GERBER SCIENTIFIC

Fiscal 2010 First Quarter Earnings Conference Call Transcript
August 27, 2009 – 10:00 a.m. ET
Moderator: Marc Giles

Operator: Good day everyone and welcome to the Gerber Scientific Incorporated First Quarter 2010 Earnings Release conference call. Today's conference is being recorded and broadcast over the Internet.

I would like to remind everyone that some of today's remarks and the responses during the question and answer session will include forward-looking statements as defined in the federal securities laws regarding Gerber's expected financial condition results of operations, cash flows and other matters relating to the business. For discussion of the important risk of uncertainties that could cause Gerber's actual results to differ from the results expressed or implied in the forward-looking statements, you should read Gerber's Annual Report on Form 10-K for the fiscal year ended April 30, 2009 as well as Gerber's other filings with the Securities and Exchange Commission.

At this time for opening remarks and introductions, I would like to turn the conference over to the company's President and Chief Executive Officer, Mr. Marc Giles. Mr. Giles, please go ahead sir.

Marc Giles: Thank you operator and good morning everybody. We appreciate your continued interest and participation today in Gerber Scientific's Fiscal 2010 First Quarter conference call.

Joining me on the call today is our Executive Vice President and Chief Financial Officer, Mike Elia and our Vice President and Chief Accounting Officer, John Krawczynski.

I'm going to provide a high level of overview of last quarter's performance, current business conditions and our outlook and then Michael will provide more details regarding financial results and liquidity.

While global market conditions continued to be weak in our fiscal 2010 first quarter with sales down by almost 25% compared to a year ago, 17% in constant dollars, we do believe there is growing evidence that our markets have bottomed.

Also encouraging with that despite the sharply lower revenue we were able to deliver noticeable improvement in most of our financial metrics, including gross profit margin, SG&A as a percent of sales, operating margin and cash generation. If you will recall we said last quarter that we believe the fourth quarter was likely the bottom of the depressed economic cycle.

On a sequential basis, current quarter sales were essentially flat from our reported fiscal 2009 fourth quarter. Excluding FOBA from both periods, sales from continuing operations on a sequential basis were actually up about 3.5%. Our book to bill ratio remained at one and our aftermarket sales were up 7% encouragingly indicating increased equipment utilization.

We are also seeing increased order activity in some geographic markets; activity in China in particular has strengthened. While revenue from China is still well below its peak during our fiscal 2008; on a sequential quarterly basis, revenue was the highest it has been since the second quarter of fiscal year 2009 and up over $1.1 million or 30% versus the fourth quarter driven by improvement in the apparel business there. All of these factors cause us to be a bit more optimistic regarding the strength of the market we serve.

From a profitability perspective the company generated operating income more than double the prior year at $3.8 million in the current first quarter versus $1.6 million a year ago due to both cost savings initiatives and gross margin improvement. Our gross margin was up a 160 basis points, the details of which Mike will provide in a moment. Suffice it to say, we're pleased with this performance in the face of the difficult year over year revenue comparison.

Let me just touch on a couple of other positives in the quarter before reviewing segment performance. Notwithstanding the weak sales performance, cost savings initiatives and effective working capital management enabled the company to generate more than $13 million of operating cash flow after capital expenditures, which allowed us to significantly reduce our outstanding debt.

Equally important, we announced the sale of FOBA, which will generate net proceeds to approximately $8 million to $8.5 million. As discussed last quarter, we have been pursuing the potential sale of non-core non-strategic assets that would allow us to generate cash to improve our financial flexibility.

FOBA was acquired as part of the Virtek acquisition and while it is an attractive laser marking and engraving business, it was not a core strategic focus for us. We've just received word that this transaction has been cleared by the German Cartel Office and should close in a next week or so. We are also reviewing other non-core asset sales to further reduce our debt and will report those as they occur.

For fiscal Q1, on a consolidated basis equipment and software sales declined 38% in the first quarter from a year ago while aftermarket revenue was down 22% and service revenue was off 11%. Sales in the sign-making segment, which consist of Gerber Scientific products in Spandex, were down 23% year over year to $73.1 million in the current quarter. Unfavorable currency rates had a significant impact so then on a constant dollar comparison basis total sales for the segment were down 13%. All categories within the segment posted significant sales declines during the quarter with equipment posting the largest decline of 35% versus a year ago. Nonetheless, in the equipment category sales of Solara ion system and related inks contributed about $2.6 million to the segment's top line with 31 units shipped in the quarter, which is similar to this product's fourth quarter revenue in shipments. Despite the sharp sales decline, first quarter operating profit for the Sign Making and Specialty Graphics segment was up 2% to $2.2 million versus a year ago due principally to cost savings initiatives.

Looking ahead, economic uncertainty and tight credit continue to adversely impact the segment's revenue. Yet with the improvement in sequential sales performance, which was largely driven by aftermarket sales, we are more optimistic that we are at the bottom of the depressed market cycle.

In the Apparel and Flexible Materials segment, which consisted of Gerber Technology and the new acquisitions of Virtek and Gamma and excludes FOBA, business continues to be affected by lower consumer spending for apparel, furniture and automobiles, particularly in the U.S. and Europe. First quarter sales were down 28% year over year to $35.1 million. On a constant currency basis, year over year sales were off 25% in the first quarter.

The Virtek and Gamma acquisitions contributed $3.8 million in sales in the quarter. Excluding these sales, GT's base business was off 36% reflecting particular weakness in systems and higher margin software sales.

Despite the weak year over year sales comparison sequentially Apparel and Flexible Materials segment sales were up 9% from the fourth quarter and operating profit for the segment was up 500,000 or 13% from the same quarter a year ago reflecting the impact of the cost saving measures.

Gerber Technology's business in China appears to have turned the corner. From a year ago, revenue from China was off about $800,000 in the first quarter. However, on a sequential basis from the fourth quarter, GT's business in China was up $1.4 million to $4.9 million. We are optimistic this is the start of a trend in China as this is the largest single geographic market for this business unit.

Unfortunately in Europe, including the growth markets of Eastern Europe, we have yet to see any kind of meaningful improvement though we are not seeing any continued worsening either. Through our acquisitions Virtek and Gamma contributed positively to our first quarter. The collective revenues declined in the first quarter from their pre-acquisition levels a year ago.

Virtek continues to actively quote in the aerospace and composite markets. However, aerospace contracts are being threatened by possible production delays for new commercial aircraft. On the other hand, Virtek's PCI business, which serves the housing construction market, seems to reviving somewhat, which is a very encouraging development.

The story is similar to Gerber Coburn. Coburn's wholesale lab customers are continuing to report significantly reduced volumes and major retail eyewear and lens processing customers in the U.S. are reporting sluggish same store sales.

As a result, for the first quarter of fiscal 2010, sales from this segment were down 26% to $11.5 million from a year ago and in comparison to Q4, sales were up 18% or $2.5 million. Excluding an unfavorable currency impact of $500,000, current quarter sales were off 23% from a year ago. Despite the sales decline, Gerber Coburn made an operating profit of 6% of sales driven by the management teams aggressive cost management and the improved gross margins.

Operating income for this segment in the current quarter was $695,000 compared to operating income of $115,000 last year. Looking ahead, while we do not expect a further decline in Gerber Coburn's business, it is difficult to see any top line improvement until the retail eyewear market strengthens in the United States.

At this point, I will turn the call over to Mike Elia and then afterward I will provide our current outlook summary and take your questions. Mike.

Mike Elia: Thanks Marc. As a reminder, a Webcast replay of this call and a transcript will be available on our Web site shortly after the call.

As Marc mentioned, we expect the sale of FOBA to close next week. Thus FOBA's financial results are included in discontinued operations and excluded from the results that I'll be discussing today.

On a consolidated basis, revenues were down $39.2 million or 24.6% from a year ago. Revenues from recent acquisitions added about $3.8 million or 2.4% while unfavorable exchange rates reduced revenues approximately $11.6 million or 7.2%. Constant dollar basis excluding acquisitions, revenues were down $31.4 million or 19.7%.

From year-end fiscal 2009, our first quarter consolidated order backlog was up about $500,000. In comparison to our fiscal 2009 year end, order backlog in the Sign Making and Specialty Graphics segment was down about $300,000 to $1.6 million. Backlog in the Apparel and Flexible Materials segment excluding FOBA was up about $900,000 to $22.6 million. While the backlog in our Lens Processing segment was flat at $1.2 million.

Compared to the first quarter of last year, consolidated gross profit was down $8.4 million to $33.6 million due to the lower revenue level. However, due to efficiency gains, cost cutting measures and the effective higher margins from the recent acquisitions, our gross profit margin was up 160 basis points to 28.1%. On a constant dollar basis and excluding the recent acquisition, gross margins improved 90 basis points to 27.4%.

As most of you on this call may recall, we began attacking our cost structure last August in order to combat the impact of lower revenue levels. As a result of these measures, we were able to reduce our first quarter consolidated SG&A by $8.8 million or 25.7% from a year ago. Excluding the additional SG&A of the recent acquisitions, SG&A was down $9.9 million. On a constant dollar basis an excluding the recent acquisitions, first quarter SG&A spending was down $7.7 million, the bulk of which came from lower payroll and payroll related expenses.

We also took actions to limit R&D spending to just sustaining projects and as a result reported R&D dropped $1.8 million to $4.4 million for the first quarter from a year ago. Excluding the recent acquisitions, R&D expenses dropped $2.2 million. On a consolidated basis, operating income in the current quarter increased $2.2 million from a year ago to $3.8 million.

Operating profit from the recent acquisitions contributed about $600,000 while unfavorable exchange rates reduced operating profit approximately $1.2 million. Thus on a constant dollar basis and excluding the benefit of recent acquisitions, operating profit was $4.4 million, up $2.8 million from a year ago due to the gross margin improvement and SG&A reductions.

In the first quarter of 2009, diluted earnings per share from continuing operations was five cents per share compared to three cents per share a year ago. On a net income basis, diluted EPS for the current quarter was two cents per share compared to three cents a year ago.

However the current first quarter included a three-cent loss from discontinued operations for the pending sale of FOBA, while there's no effect on the prior year first quarter because we did not own FOBA during this period.

Now let me just touch on a few balance sheet and cash flow items. Trade receivables at the end of the first quarter were $80.1 million compared to $87.8 million at our fiscal 2009 year-end. So a quarter or a quarter-to-quarter drop of $7.7 million due to the lower volume and effective collections.

In fact, DSO decreased to 60 days in the first quarter from 66 days at year-end. From a cash flow perspective in the current - in the current first quarter, we generated cash of $10.6 million related to accounts receivable.

Inventories at the end of the first fiscal quarter were $69.8 million compared to $72.1 million at year-end last year were down $2.3 million. Inventory turns at the end of the first quarter were $4.9 times compared to 4.6 times at year-end. From a cash flow perspective, we generated $2.2 million in positive cash flow during the first quarter from a reduction in inventories.

In the current quarter, net cash provided by operating activities net of capital expenditures was $13.3 million compared to a cash usage of $7.2 million in the first quarter of last year. The change was due principally to the reduced operating expenses and effective working capital management.

Capital expenditures were down a million dollars year over year in the current first quarter to $1.2 million and in this environment; we plan to continue to minimize capital spending and keeping it within an annual range of 7 to $8 million.

As of July 31, 2009 we had $60.5 million in debt. This included $54.5 million drawn under our senior revolver accruing interest at various LIBOR rates plus 400 basis points and $6 million in industrial revenue bonds accruing interest at about 3%. We also have outstanding $7.6 million of un-drawn letters of credit.

Total debt net of cash outstanding on July 31, 2009 was $48.9 million. Total liquidity was $21.6 million, which consisted of $11.6 million in cash and $10 million in availability under our senior revolving credit facility based on current financial covenants. We're in compliance with our bank covenants at quarter end.

We're aggressively working on our 2010 plan to further reduce costs and improve earnings. Though we expect to complete the FOBA sale next week, we continue to review potential non-core asset sales to further improve our flexibility and availability under the existing credit facility. We expect that these asset sales if consummated could generate up to an additional $10 million to $12 million.

I'll now turn the call back over to Marc and then we'll open the call up for questions.

Marc Giles: Thanks Mike. So in summary, here are the takeaways for the quarter and our outlook. Year over year quarterly comparisons from last fiscal year will be difficult for at least the next quarter. We believe we've reached the bottom of the weak economic cycle and sequentially we should continue to report modest top line growth if the current trends continue.

Visibility remains clouded. However, we are seeing increased activity in terms of orders and revenue particularly at GT and Spandex and expect that we'll begin to see a modest recovery in the last half of our current fiscal year. If this assessment is correct, we believe that given our reduced cost structure, we are positioned to deliver earnings improvement in this fiscal year versus fiscal 2009, especially in the last half of fiscal 2010.

Having said this though, with the lack of real market visibility, we are still not comfortable providing more detailed guidance but we will resume doing so as soon as business conditions become more predictable.

Now I will open up the call to your questions. Operator.

Operator: Thank you, sir. The question and answer session will be conducted electronically. If you would like to ask a question, please press star you're your telephone. Again, that's star 1 to ask a question or make a comment. Also if you are on a speakerphone, please make sure your mute option is turned off to allow your signal to reach our equipment. And once again that is star 1. And we'll pause for a moment.

Our first question comes from Arnie Ursaner with CJS Securities. Please go ahead sir.

Arnie Ursaner: Hi. Good morning Marc.

Marc Giles: Good morning Arnie.

Arnie Ursaner: You weren't kidding about cost cutting controls – down 25% on SG&A is very impressive. On the - on the revenue side, can you comment on where we stand on some of your key products, specifically the Solara ion, where are we on backlog and what other perhaps key new products should we be focused on for the balance of the year?

Marc Giles: Yeah. From the new product standpoint, we'll start with the ion is, you know, the market remains very sluggish for equipment sales, even equipment sales in this kind of a price range. So I think, you know, the market is just slow. I mean we did move 31 units in the quarter.

I don't see any indications at this point in this market that we would expect to see much more than that. We are going to be exhibiting another - the next generation of the Solara ion next month at the SGIA show, Sign Graphics Industry Association show.

And that's going to be a higher price point, higher resolution printer that we have - that we're pretty excited for. I mean we're still launching into a difficult market, but we see some pretty good demand for that - for that kind of a - for that kind of a printer in the higher end.

So we're excited about previewing that or showing that. We're optimistic that we'll be able to launch that next generation commercially before the end of the fiscal year although we don't have a specific time that we've communicated as yet.

As far as other products, last year Gerber Coburn launched the Advanced Lens Processing System. We're very excited about the long-term prospects of that - of that product technology but again going into the market for capital equipment purchases are sluggish. We did move a couple of those systems today. They're pretty expensive. They're also a nice margin for us though and that helps Gerber Coburn's gross margin and helped in this quarter. We've actually installed a few now in Asia and also now in the U.S. as well.

So as the economy begins - the economy begins to improve for capital equipment purchases that would be another technology to look at. Also from Gerber Coburn, we expect to launch sometime during this fiscal year a next generation Blocking System, which is the E2G with what we think is a revolutionary new blocking material that we think will create extremely high demand in the marketplace for this system and could be, you know for Gerber Coburn's market a blockbuster actually. So we're very excited about that.

On the Gerber Technology's front, of course we launched the Z7 industrial cutter last year. We've had pretty good movement on those Arnie. That's another thing that we should watch is going to be more attuned to the industrial markets as opposed to the apparel markets however. And so we still see pretty slow conditions in the automotive and their supply base. So that's kind of the overview of products we should watch this year.

Arnie Ursaner: Okay. My final question if I can. You mentioned you're seeing, I think some improving trends in both GT and Spandex and I'm trying to kind of get a little bit of feel for that given the summer doldrums. You know, a lot of the business you do in Spandex is in Europe.

Marc Giles: Yeah.

Arnie Ursaner: Can you give us a little more feel for some of the factors that are - that you're citing for this encouragement?

Marc Giles: Yeah. It's really at Gerber Technology, it's quote activity has increased, business in China has increased and although it's got a long way to go, it's kind of established a pattern now of continued improvement in China. And what's encouraging there is that's being driven by the apparel industry I mentioned for Gerber Technology, but imports - exports from China continue to be down to the U.S. and to Europe.

So what's happened is its domestic consumption, which now represents I think close to three quarters of total production in China, is creating the demand, their own internal demand and that's having a ripple effect back to suppliers such as us.

So when the economy retail sales in the U.S. and Europe do improve for apparel and furniture, I think we'll see an additional boost on top of what we're seeing already. So when that happens, we're kind of expecting, you know, kind of the back half of our fiscal year, so we're talking, you know, kind of December and later, but we do expect to see a boost from that eventually come through.

On the Spandex side, you know, yeah, I mean virtually all the sales are in market - are in Europe. We have had good sales in Australia though which is actually posting gains and everybody else is down on a year over year basis.

Sequentially, Spandex continues to improve and they, you know, they went down Arnie. They took a big hit in the third quarter this last winter and have improved consistently and I attribute a lot of that to the team's work in driving market share in certain key countries such as - such as the United Kingdom. So I think its attribute to their actions.

Arnie Ursaner: Two more real quick ones if I can for Michael. Michael, what is your tax rate guidance for the year?

Mike Elia: We'll stay around 30%, 35%. As you know, I mean with the recent accounting changes on the book side, it's going to fluctuate quarter to quarter.

Arnie Ursaner: And remind us again of your coverage ratios. With the sale, I guess you do it off trailing 12 months. How much flexibility do you have on any of your covenant issues? I know you have a fair amount. Just remind us what that is please?

Mike Elia: At the end of - if you pro forma the last quarter were the sale, we'll have a fair amount of cushion on the EBIT cushion, which is the interest coverage ratio and we'll have a fair amount of cushion on the leverage ratio. So the covenants are 2.25 for the - for the first fiscal quarter on the interest coverage ratio and 3.75 on the leverage ratio.

Arnie Ursaner: Okay. Thank you very much.

Marc Giles: Thanks Arnie.

Operator: Our next question comes from Jim Ricchiuti with Needham & Company. Please go ahead sir.

Jim Ricchiuti: Hi. Thank you. Good morning.

Marc Giles: Good morning Jim.

Jim Ricchiuti: Question on the service gross margin. You showed some nice quarter on quarter improvement here. Do you see this as sustainable? Anything contribute to the strength in service margin in the quarter? I know you've taken a lot of costs out.

Marc Giles: Yeah. That's the primary driver Jim. We are seeing some improvement in our direct sales areas in terms of service and support as opposed to our indirect areas and that has a - that's kind of a geographic mix improvement. So that shift or that mix shift helps us, but then the bulk of it I believe is a result of the cost actions that we've taken. So it's sustainable to the - to the - to the extent that we carefully manage any cost add backs as business levels improve.

Jim Ricchiuti: Okay. And you provided in some supplemental information this quarter on equipment software, aftermarket supplies and service. You also provided it in Q4. And I'm wondering Mike if you had the data in front of you, if you had those three line items for Q3.

I'm just trying to get a sense, if we look at your equipment and software revenue, it looks like it was down about 14% quarter on quarter. I'm just trying to get a sense of the trend here and when we might begin to anticipate that? Do you see that flattening out this quarter perhaps?

Mike Elia: Let me - let me grab some information.

Marc Giles: You're looking for what kind of trends and the different kinds of revenue?

Jim Ricchiuti: Yeah Marc. You know, basically looking at that equipment and software revenue line. I think it's going to be interesting to see how that's been trending. And do you see that's now flattening out, particularly with what you're seeing now coming out of China?

Mike Elia: On the sequential quarter basis, you know, it took the biggest drop was in the fiscal fourth quarter of last year. And, you know, we saw some improvement from fiscal fourth quarter to the fiscal first quarter on the system side.

Jim Ricchiuti: Okay.

Mike Elia: All right. And software followed a similar pattern. But I will mention that in the first quarter of - the most current first quarter, because of the revenue recognition rules, we picked up about a half million dollars of software from a large software sale and that actually had occurred about a year ago. I hate to say that, but that's just the revenue recognition.

Jim Ricchiuti: Okay. Okay. Now looking at - again Marc, I just wanted to go back to some of the commentary you made about China since it is pretty crucial for you guys. How is the visibility there? It sounds like you feel the businesses turned. Do you see the momentum more toward the second half of the year or are you just feeling better that business has, we should see some nice progress over the next several quarters?

Marc Giles: It seems like we should continue to see growth and progress there over the next few - the next few quarters. Our order rates for new equipment and software sales continue to be improving through to today. So that it seems like it's a pretty solid trend almost getting close to three quarters now of trending improvement in China basically and I would expect to see another quarter of improvement there again in the current quarter in Q2.

I think - what I was saying earlier is we're really not seeing a lot on, for lack of a better term, industrial based activity. Its apparel based that is driving the improvement there. But it's still sluggish when it comes to other industrial sectors that we serve.

And in addition, the other comment I made was it's really seems to be driven by two factors on the apparel side. One is industrial consumption growth as opposed to export growth, which really hasn't happened yet.

So as I say, that should be a nice kicker once we start to see improved exports from China to the U.S. and Europe as far as apparel is concerned. And then the other kind of more strategic driver, I think we talked about this maybe quite a while ago, is that this economic cycle wreaked havoc on the - on the small players in the apparel industry in China, not even the apparel industry, but in a lot of different industry sectors. So we've seen significant industry consolidation.

There are still a lot of players, but there are fewer larger, stronger players today than there were beforehand and that lends itself to more capacity being done through automation. So improves the odds - our business and odds for automating production in China by virtue of this industry consolidation.

So we're seeing some of that too. As a matter of fact in this quarter, this past quarter, we took a very substantial order for a series of new cutters from one of the large suppliers to Nike in China. So these are major purchases that we're seeing.

Jim Ricchiuti: Okay and a question on expense levels, operating expensive levels. You guys have done a great job there. It's certainly I think better than we were looking for. As we look out into the latter part of the year when we potentially see the revenue growth start to pickup, can you talk a little bit about how much we might see in the way of add backs? You know, are some of these expense reductions temporary in nature that you would think could begin to get restored later in the year if we see the revenue growth pickup?

Marc Giles: Yeah. I mean some of this is temporary cost constraints that we would like to - like to add back and we'll see add back. I don't have that analysis in front of me, so I can't give you a good feel for the percentages. But for example, the beginning of this year we stopped - we stopped the company match of our 401(k) plan and so that is something that we plan to and will restore.

On the other hand, we froze our pension plan at the end of the fourth quarter and we don't have any intention of restoring our defined benefit pension plan. So that reduction is permanent, but the 401(k) company match is a temporary cost reduction.

We have - we've done forced furloughs. We did the forced furlough during the most recent quarter. Obviously that's something that as business comes back we will not want to be doing forced furloughs. So those kinds of costs will come back.

So it's - then on the other hand, there is, you know, a substantial amount of the cost out that we - that we believe is structural in nature and won't come back. So it's a blend.

Jim Ricchiuti: Okay. Last question just with respect to other asset sales. You talked a little bit in terms of what we might expect then from a dollar standpoint. What are the timing on that? Do you feel that's something in the next one to two quarters? Is it closer than that?

Marc Giles: You know, I think it's something that if it's going to happen is likely to happen in this current quarter Q2. I doubt it'll stretch to Q3, but you never know. But I - that's my expectation. If they're going to happen it is likely to happen, you know, soon. At least the one that we're indicating here.

Jim Ricchiuti: Okay. Thanks very much.

Marc Giles: Sure.

Operator: As a reminder that is star 1 to ask a question or make a comment. Our next question comes from Garrett King with Truffle Hound Capital.

Garrett King: Hi. Do you have any idea regarding the end markets for your products in China, whether they typically go to like the larger multinational apparel manufacturers like Nike or to smaller domestic Chinese companies?

Marc Giles: Well most of the sales that we're talking about for Gerber Technology into the apparel and apparel related sector in China actually go to large independent Chinese owned manufacturing operations. So when we talk about Nike, Nike is, you know, sources its product from a variety of suppliers, but doesn't own any of its own operations or manufacturing operations in China.

So our - the end user of our equipment is in fact Chinese owned operations. They not tend to be the larger, well not tend to be, they are definitely the larger manufacturing operations who have the scale to benefit from automation.

Garrett King: Okay. Thank you.

Marc Giles: Sure.

Operator: Our next question comes from Zahid Siddique with Gabelli & Company. Please go ahead.

Zahid Siddique: Hi. Good morning.

Marc Giles: Good morning.

Zahid Siddique: A couple of questions; first on CAPEX, what's the estimate for the year?

Mike Elia: Seven to eight million.

Zahid Siddique: Above 8, 9?

Mike Elia: Seven to eight million.

Zahid Siddique: Okay. Eight million and the other question I have is about your business in China. What is - in terms of percent of your sales, how much business comes from China?

Marc Giles: I think - well I mean normally in a - in a - in a good year, we were doing revenue of - in China I think in fiscal 2008, we did about 32 or $33 million in China. So, that was, you know, approaching the 5% level.

This past year in fiscal '09 we were more like around 18 or so million dollars. So we were down 30, a little bit over by about one third, which, you know, last year put us more like in about whatever that is, 2.5% to 3% of total sales. So, you know, in that range. So in a good year we should be seeing, you know, 5% and growing, as that's the fastest growing market that we have.

Zahid Siddique: Okay. And are there any other China like markets maybe India or Brazil that you guys are - that you guys have a presence in?

Marc Giles: Sure. I mean actually for those - for that end use and related market, Vietnam is currently the number three manufacturer of apparel - of export apparel in the world and is expected to be number two overtaking India probably within the next few years. And that's why we went direct and invested in Vietnam with the technology center and our own service organization and direct sales of course there.

India is number three and that region tends to be fairly strong. India, Bangladesh, Sri Lanka is a traditional apparel manufacturing area and those are strong markets for us as well. We go - we are indirect; we go through distribution in that - in that segment. That'll - but nevertheless that'll continue to be a strong segment for us and we have historically done well there. Neither of those areas are anywhere near the size of China, that being said.

So you kind of go from China and then there's the next tier of Vietnam and then Southwest Asia and then you get into places of far Eastern Europe, which has been important. So the Stans and Ukraine and Russia has been an important player. Turkey is another important player where we have a long-term presence. So anywhere that there is a significant growth opportunities, we're there. We're not there always direct, but we're there.

Zahid Siddique: Okay and just a last question. Could you comment on your European markets and maybe contrast that with the U.S., you know, how the trends in Europe?

Marc Giles: Yeah. I mean Europe - for our business in Europe, you know, when we talk about the apparel and flexible materials industry, it tanked us hard, if not harder than here in the U.S. So it's been hit very hard even though the automotive sector and related didn't really - we didn't see quite the same level of impact in that one particular sector.

You know, we look at the growth markets of Eastern Europe, so that's kind of pulling it east to some of the countries I just mentioned. They really took a big hit and we have not seen any meaningful recovery in that area even yet. So that's still got - that's still got a ways to go I think to come back. And we're really not seeing any strengths- any particular strength or improvement in either the European sector or the U.S. sector right now.

Zahid Siddique: Okay. Thank you so much.

Marc Giles: Sure.

Operator: And again as a reminder that's star 1 to ask a question. Our next question comes from Graene Macletchie with Deutsche Bank.

Graene Macletchie: Hi guys. Nice job on the cost side of the equation.

Marc Giles: Thanks Graene.

Graene Macletchie: A question on - a couple of specific questions on numbers and then a general question. A question on inventories. At today's level or current level of sales, how low can we reduce inventories?

Marc Giles: Well, you know, we have a challenge that's in front of our - that's in front of our team to take out by I think roughly another $5 million of inventory at current - at current revenue levels. So that's a - that's our target. The challenge I think is going to be Graene as we see revenues increase, the challenge in front of the team is to not grow our inventory levels.

So to try to get back to at least to the turns where before when we were approaching between 6.5 and 7 in the near term; so that's kind of our goal is not to add back as things start to increase in the back half of this year.

Graene Macletchie: Okay. Could you discuss your efforts in supply chain management, which you've talked about over the years? Where do you think you are in terms of progress? Is there any way to put any numbers on that and how much more do we - can we anticipate?

Marc Giles: I think there's an awful lot more. I think we've just started to scratch the surface really. I mean, I think the team - our operations team is doing an excellent job finally in making progress. You know, if you look at the crawl, walk, run, maybe we've started to finally walk. It took, you know, a number of years frankly to get enough focus and to get the right folks in place to get to this point, but we're walking in, you know.

I begin to see real improvement when I look out in our assembly operations in (Thailand), that's the most noticeable place where you see what's going on and the benefits there. You see it in the supply chain where we - I think we've reduced our supply base over the past year by almost 40%. So we have fewer, stronger, better relations and more influence with our - with our key suppliers and we're beginning to see the benefits of that and material costs helped and in new product development assistance and then in costs out right on our assembly floor in terms of efficiency and labor content.

And it's also obviously one of the (thought) is it's enabling us to get at some of those inventory reduction plans. So we're beginning to see those things, but I think it's really just the beginning, Graham. I think, you know, over the next few years, I think we have the opportunity to continue to accelerate that.

Graene Macletchie: But can we get a framework on that Marc? For example, might that have contributed 1% to gross margin improvement and how many percentage points of gross margin could that if successful over the next two years add?

Marc Giles: Yeah. I mean I'm not prepared to lay that out for you today, Graham. I appreciate the question and maybe we'll take a stab at looking at some kind of metric that we can all track together. It does get a little bit - it does get a little bit, you know, muddy. You know, if you look at gross margin improvement today, you know, we're getting negatively impacted in a big way...

Graene Macletchie: By absorption.

Marc Giles: ...by absorption. You know our fixed overheads are pretty - really a very substantial part because a lot of it is just facilities. And we have a lot of facilities because of the old sale-leaseback that we're hanging onto that we really don't even need anymore. And, you know, those - that overhead, you know, stays in place and whacks us pretty good.

But the teams, you know, through a combination of higher margin gross products, sun setting older, lower margin products; pricing improvements over the last few years, more intelligent pricing actions and lean implementation and material cost control have, you know, at least started, at least indications are we're able to offset a lot of that. So as volumes come back, we'd like to see pretty good kick.

Graene Macletchie: So really what we have to wait for is the volume increases - dollar volume increases in the second half of the year to see what real impact that's going to have?

Marc Giles: Yeah. I wouldn't anticipate any noticeable, you know, meaningful, sustainable improvement until we see some volume from that.

Graene Macletchie: Next question is apparel software. Specifically could you sort of tell us where you stand on that and is there any - do you see any light at the end of that tunnel?

Marc Giles: I'm sorry. I didn't...

Graene Macletchie: The software programs that you sell specifically in the apparel area...

March Giles: Yeah.

Graene Macletchie: ...what are you seeing there, because these are nice high margin?

Marc Giles: Yeah. It's soft. It continues to be soft and we haven't seen any kind of significant rebound. We have seen improve - outside of China, I would say. But we haven't seen any significant improvement there. You know, Mike mentioned the large, you know, PLM or FLM order that we got.

That really goes back some time. We just were able to recognize that revenue in the first quarter. But large, you know, software sales, you know, people still hesitant. They're still shying away from - if they can from those investments. So the improvement we are seeing tends to be from, you know, some smaller shops or some - or some - or some of our traditional customers upgrading where they can or have to.

Graene Macletchie: And Marc, could you talk specifically about your competitive position with your - I can't remember if it's Spanish, French or do they combine in the apparel and flexible materials area? How are you doing versus them? What's going on with market share? How is pricing; stuff like that?

Marc Giles: Yeah. I mean I think we're doing - I think we're doing well. I don't think that we're on the large global scale that we're losing any market share. I think in fact we gained market share for probably the last year or so up until recently things seem to have stabilized. We definitely continue to gain share in our position in China, which has been the strategic thrust for us versus that competitor in that space and we continue to make progress there.

In terms of Europe, you know, they're stronger in Europe and we're - you know, we tend to be stronger here in the U.S. We're not seeing much change either way on that. They do well right now.

They do - they have done well, probably better than we have in securing software, continuing software support contracts. And that's something that keeps them going, it's an advantage they have that keeps them going financially even though, you know, the last couple of quarters they've - I think they've lost money both in their first and second quarter, so the full half of this year, and have reported continued declines in sales and losses in terms of income.

But they do have some good positions and those positions reside in certain countries in Western Europe particularly and with their software support contracts.

Graene Macletchie: Okay. And pricing generally?

Marc Giles: Generally pricing has remained firm. We have not had to do anything in pricing. I think to some extent obviously the euro dollar exchange rate, you know, the weakened dollar, has helped us sustain that.

And quite frankly, I think we have - we have a discipline of saying no. And that's not just at GT that we've implemented that, but one of the important changes that have happened over at Spandex that our, you know, our management over there has implemented is, you know, a more disciplined and rigorous approach to pricing and letting, you know, not certain customers go away.

Graene Macletchie: And your competitive position in the new Solara markets that you're entering, how - what's happened with the competitive aspect there? I think one of the companies was acquired by a major and what's going on there?

Marc Giles: Yeah. Really not a lot of change there, Graene, over the last couple of quarters. There was a large I guess grand format player, so somebody who competed in this space well above us that went - that went bankrupt here in the last quarter, pretty big player about a $200 million inkjet company.

So I think there's stress throughout the sector because of the decline in capital equipment sales. When it comes to our revenues and our percentage share, I really don't see much change in the narrow segment that we serve. It's just - it's just depressed.

Graene Macletchie: And then finally could you discuss how the remaining assets that you acquired from Virtek are doing and how that integration is working with your - the core business you've added that to and...

Marc Giles: Yeah. It's great. I mean that - I think of that acquisition despite some of the stress that it has put on us when we - when we grew our debt back a year ago as a result is a great strategic acquisition that's done extremely well. Their gross margins are, you know, substantially accretive to our own gross margins. They have leading positions.

We have programs underway to take advantage of the marketplace synergies, the technology synergies that exist. Those things will be happening, are active now. We're planning a new product launch from Gerber Technology here this year. That's in beta right now that I haven't talked about yet and we'll talk about it later, but that is - that is based on the Gamma acquisition that we're very excited about. And then we have technical integration opportunities that are happening within Virtek's space.

And so as a result of the combined Gerber Technology, Virtek product line for example, we're getting increased activity in the wind energy construction business. So, you know, composites are used in these big wind energy blades and our cutting technology combined with winding technology and now laser layout technology is a - is a strong - is a strong offering for us.

Graene Macletchie: That's great. That does me. Thank you very much.

Marc Giles: Thanks Graene.

Operator: As a reminder, that is star 1 to ask a question or make a comment. And we'll pause for a moment.

And there are no further questions. I'd like to turn the conference back over to our speakers for any additional or closing remarks.

Marc Giles: Thanks operator. We're pleased to report our results for this fiscal first quarter. I'll remind everybody that, you know, things remain difficult in terms of visibility. And while we're encouraged that we may have - that we appear to have bottomed in term of our markets, we don't see any significant, you know, improvement happening as of yet. And so what that means that, you know, things can be variable and bumpy in our outlook and that's why we're not providing an outlook.

And hopefully things will begin to turn now in this - in this coming quarter and if they do, we'll look forward to talking to you again at the second quarter conference call. In the meantime, we're going to be - continue to be very, very focused on managing our costs and balance sheet to make sure we come out of this cycle in as good a shape as we can.

And so until then, we will - we will look forward to talking to you at the end of the second quarter call. Thanks operator. Thanks everybody.

Operator: And that concludes today's teleconference. Thank you for your participation.

END