Operator: Greetings and welcome to the Transcat, Inc. First Quarter Fiscal Year 2016 Financial Results Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Mr. Craig Mychajluk, Investor Relations for Transcat, Inc. Thank you sir, you may begin.

Craig Mychajluk: Thank you and good morning everyone. We certainly appreciate your time today and your interest in Transcat. With me here on the call is our Chief Financial Officer, John Zimmer. Our President and Chief Executive Officer; Lee Rudow is unable to join us on the call today due to a death in the family. After formal remarks, we will open up the call for questions.

If you don't have the news release that crossed the wires after the market close yesterday, it can be found on our website at www.transcat.com. There are also slides that accompany today's discussion, which you can find at the same location on the website. Please refer to slide 2. As you are aware, we may make forward-looking statements during the formal presentation and 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 & 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. So please review our forward-looking statements in conjunction with these precautionary factors.

With that, I would like to turn the call over to John.

John Zimmer: Thanks Craig. Good morning everyone. Thank you for joining us on today's call. If you're looking at the slides, I will start by talking to slide 3. We had a solid start to the year and expect our momentum to continue and to drive us to an overall strong fiscal 2016. Our first quarter performance was driven by consistent execution of our plan and our compelling value proposition, both of which enabled us to achieve our expected double-digit revenue growth in the Service segment.

We delivered 11.5% year-over-year growth in Service revenue, which accounted for 46% of our total revenue in the first quarter. Our Service revenue growth can be attributed to a combination of strong customer retention, strong organic growth as our new business pipeline continues to develop and our business development team continuing to fire on all cylinders, as well as the impact of recent acquisitions. The quarter was highlighted by a 35% year-over-year increase in operating earnings. This earnings increase underscores not only the profitability of the Service segment but it also demonstrates the operating leverage inherent in the Service business.

As we continue to run the playbook we look for operating earnings to continue to grow at a faster rate than revenue. We're also pleased to report that we expanded our Service operating margin by 260 basis points, which further demonstrates our operating leverage. In fiscal 2015, for the first time our Service segments surpassed our Distribution segment in operating income and we expect that trend to continue into the future.

Distribution segment sales were down compared with the prior year's first quarter as we continue to face a soft market, as well as headwinds created by weakness in the oil and gas industry sector. In our Distribution segment, we continue to launch new and innovative programs, including a new instrument rental service which leverages our current distribution infrastructure, expanding and diversifying our product portfolio, and putting even more emphasis on maximizing the leverage between our Distribution segment and our Service segment by offering an expanded range of new product calibration options on the products we sell. We expect it to take some time for these programs to get up to speed and gain traction but we're confident they will produce results and offset some of the softness in the market.

On the acquisition front, we are particularly pleased with the progress we are making. The talented leadership team at Ulrich Metrology continues to perform very well and has played a huge role in fostering our services leadership in Canada. The integration of Apex Metrology Solutions, which we acquired in March, is on schedule and the early results are positive. Our most recent acquisition of Calibration Technologies, which we acquired in June, deepens our presence in the life science market and brings a strong level of expertise to our analytical team. We're pretty excited about all three of our recent acquisitions.

They have enhanced our capabilities, expanded our geographic presence, and leveraged our current infrastructure. Importantly, we continue to have the financial flexibility to move fast on acquisition opportunities when they present themselves and our pipeline for future acquisitions is well developed and growing.

We continue to maintain a strong balance sheet. As always, our strategy involves operating and investing with discipline. CapEx investments are primarily focused on improving our service capability, flexibility and overall efficiency. We will continue to invest in our new rental business as the early returns have been very positive. It is still a small business, but with strong margins. Overall, we are off to a great start as we are capitalizing on the strong underpinnings we had in place entering the year. The business is generating solid cash flows and we continue to build value for our shareholders.

Now I will get into a little more detail on the financials. Looking at slide 4, while we achieved modest revenue growth overall in the fiscal 2016 first quarter, revenue on our higher margin Service segment increased by double-digits, more than offsetting the impact of lower revenue in our Distribution segment.

Included in our reported results are those of Ulrich Meteorology acquired on August 31, 2014, and Apex Meteorology Solutions acquired on March 6, 2015. The acquisition of Calibration Technologies was completed on June 22, so it had no material impact on our quarterly results. Looking at the Service segment specifically, first quarter revenue was up 11.5% to $13.5 million a record for the first quarter, and was comprised of both organic and acquisition-related growth. On a trailing 12 basis revenue was up 9.5% compared with the 2015 first quarter trailing 12 months. We believe that looking at revenue growth on a trailing 12 month basis is more indicative of the long-term progress of the Service segment which offers our largest and most profitable growth opportunity.

Sales in the Distribution segment declined $800,000, or 5%, to $16.1 million in the quarter due to a softer market in various industries such as oil and gas.

Moving on to slide 5. Our Service segment continued to deliver strong gross profit and operating margins. For the first quarter gross margin for the segment improved 190 basis points to 26.1%, while operating margin expanded 260 basis points to 4.8%. The Distribution segment's gross profit for the quarter was $3.5 million, down $200,000. The segment gross margin was 21.9%, consistent with last year's first quarter. Higher vendor rebates in the quarter partially offset the effect of reduced volume and increased price discounts. Vendor rebates accounted for 130 basis points to segment gross margin in a quarter. As we said on our last earnings call, we did not expect vendor rebates to negatively impact fiscal 2016 and there may be some upside. We do expect to continue to be price competitive for the reminder of the fiscal year to maintain share and offset market softness.

On a consolidated basis, first quarter operating expenses increased $100,000 to $6 million. The favorable impact of operating leverage on the Service segment sales growth neutralized the modest increase in expenses. As we indicated in our earnings release, we believe we will have an increased level of achievement against our performance-based metrics. Performance-based variable compensation expense is expected to be higher in fiscal 2016 and primarily impact operating expenses and income in the fourth quarter when compared with the prior year.

We'll now move on to slides 6 and 7, where we look at both the contribution margin and Adjusted EBITDA to gauge our performance. Contribution margin by segment excludes corporate expenses and focuses on the operating performance of the segment. We use Adjusted EBITDA because we believe it is a good measure of operating cash flow for each segment. These are non-GAAP measures so please review our reconciliation and related disclosures in our release and at the end of the slide presentation.

On slide 6, for the quarter consolidated contribution margin was $3.5 million, or 12%, of revenue compared with $2.9 million, or 10%, of revenue in the prior-year period. For the Service and Distribution segments, contribution margin was $1.9 million and $1.7 million, respectively, or 14% and 10% of revenue, for each segment, respectively. On slide 7, consolidated first quarter Adjusted EBITDA increased more than 30% to $2 million, which reflects strong Service segment growth of $600,000, or nearly 70% over the prior-year period.

On to slide 8, where we have our bottom line performance. First quarter net income increased 35% to $600,000, or $0.08 per diluted share, compared with $400,000, or $0.06 per diluted share. Our net income compound annual growth rate since fiscal 2012 is about 8%.

Slide 9 provides detail regarding the strength of our balance sheet. As of the end of the first quarter, we had $18 million in availability under our credit facility. CapEx was $1.1 million, up $700,000 from last year and was primarily for expanded Service segment capabilities and acquisition of assets for our growing rental business. We expect total CapEx to be approximately $4 million in fiscal 2016. More than half of the estimated CapEx will be focused on increasing our lab capabilities and capacity.

We believe that our balance sheet structure offers the financial flexibility to facilitate our acquisition strategy, satisfy working capital requirements and capital expenditure needs. Slide 10 is an illustration of key investments and the impact on debt on a trailing 12 month basis. It demonstrates that our debt is related to the investments made in just the prior 12 months and that our cash flow funded all previous investments.

We also noted our return on invested capital, or ROIC metrics, on a trailing 12 month basis along the bottom of the slide. We continue to be disciplined in our capital deployment with the objective to consistently generate returns in excess of our cost of capital.

Let me wrap up saying that we are confident on our direction and how we have positioned the Company to capitalize on future growth opportunities. In the last two years we stepped up our technology game and are successfully leveraging the recent investments in our C3 Asset Management and Calibration Software and our new e-commerce platform.

We continue to expect double digit growth in our Service segment. The growth will continue to be a combination of organic and acquisition-related growth. We think we have a great leadership team and a talented business development team in place.

We still believe strongly that life sciences are the right target market and that the long view of Transcat continues to be quite compelling. I'll conclude by saying that we expect the continued strong operating leverage in our Service segment business to drive fiscal year 2016 consolidated operating income growth in the mid-teens.

With that, we can open the line for questions.

Operator: Thank you. Our first question comes from the line of Chris Reynolds with Neuberger Berman. Please go ahead with your question.

Chris Reynolds: Good morning, that was an excellent quarter. I have a question about your Distribution sales and I am wondering if there is a correlation between growth in the Service business and the Distribution business in sales of equipment. It doesn't appear that there is a correlation but I would think that there would be opportunities as you expand your Service sales to improve the rate of growth of the equipment business.

John Zimmer: Thanks Chris, there isn't a direct correlation in the growth, but there are opportunities and we take advantage of opportunities to cross-pollinate the two segments where we will share leads that are developing. When we have someone on our Service platform that isn't buying products from us, we're aware of that and we market to those customers as potential Distribution opportunities.

So there is some cross over and carry over from growth in the Sservice segment that helps us to facilitate growth on the Distribution side, but in many cases they operate from different parts of a customer's facility, so calibration Services may be handled by quality control and in those areas, whereas purchase of the equipment may come out of a different area, such as manufacturing operations. It's our job from a marketing and a sales standpoint to connect us between those sources in those customers and we have had success in doing that.

Chris Reynolds: Okay, thank you.

Operator: Thank you. Our next question comes from the line of Steven Stern with Stern Investment Advisory. Please go ahead with your question.

Steve Stern: Thank you and congratulations on a very successful quarter.

John Zimmer: Thanks.

Steve Stern: I have two questions. We've been expanding in the life science base very nicely, successfully. Within that area, there's been increased merger activity of pharmaceutical companies. Mylan, Johnson &Johnson, Roche and mergers in the healthcare providers. Does that have a direct impact on sales, those mergers at the higher corporate level?

John Zimmer: There is really no direct impact. Our services and our products are sold into manufacturing operations, in most cases. As long as the volume of product is being produced by those manufacturers, then that is going to drive the demand for our products and services. A lot of these mergers are driven by the market needs and combination of corporate overhead and other factors, and there is some consolidation of manufacturing facilities to use out some excess capacity and that would potentially have an impact on our business. But these mergers have been occurring for a relatively long period of time and we've been growing our business and growing in the life science space, and so any impact from that is not driving demand or lack of demand for our services.

Steve Stern: Okay, very good. Transcat is a provider of accredited calibration and compliance services, has any thought ben given or any activity been considered in becoming an actual manufacturer or developer of unique products? Is there a research and development department and if so what type of things do they look at?

John Zimmer: The short answer is no, we haven't looked at manufacturing our own products. We feel as though we have a core competency in the distribution and marketing of products and the provision of those services on the calibration side and our other compliance services. The answer is no, we are not really investigating manufacturing of products. That is not part of our strategic plan.

Steve Stern: Okay, very good. Thank you very much and again congratulations on the quarter.

John Zimmer: Thanks Steve.

Operator: Thank you. Ladies and gentlemen, we have no further questions at this time. I would like to turn the floor back over to John Zimmer for closing remarks.

John Zimmer: Thank you. And thanks everyone for your participation today. We certainly appreciate your interest and support of Transcat. For those of you in the Chicago and New York City area, we are attending the IDEAS Conference on August 27 in Chicago and then a week later we will be at the Sidoti Microcap Conference in New York City on September 2. Let us know if you're interested in meeting at either of those locations.