomenon occurring with their existing base. We're reducing their volume from that base and they're not able to replace it because they don't have the sales force that we have and the infrastructure in place.

**Bill Nicklin:** One final question, if you don't mind. If you look at your cash generation and how much of the debt you've paid down for Westcon so far, it would seem to me that you'll be in financial condition to do a Westcon deal every couple of years. Is that part of the plan? And is the industry fragmented enough that you may be able to have those opportunities?

**Charles Hadeed:** That would be, yes. Westcon was unique in that it blended both a product and a calibration business and fit a lot of the criteria that we talked about before. I would suggest that if you look at what our cash generation has been and the size of that acquisition, I think the timeframe you suggested might be on the far end rather than the shorter end.

**Bill Nicklin:** In other words, you could swallow more?

**Charles Hadeed:** More or sooner. I think one of the things to follow up on is that Westcon was a \$9.5 million company, when you look at both the product and the calibration side of things. If we're looking at an owner-operated calibration lab, there aren't too many that are of that size, other than the national players. So we're probably looking at, in terms of calibration, is something on the smaller side, which we would be able to absorb more easily. Westcon was a fairly large acquisition for us. On the product side there may be some larger opportunities but those tend to be less complex in terms of the structure of those acquisitions.

**Operator:** Thank you. Our next question is from the line of Dave Rode with Stifel, Nicolaus.

**Dave Rode:** Further on Bill's comment about financing in the utility industry, in addition to Calpine, it seems like a lot of the diversified energy utilities, some of the natural resource and even energy distributions, are getting their financing secured successfully, particularly in the last few weeks. Also in the regulation side of your business, there has been talk, now, that with a change in the administration, of further regulation in many of these industries. What is your view of that and how does that bode for you in the future?

**Charles Hadeed:** I think one industry that has been in the press fairly recently has been the food industry. When we talk about a segment as FDA-regulated, a big portion of that business has been pharmaceutical, bioscience, and medical devices. That whole industry, or group of industry segments, we've lumped together under FDA-regulated. It would seem that there is going to be a lot more intensity on the food business in terms of regulation and controls, or lack thereof, that may, in many cases, be surfacing relative to the industry. I think with that, and a focus on quality, comes a compliance program, of which calibration should be an integral part.

Any industry that is going to enforce more or implement more self-regulated control requirements, in terms of their processes to the extent that the quality of the process or the control is an important element of the whole program a company has and to the extent calibration is an important part of that, we certainly would welcome that. As I've said before, the key part of the calibration business is trust in the organization and the technicians who are doing the work, and it's not something you can see.

**Dave Rode:** Can you talk a little bit about the Internet sales? I know its primary focus is product sales at this point. Could you elaborate a little bit? I think I saw an up-tick in your international sales. Can you talk a little bit about the breadth of your Internet sales, what you see going forward? Are you offering various language-friendly opportunities out there for different countries, etc.?

**Charles Hadeed:** I'll deal with the latter question first. At this stage, no. We're not doing anything language different. International business is unique because there are a number of product lines that we are not allowed to sell outside the U.S. or into international markets because there are separate distribution models that strategic vendors have outside the U.S. Specifically, in terms of the Internet, there is good and bad. When you look at Canada, there used to be two very different markets. I think the Internet has made U.S. pricing very visible, which, given the changes in exchange rates for the Canadian dollar over the last 18 months, has made that a challenging market. I think that we're going to continue to see companies use the Internet for simplicity when they know what they want, and they know we have the inventory to do that.

There are a number of new customers who are looking to buy a product we have, and we've done a good job of marketing ourselves to be present to them. They may buy something from us, and we may not see them again for a number of years. We are making an investment this year to rejuvenate our calibration piece of the web to a status similar to that on the product side of the business. Even though that business has different issues that have to be addressed in terms of purchasing a product, it's different from purchasing a product out of inventory. Then, there's the ongoing balance of marketing to customers over the longer term, between online marketing and print marketing, and how

customers who are responding to that marketing want to buy product. Do they want to buy online or do they want to buy through a conversation with a sales rep.

**Dave Rode:** At 7% of your product sales right now, where do you see the Internet in four or five years as far as revenue contribution?

**Charles Hadeed:** Higher. I don't know the real answer to that, Dave. It's going to depend a lot on what we think the customers are going to decide. We want to make ourselves available to whatever method our customers choose, to be marketed and/or purchase. As you have seen the workforce age turn over, and younger people become the decision makers within their companies, they have become much more Internet-friendly and are using that as a vehicle for both sourcing, deciding and even purchasing. There are a number of customers that like to call up and talk to their rep. They want to have that conversation and dialogue. We're going to be there for those customers as well. So when I said growing, I meant it, but I think that the pace, for a while, is going to continue to grow at a fairly rapid rate.

**Dave Rode:** Thanks, Charlie. Do you have an annual meeting date yet?

**John Zimmer:** Yes. September 15<sup>th</sup>.

**Operator:** Our next question is from the line of Bill Nicklin with Brown Advisory.

**Bill Nicklin:** I have one follow-up from before, if you don't mind. We were talking about these acquisition candidates, and we were saying that the opportunities are in, what we might call, "mom-and-pop operations," which are smaller. Could I make the assumption that these are also cheaper and easier to integrate and, therefore, have more accretion from these deals quicker rather than on some of the much bigger deals?

**Charles Hadeed:** Yes and no, sort of, I think would be a good way to say that. The real benefit of accretion would be to acquire a business where we already have a laboratory. Consolidation of fixed expenses and everything else would make the leverage in whatever growth we acquire and grow

from that base favorably impact our earnings at a lot quicker pace. I think smaller business, on a relative scale to what we've done with Westcon, are easier to assimilate into the business. The third point, Bill, is that Westcon had both a product element and a calibration element which added another level of complexity as well.

**John Zimmer:** So, for the most part, I think that it's probably a good assumption. You just have to be careful. They don't all fit into a nice box; they're all a little bit different. One of the interesting things when you're buying a smaller business is that they haven't had audits before or don't have the financial controls. As a public company, we've got a lot of those things that we need to be careful of, especially with the Sarbanes-Oxley. Regardless of the size, there is a level of complexity to move them onto our systems and our quality programs and all the things that go with that. But I think, as a general statement, we're looking at it as being easier to do a smaller acquisition.

**Bill Nicklin:** Also, my point was that I'm involved in a private business in a totally different industry that has both a product and a service component. My experience has been that you can typically buy these smaller one-person, "mom-and-pop" type companies that are one or two EBITDA points below what you would buy a larger company for. So, today, what we would normally pay for a medium to larger-sized company 5 to 5.5 times EBITDA, we're able to buy companies at 3.5 to 4.5 times EBITDA. I was wondering if you were seeing that same thing?

**Charles Hadeed:** The answer is, yes.

**Operator:** Thank you. There are no further questions at this time. I would like to turn the floor back over to management for closing comments.

**Charles Hadeed:** Thank you for joining us today on our fourth quarter fiscal year 2009 earnings teleconference call. We certainly appreciate your time and interest in Transcat. Thank you, and have a good day.