

**Operator:** Greetings and welcome to the Transcat, Inc. Third Quarter Fiscal Year 2014 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.

I would now like to turn the conference over to your host, Deborah Pawlowski, Investor Relations for Transcat, Inc. Thank you, Ms. Pawlowski. You may now begin.

**Deborah Pawlowski:** Thank you, Jessi, and good morning, everyone. We certainly appreciate your time today and your interest in Transcat. On the call, I have President and Chief Executive Officer Lee Rudow, and our Chief Financial Officer John Zimmer. After formal remarks, we will open the call to questions and answers. If you don't have the news release that was sent out after the market closed yesterday, it can be found on our website at [www.transcat.com](http://www.transcat.com).

As you are aware, we may make some forward-looking statements during the formal presentation and the Q&A portion of this teleconference. Those statements apply to future events which are subject to risks and uncertainties, as well as other factors, that could cause the actual results to differ materially from where we are today. These factors are outlined in the news release, as well as the documents filed by the Company with the Securities and Exchange Commission. You can find those on our website, where we regularly post information about the Company, as well as on the SEC's website at [sec.gov](http://sec.gov). So, please review our forward-looking statements in conjunction with these precautionary factors.

With that, I'd like to turn it over to Lee to begin the discussion. Lee?

**Lee Rudow:** Okay, thank you, Deb. Good morning, everyone. Thanks for taking the time to join us. Before I get started with our third quarter results, let's start with a review of our strategy. Two weeks ago, we presented at an investment conference in New York City and our message centered around three takeaways. First and foremost, we've developed a very robust infrastructure, particularly on the Service side, and now we have what we believe is a strong foundation that will support significant growth. The second takeaway was we've reached the inflection point on our Service business, a critical mass, if you will, where we expect our operating earnings to grow at a faster rate than revenue moving forward. And the third takeaway was that we have a new leadership team in place that has a demonstrated track record for growth, and that we are poised to take Transcat to the next level.

In addition to the three primary takeaways, we covered the expanded addressable markets by virtue of the fact that we've acquired the Anacor Compliance Company, and our differentiated value proposition, which begins and ends with quality.

For those of you who may be unfamiliar with our quality proposition, generally speaking, it's driven by regulation. That is to say that most of our customers operate in a highly regulated environment and our primary market is life science, so the regulating body is the FDA. Our customers use test equipment in the manufacturing process and the R&D process, as well. Transcat, through our calibration services, ensures that the instruments are measuring according to manufacturer specifications and sometimes the customer's specifications. When an instrument is found to be out of tolerance, our customers often have to perform very costly analyses to determine the impact and root cause. These processes can cost between \$10,000

and \$50,000 per occurrence and, in some cases, plants are actually shut down by consent decree. In the case of one of our larger customers, McNeil Pharmaceutical, their Mylanta plant has been shut down for the last two years. They've spent tens of millions of dollars remediating their quality processes, which included their calibration programs. So, quality is hugely important and represents for us the tip of the spear for our value proposition.

Let me jump back for just a minute and cover our expanded addressable markets. With the recent Anacor acquisition, we acquired expertise relative to providing a new suite of science services, including validation, analytical qualifications and remediation. These services, combined with our core calibration service, puts us in a unique position in the market, unique in that we now provide a comprehensive suite of life science services, and relative to compliance. To that point, we're just now beginning the process of integrating these new services into our sales engine.

So, for the quarter, we executed well against our strategic plan. We continue to be pleased with our double-digit growth in the Service segment, as we grew 17% in the third quarter. In a few minutes, John will review the inherent leverage in our Service business. Our operating income continues to grow at a higher rate than our Service revenue. And as we turn the corner on the final stages of integrating our two most recent acquisitions, we expect our operating earnings to reflect the completion of these integration processes.

In terms of Distribution, we did a nice job offsetting the wind-energy business, which was down \$800 thousand in the quarter. As we reviewed on our last call, there is unpredictability with the start/stop government incentives, which come in the form of the production tax credits, and it creates a boom/bust market. At least in recent years, it has. The good news is that there is some light at the end of the tunnel. We're looking for a fairly stable wind energy market as we enter into fiscal 2015.

Now, outside of wind, we continue to be aggressive in terms of defending our market share. We see our web presence as a critical component of the Distribution business moving forward and, to that point, we are upgrading the look, feel and functionality of our current website.

So, with that, let me turn it over to John and he'll walk through some of the third quarter results.

**John Zimmer:** Thanks, Lee, and good morning, everyone. As Lee noted, we achieved strong Service segment growth of nearly 17% to \$11.5 million in the quarter, and that offset the 2.3% decline in Distribution segment sales. Overall, our revenue increased about 4% to \$30.5 million. Operating income for the quarter was \$1.3 million, up about 10% from the prior fiscal period, and our operating margin expanded to 4.4% from 4.2% year-over-year.

We look at contribution margin, as well as EBITDA, to gauge our performance, particularly on a segment basis. Contribution margin by segment highlights the operating results of the segments before corporate expenses, and we use EBITDA as a metric, because we believe it gives us additional insight into the cash flow from each segment. These are both non-GAAP measures, so please review our reconciliation-related disclosures in the earnings release.

Contribution profit for the Service segment is, in essence, our report card on where we are relative to the inflection point and the profitability for that segment. For the quarter, contribution profit grew about 20% to \$974 thousand, and was 8.5% of revenue compared with 8.2% in the prior year.

Contribution profit for the Distribution segment improved slightly, even as sales declined, mostly as a result of disciplined cost management and increased co-op advertising income.

On a consolidated basis, we generated \$2.1 million of EBITDA in the third quarter, an increase of \$200 thousand from the third quarter of fiscal 2013. That increase was due to the Service segment EBITDA being up 67.7%, demonstrating a larger contribution to the overall EBITDA and a favorable comparable to last year, because last year we had a loss in our Service segment.

Our third quarter net income was \$800 thousand, or \$0.11 per diluted share, which is a penny higher than the prior year, due to fewer shares outstanding.

To briefly touch on our year-to-date performance, total revenue increased 8.5%, or \$6.9 million, to about \$88 million over the prior-year, nine-month period. This was due to a 20% growth in the Service segment, aided by Distribution segment sales growth of 1.2%. Operating income improved 26% to \$3.8 million, and EBITDA was \$5.9 million, up about 21%, reflecting a consistently improved contribution from the Service segment throughout that period.

That concludes my remarks. Lee, I'll pass it back to you.

**Lee Rudow:** Okay. Thank you, John. As we proceed through fiscal 2014, we expect continued strong performance on the Service side and to realize the inherent operating leverage as we grow the topline. The Distribution business will likely face continued pressure combined with the shorter term wind products challenge, but, as I mentioned earlier, it's our intention to maintain our market share and, as always, we're going to leverage the unique synergies that exist between Distribution and Service.

Our longer-range view continues to expect double-digit growth for Service and low- to mid-single-digit growth for Distribution. Services strategies will include a shift from lower volume transactional business to larger, national enterprise type business. The enterprise business offers us a better opportunity to imbed ourselves with our customers, to be more intimate, and these sized accounts typically start at about \$250 thousand a year and can go into the millions.

Also, as we've successfully demonstrated, we're going to continue to pursue strategic acquisitions in our Service segment. Our acquisition strategy is fairly straightforward. There are three primary drivers: number one, we look to expand our geographic footprint; number two, we look to acquire new capabilities and expertise; and number three is the traditional bolt-on acquisition, where we leverage our current local infrastructure.

So with that, Operator, we'll open the call for questions.

**Operator:** Thank you. Ladies and gentlemen, at this time we will 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'd like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing your star keys. One moment, please, while we poll for questions.

As a reminder, ladies and gentlemen, if you would like to ask a question at this time, please press star, one on your telephone keypad.

Thank you. We do have a question coming from the line of Steven Stern with Stern Investment Advisory. Please proceed with your question.

**Steven Stern:** Good morning. My question is concerning dividend policy, especially in light of your recent share repurchase program. We are a registered investment advisory firm. We have a large number of clients who mandate that we can only hold income-producing assets. As such, we're not eligible to be shareholders of Transcat. The establishment of a dividend would expand the ownership of Transcat, not only with our firm, but I'm sure in the marketplace. A simple dividend of a penny per quarter, or \$0.04 a year, would represent, from your last statements, approximately a 10% dividend payout, and would only be 5% of the monies that you spent on the share repurchase, which is also a return of capital to the shareholders. Is a dividend policy being considered to put Transcat into the income-producing equity category for us investment managers?

**John Zimmer:** Steven, it's John Zimmer. I'll answer that question. Currently, we don't have any plans for dividends. I think it gets into a larger question of capital allocation, and when we look at the way that we view our capital allocation, we look at a few things. First of all, we're supporting our existing operations; that's sort of number one at the top of the pyramid. That's the cap ex that goes into the businesses and supporting the working capital needs. Then, the second thing is we'll look at acquisitions where we believe we can expand, as we've said, our geographic footprint, or bolt-on and get synergies in an existing market, or add capabilities of some sort. So, we think we can get a pretty good return on those investments, as we have in the past, and we're going to continue to allocate capital that way.

Once we're beyond that, then we'll look at share repurchases and dividends. Recently, in this past quarter, we repurchased shares and that, we thought, was very opportunistic at the time. We feel that our stock is undervalued, and we were able to acquire those shares, and we think we'll get a good return on that investment.

So, that's kind of how we look at the way we allocate our capital. If we get beyond those and we have enough cash that we think we can support a dividend, then we will consider that in the future.

**Steven Stern:** Thank you.

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

**Lee Rudow:** Well, thank you all for joining us and we look forward to speaking with you again in the future.

**John Zimmer:** Thank you. Take care.

**Operator:** Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time and thank you for your participation.