



THIRD QUARTER FISCAL 2010 EARNINGS CONFERENCE CALL
March 4, 2010 – 10:00 a.m. ET

Operator: Please stand by. Good day and welcome to Gerber Scientific, Inc.'s Third 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 certain 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 important risks and uncertainties that could cause Gerber's actual results to differ from the results expressed or implied in these 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. Good morning everyone. We appreciate your continued interest and participation today in Gerber Scientific's Fiscal 2010 Third Quarter conference call.

Joining me on the call today is Mike Elia, our Executive Vice President and Chief Financial Officer. I'm going to provide a high level overview of last quarter's performance and current business conditions. Mike will provide more details regarding financial results and liquidity and then we'll wrap up with our outlook and then take your questions.

This economic downturn has certainly been very tough and we have focused most of our energy over the past 18 months on the short term.

However as a result of our actions, combined with continued signs of improving conditions on our markets, I want to take this opportunity to reaffirm the company's longer term goal to become a double digit operating profit on sales business.

Although business has been very slow during this cycle, we haven't slowed down in any of the initiatives to drive to this goal and we remain intently focused on four areas:

Cost Reduction – and not just temporary cost reductions to weather the lower sales volumes. But we have been and are fully focused on identifying and executing actions to reduce our permanent cost structure and by this I mean both below the line expenses and our costs above the gross profit line to improve margins.

Debt Reduction – through working capital improvements, cost reductions and sales of non-core assets.

In addition – **Portfolio Optimization** – making sure we have the right businesses that fit strategically with Gerber and where we are confident we are best positioned to drive shareholder value.

And lastly – **New Product Development** – to ensure we're best positioned to drive customer value. Let me talk a little bit about each of these key areas and what we've accomplished this quarter as well as year to date and fiscal 2010.

Cost reductions this quarter, on a currency adjusted basis and excluding severance and acquisition transaction costs, SG&A spend was down \$1.6 million from last year in the third quarter.

For the first nine months of fiscal 2010, we are down \$9.8 million in SG&A. And remember that many of our cost reduction actions were already completed by the third quarter of last year. We are continuing to identify and drive down costs wherever we see opportunity and we anticipate further cost reduction actions in our fiscal fourth quarter as well as the related restructuring charges.

On the gross margin improvement front, we further built our capabilities in low cost operations in China during the quarter through the expansion of our own assembly operations there. We've been using Gamma, our acquisition from a year ago as a base for this activity. And as a result we are now assembling our own line of plotters there as well as beginning to assemble spreaders. Both products are for our Gerber Technology business.

Through our cost reduction initiatives and working capital improvements we were able to generate an additional \$3.7 million of operating cash flow in the third quarter, bringing fiscal 2010 year to date cash generation to \$19.5 million.

Now on debt reduction, in the current third quarter we reduced our outstanding debt by an additional \$6 million. Since our fiscal 2009 year end of April 30, we have reduced outstanding debt by \$28.5 million or almost 40%.

Portfolio optimization – this is an ongoing strategic process whereby we are reviewing all of our businesses, assets and geographic locations to ensure that they are a strategic fit, are well positioned to create value for shareholders and contribute to our longer term goal of generating double digit operating profit. This analysis led to the closing of the after market businesses in Poland and the sales of ND Graphics business and our FOBA business within the last year. More recently we announced the closing of our Gerber Coburn Australia operations. While good businesses, they just weren't the best fit for Gerber's strategy going forward.

These sales also helped us to reduce our outstanding debt and reallocate resources to the businesses where we do see the greatest opportunities for profitable growth. The acquisition of Yunique Solutions is a great example of this by Gerber Technology. We were able to buy a product life cycle management product technology that greatly enhances our product offering in the apparel and flexible materials segment while also allowing us to reduce our R&D expenses.

On the new product development front, despite the weak market conditions and the heightened focus on cost reduction, we have continued to selectively invest in new product development where we see the best opportunities for growth as our markets begin to rebound.

Equipment revenue from new products totaled about \$4 million in the current third quarter which included sales of nine ion units. Within our Sign Making and Specialty Graphics segment we have continued to invest in our Solara ion product line – both in refining the current technology and enhancing capabilities for the next generation, which we expect to launch within the coming months as the markets rebound.

Gerber Coburn continued to make inroads in Asia with several significant orders in the last quarter for their new advanced lens processing system or ALPS despite the weak global economy, and they're ready with the new E2G green lens blocking system, which was shown and well received by attendees at the recent Optica Labs Association Trade Show, and which we expect to fully launch at the Vision Expo Trade Show in New York City later this month.

At Gerber Technology, market reception for the new Yunique PLM product line we acquired has been very exciting, and Gerber Technology has already begun to secure new business based on the promise of this product's unmatched performance, now backed by Gerber Technology's global service and support infrastructure.

We're also excited about the launch of the new XLP plotter in China and just more recently in the United States. This is a lower cost, yet very high performance plotter designed and built as a result of our Gamma acquisition in China last year.

Okay, let me just talk for a few minutes about what we're seeing in our markets right now, and then I'll turn the call over to Mike for more detail. While market conditions remain lumpy, we are seeing positive indicators that give us more optimism that the depressed market cycle has bottomed.

In the Apparel and Flexible Materials segment, sales were up 10% versus the third quarter a year ago and operating income was up about 50%. Overall orders however were up 43% versus the third quarter of fiscal '09.

Hence, we built some decent backlog going into our fourth quarter. Both the apparel segment and the industrial business segment for Gerber Technology were up significantly. Geographically Gerber Technology's business in both North America and Europe improved slightly in the quarter and their international business continued on a very positive growth trend lead primarily by business in China and in Brazil.

In fact, Gerber Technology sales in China were up 30% year over year lead by strong growth in their CAM business with both existing and new customers. At Virtek, our acquisition of just over a year ago the weak economy continued to impact their PCI and laser QC businesses. However the aerospace market is quite active and we are hopeful that the first flight of the Boeing 787 will begin to spur business there.

So, while a bit uneven, overall we're optimistic with what we're seeing from this segment's markets.

In the Sign making and Specialty Graphics segment, conditions remain quite challenging. Our global distribution business, Spandex, reported 11% growth year over year in the third quarter, but this was due to favorable currency impacts. On a constant currency basis, both equipment and after market sales were down slightly across most of Spandex's markets. However, the good news at Spandex is that they continue to improve their year over year operating performance, \$2.7 million of operating income in this third quarter versus \$700,000 of operating income in the third quarter a year ago. On a constant currency basis, operating income was still a healthy \$2.1 million in the current quarter to compare versus a year ago.

At Gerber Scientific Products, the market landscape has not changed much in the last quarter. Demand continues to be soft across the board for equipment, software and after market products and as a result Gerber Scientific Product sales were off 22% compared to a year ago. Key customers in the sign shop industry are reporting double digit same store sales declines in 2009 versus 2008 and little to no growth is forecast for the current year. As a result we are still seeing hesitation on the part of our customers in committing to capital purchases and customers are reporting no improvement in the availability of credit either.

Also, Gerber Scientific Products has continued to make progress on reducing ion warranty costs though we still have some work to do. And progress also continues with the latest generation of the ion, which we expect to be highlighted at the upcoming ISA show in Orlando in April.

Finally market indicators are mixed in the Ophthalmic Lens Processing segment. While Gerber Coburn's business in North America and Europe remains weak, orders from the rest of the world principally Asia, Latin America and Australia are up 30% year over year in the current quarter.

North America and Europe remain depressed with no near term signs of improvement. As a result, sales were off 11% in this segment in the quarter. As I mentioned earlier, Coburn is making inroads with its new ALPS lens processing system and is in the final launch stage for its new E2G blocking system.

With a little help from their markets we should begin to see improvement there. At this point I will turn the call over to Mike and then afterward I will provide our current outlook and summary and then take your questions. Mike?

Mike Elia: Thanks Marc, good morning everyone. As a reminder a webcast replay of this call and a transcript will be available on our website shortly after the call.

For all periods discussed today we are excluding FOBA, ND Graphics and the Poland aftermarket operations, which were all sold or closed earlier in fiscal 2010 and are reported as discontinued operations.

Compared to the third quarter a year ago consolidated revenue in the current quarter was \$110.7 million, up \$4.5 million or 4.2%. However favorable currency exchanges added about \$8.5 million, so after adjusting for currency sales were off roughly 4% or \$102.2 million in total. Since currency played a large role in our year over year comparison, let me take a moment and provide you with segment revenue on a currency neutral basis.

Starting with the Sign Making segment, GSP sales, which are not impacted by currency, were \$9.3 million, or down 22%. Spandex sales reported \$4.2 million or down 2.7%. Apparel and Flexible Materials sales were \$38.2 million, or up 4.8%. And, finally, the Lens Processing segment sales were \$10.5 million, or down 15.5%.

On a consolidated basis we posted an operating loss of \$200,000 in the current quarter compared to operating income of \$200,000 a year ago. The current quarter includes \$1.2 million in restructuring and other expenses. However, the operating loss also includes a benefit from currency of \$1.2 million. So in other words, on a currency adjusted basis and excluding the restructuring and other expenses, our operating loss for the quarter was \$200,000.

With that backdrop, let's take a look at some of the line item details.

Consolidated gross profit for the third quarter 2010 was up \$631,000 to \$32.9 million from a year ago. After adjusting for currency, gross profit was \$29.9 million or off \$2.3 million from a year ago, reflecting lower sales, less favorable sales mix and lower manufacturing cost absorption. Lower absorption of manufacturing costs and a less favorable sales mix also affected gross margins in the current quarter. Reported gross profit margin was 29.7% for the current quarter compared to 30.7% a year ago. After adjusting for the effects of currency, gross profit margin was 29.3%.

While currency had a positive impact on our revenue and gross profit, it masked the benefits of our expense actions. For example reported SG&A expenses were \$27.3 million versus \$27.1 million a year ago. However, adjusting for currency, SG&A was \$25.6 million in the current quarter or down \$1.6 million. On a reported basis SG&A as a percent of sales was 24.6% and 25% on a currency adjusted basis compared to 25.5% a year ago.

For the first nine months of fiscal 2010, SG&A expenses, on a currency neutral basis, were down \$9.8 million. But, keep in mind, though, that year to date fiscal 2010 expenses included approximately \$6.4 million of Virtek and Gamma expenses, which were not in last year's numbers. Which means SG&A is down closer to \$16.2 million on a year to year basis from last year. So you can see the cost reductions are there and they are very significant.

R&D spending, which we've been limiting to sustaining projects for more than a year now, dropped roughly \$200,000 to \$4.6 million for the third quarter from a year ago. We expect R&D to finish the year around \$18.5 million. In the current quarter we incurred \$1.2 million in restructuring and other expenses which include approximately \$470,000 in severance and \$500,000 in transaction related expenses for the

acquisition of Yunique. As you may recall the acquisition of Yunique allowed us to acquire important technology and take immediate advantage of 1.3 to \$1.6 million in product development synergies.

We also expect to incur additional restructuring expenses in the fourth quarter which could be as high as \$2.5 million depending on the timing of additional cost reduction actions and our ability to execute the exit of certain underperforming regions.

We reported a loss from continuing operations for the current quarter of \$800,000 or 3 cents per diluted share compared to a loss of \$1.3 million or 5 cents per diluted share last year. The lower loss reflects the absence of a \$2.3 million non-cash write down of investments in our supplemental retirement plan that we incurred last year. This was offset by about \$500,000 additional decline in operating profit, reduced tax benefit of \$600,000 and a \$700,000 increase in interest expense.

Let me point out that the interest expense included a \$400,000 non-cash write off of deferred financing fees. Our net loss for the quarter was \$800,000 or 3 cents per diluted share compared to a net loss of \$2.2 million or 9 cents per diluted share last year.

Now let me highlight a few balance sheet and cash flow items for the nine months ended January 31 2010.

Trade receivables at the end of the third quarter were \$72.7 million. We generated cash from trade receivables of \$13.8 million due to lower sales and strong collection efforts. As of January 31 2010 our DSO was 59 days compared to 66 days as of April 30 2009.

Inventories at the end of the third quarter were \$66.9 million. We used about \$200,000 of cash on inventories. Inventory turns at the end of the third quarter were 4.8 times compared to 4.6 times a year ago. I'm sorry, at year end. Operating cash flow for the nine months ended January 31 2010 was \$19.5 million compared to \$6.3 million for the same period a year ago.

Capital expenditures were down \$3.2 million in the current nine month period. We continue to minimize capex spending in the current environment and expect capex spending for fiscal 2010 to finish around \$5 million.

Total debt outstanding under our senior revolving credit facility as of January 31 2010 was \$45 million and accrued interest of various LIBOR rates plus 325 basis points. During the quarter we retired \$6 million in industrial revenue bonds, which had an all in cost of roughly 7% and in turn reduced our outstanding undrawn letters of credit by \$6.5 million down to \$1.1 million.

Total debt outstanding, net of cash, on January 31 2010 was \$37.1 million. Total liquidity was \$20.3 million which consisted of \$7.9 million in cash and \$12.4 million in availability under our senior revolving credit facility based on the current financial covenants.

At the end of the current quarter we were in compliance with all our bank covenants. I'll now turn the call back over to Marc to review our current outlook and then we'll open the call up for your questions. Thank you.

Marc Giles: Thanks Mike.

So in summary here are the takeaways for the quarter and our outlook. With the quarter end backlog level being the highest it has been since the second quarter of fiscal 2009, we're looking for continued improvement in sales as well as improved profitability due to our cost reduction initiatives.

We continue to drive down costs and are targeting additional permanent cost reductions and portfolio optimization actions which if consummated as planned will generate additional one time charges in the fourth quarter that are also expected to reap longer term significant benefits.

I also want to mention that we are delighted to announce that we just recently brought on board Mr. Tom Finn as our new Senior Vice President of Operations. Tom will be helping us to continue to drive out waste and improve our operating performance. Tom is well known actually for building and leveraging world class supply chain networks as extensive global experience including living and working in China. And has substantial experiences in operations change agent, achieving cost reductions, margin improvement and enhancing cash flow. Most recently, Tom was executive vice president operational restructuring with Medis Technologies which produces the world's first and only commercially available portable fuel cell. And has also held senior operational leadership positions with Lucent Technologies during their transformation, Selectron and Texas Instruments.

With our streamlined organization, and reduced cost structure we are now more focused on the future and continue to position the company to deliver earnings growth with double digit operating profit margins.

As we've reported for the last several quarters through, with the lack of real market visibility we are still not comfortable providing more detailed guidance. 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, ladies and gentlemen the question and answer session will be conducted electronically. If you would like to ask a question please press star 1 on your touch tone phone. If you're using a speaker phone please make sure that your mute function is turned off to allow your signal to reach our equipment. Again that's star 1 for any questions at this time. And we'll go first to Arnie Ursaner with CJS Securities. Caller, your line is open please go ahead with your question.

Arnie Ursaner: My first question - good morning, my first question is for Mike. Mike, if you do take the additional \$2.5 million of cost reductions, just want to be sure that would not trip any of your covenant issues?

Mike Elia: That's correct.

Arnie Ursaner: Okay. And Marc, I'm actually looking back at the original basic report we did on you in 2005 and in your 2004 annual report you had talked about double digit operating margins. And I just want to make sure that as we think - go forward and look ahead your operating margins obviously going to be some combination of your gross margin and your SG&A together.

Where I think you have failed to meet it so far has been the ability to get the gross margin. Can you comment on the components of how you're thinking about double digit operating margins and what will drive higher gross margin if that's the necessary ingredient to get there?

Marc Giles: Yeah, I mean it's a combination of factors. I reviewed kind of the four things we're focused on. Arnie, good morning, by the way. But it's really a combination of one cost reductions, and supply chain optimization which is why we brought Tom on to accelerate that process to drive improvement in our gross margins.

New product development accented by sunseting of older low margin products and three portfolio optimizations, so that means exiting certain product lines and exiting businesses that don't either meet our current goal of delivering double digit operating profit, don't support that objective or don't support that objective going forward. So completing that analysis of what businesses and what product lines we're going to stay in and exiting those that we are not going to stay in.

Arnie Ursaner: Can you do it with your manufacturing footprint that you currently have in place?

Marc Giles: We can with our current manufacturing footprint if we recall that we are shifting and have been in the process of shifting substantial amount of our manufacturing, or I should say supply chain and

assembly operations to Asia. So that - it's a pretty significant step forward that we have launched and actually expanded, are planning to expand significantly our own assembly operations in China now. So we've gone from - we're moving from a sub contracting everything to a subcontracting some things there and then doing some of our own supply chain management and assembly operations there in market to optimize our margins. So we're really building a new supply chain and assembly operation there from scratch the way it should be as we're toning down and will be easing up on the manufacturing footprint we have here in the United States.

Arnie Ursaner: Well it won't be finally determined until your board makes its decision after your fiscal year ends, but do you expect your management incentive compensation to be driven off double - off achieving double digit operating margins?

Marc Giles: I haven't even begun to think about what we'll do in terms of management and incentive compensation for the next year or so. At this point to tie it all together since we're just coming into our fourth quarter. But that will be a process of what we'll be looking at over the next quarter.

Arnie Ursaner: Thank you very much.

Marc Giles: Sure Arnie.

Operator: Ladies and gentlemen, once again it is star 1 for any questions at this time. We'll go next to Jim Ricchiuti with Needham & Company.

Jim Ricchiuti: Marc, as you look at the portfolio right now do you think the three businesses are capable of generating operating margins, double digit operating margins? I mean it looks like on the Apparel and Flexible Materials side you're basically there. But, what about the other two businesses?

Marc Giles: I mean I think it's fair to say and as I have been saying Jim that you know the company is not going to look the same three years from now as it looks today. We are not going to be doing the same product lines as we do today, we are not going to be at all exactly the same business as we are today. So there are - there will be some changes over time that will contribute to our goal of achieving 10% operating profit. But anything more specific than that I have no comment.

Jim Ricchiuti: Okay. Marc, as we look at what you're doing in China from a manufacturing standpoint, do you have a goal in mind in terms of looking at the Gerber Technology business? You know what percent of your revenues you'd like to see manufacturers in some way assemblers in China?

Marc Giles: Yeah, I wouldn't say that I have a specific goal right now. You know we expect you know China currently represents - well right now it probably represents about 20% of our business in Gerber Technology and we expect that to be growing most aggressively versus anywhere else in the world.

So there's going to actually be just a natural catch up in that process. But I would expect over time that a large percentage of our equipment that's focused on the apparel segment or activity of that business, a large portion of that will be produced in China since the end markets will be largely Asian.

And if the activities that we continue to perform here will be more focused on the industrial market applications that Gerber Technology is involved in and in which we continue to invest.

Jim Ricchiuti: Okay, and just from a demand standpoint, it looks like you're generally pleased at least given the economic environment with the order activity that you're seeing in Apparel and Flexible Materials. How strong has China been thus far in the quarter? Are you seeing continued momentum there?

Marc Giles: Oh yeah. China is up, continues to be up significantly so in the overall business they were up by about 40%. And I don't have the number in front of me, but it is substantially higher than that when you look at orders for equipment and software. So you take out the more stable service and spare parts business, so that is - especially year over year was very dramatic increase.

Jim Ricchiuti: Okay, thanks.

Operator: And ladies and gentlemen as a final reminder it is star 1 for any questions at this time. We'll go next to Zahid Siddique with Gabelli & Company.

Zahid Siddique: Hi, good morning.

Marc Giles: Good morning Zahid.

Zahid Siddique: Just a follow up question, I think someone asked about the portfolio. You said in three years the company would look different. What really - I mean is there a more specific timeline? Could we see something in the near term or is it really over three years that you're going to reallocate the portfolio?

Marc Giles: Well I don't want to be you know too cryptic there Zahid but there isn't a specific timeline on any of these activities. When I say that three years from now it's - I will say that it's certainly not our intention that everything will happen in one lump in year three. So there will be a process that we'll go through that you know is likely to have some activity in each of the three years.

Zahid Siddique: Okay, and then I guess looking at 2010 calendar and into 2011, what's your take on your various businesses? I know China and I guess the (plotter) business has picked up but is North America going to remain weak and in Europe for quite some time?

Marc Giles: Yeah, I mean I've got to say I don't see any signs of significant improvement certainly in the US and our markets. So I'm not anticipating any great return to health there. You know thank goodness we have sized the business to the activity that we're currently experiencing and we'll continue to optimize our cost structure to support the business as is, not business as we wish it to be. But in the US you know I'm really not expecting anything momentous there. In Europe there are pockets of growth and pockets of continued decline frankly.

So on balance I'd say our business in Europe I would expect to be stable, maybe some slight continued improvement in Europe and it's really Asia today and south America to somewhat of a lesser extent that is driving the bulk of the growth. And - but thank goodness it's a very healthy growth prospect.

Zahid Siddique: All right, thank you so much.

Marc Giles: Certainly.

Operator: And we'll take a follow up question with Jim Ricchiuti with Needham & Company.

Jim Ricchiuti: Marc I was just wondering if you could talk a little bit about ion and the warranty issue. Can you talk about how many machines out in the field you feel are still need to be addressed? And you know where do you stand in terms of you're going to launch, I guess introduce the new product, the new ion. Can you talk a little bit about how that might roll out?

Marc Giles: Sure, let me start back on the warranty side. We continue to make improvement in driving down our warranty costs with the fixes we put in place. Generally any of the fixes that we do we roll out to our installed base, which is somewhere in the 300 machines, vicinity of 300 machines today. So I mean there are more urgent cases and less urgent cases but generally we try to keep everything up to speed. We continue to do work on that, there's still some challenges that we face. We feel optimistic that we'll get

those challenges behind us soon. Our target is you know to try to complete at least the bulk of this work this fiscal year and into the first quarter. So that's our expectation and our plan but we still have some work to do.

When I talk about the next generation product we're doing - our plan is to show that at the ISA show that's upcoming I believe in - I think it's in Orlando this year and demonstrate that technology. And we're very optimistic and pleased with that product, but we're not going to roll it out commercially until, A- we are - we do have our warranty issues under control period and that we have the path forward nailed down. And, B - we want to see some improvement in market opportunity that - so we feel confident we'll roll it out and actually get some revenue out of it and see if we can get some momentum from that.

So we'll continue to take the pulse of the target customers we think are ideal for this next generation.

Jim Ricchiuti: Okay great, thanks for clarifying that.

Marc Giles: Sure.

Operator: And Mr. Giles, we have no further questions from the phone audience, I'll turn the conference back over to you.

Marc Giles: Well I want to thank everybody again for joining us on the third quarter. I'm quite optimistic about how our fourth quarter is shaping up. I'm very pleased with the addition to the team of Tom Finn, I'm very pleased with the team we have in place overall.

And I expect a pretty exciting future here over the next few quarters and I look forward to reporting to you again in June when we wrap up our fiscal year and fourth quarter. Until then thanks again. Bye.

Operator: Ladies and gentlemen that does conclude today's conference call, we'd like to thank you all for your participation.

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