

PCTEL Q3 2016 FINANCIAL RESULTS CONFERENCE CALL

October 27, 2016

OPERATOR:

Ladies and Gentlemen, thank you for standing by, and welcome to the PCTEL third quarter 2016 conference call. At this time, all participants are in a listen-only mode. Later, we will open up the call for your questions. Instructions for queuing up will be provided at that time. As a reminder, this conference call is being recorded for replay purposes.

I will now turn the call over to John Schoen, Chief Financial Officer.

JOHN SCHOEN:

Thank you for joining us today for the PCTEL financial results conference call for the third quarter 2016. On the call today are Marty Singer, Chairman and CEO, Rishi Bharadwaj, Senior Vice President and General Manager of our Connected Solutions segment, David Neumann, Senior Vice President and General Manager of our RF Solutions segment, and I am the Chief Financial Officer.

Our remarks contain forward-looking statements and projections of future results. Please review the forward-looking statement section at the end of today's earnings release for various factors that could cause actual results to differ materially from projections.

PCTEL reports its financial results in accordance with U.S. generally accepted accounting principles. Today's call will contain various operating results on an adjusted non-GAAP basis, which excludes items that affect the comparability of reported results. Descriptions of these non-GAAP financial measures and reconciliations are included in today's earnings release, which is available on our website.

Now I'll turn the call over to Marty.

MARTY SINGER:

Let me summarize the highlights of our earnings release. As we predicted at our last earnings conference call, our third quarter was about the same as our second quarter:

- \$24.7 million in revenue, about \$500,000 greater than last quarter.
- \$2.5 million in free cash flow, slightly more than last quarter.
- \$2.1 million in EBITDA, about \$200,000 less than last quarter.
- \$1.1 million in Non-GAAP net income, about \$170,000 less than last quarter. This equates to \$.07 in non-GAAP EPS which is a penny less than last quarter.

The \$24.7 million in revenue is a high-water mark for us this year and reflects continued progress in our antenna business and our development of vertical markets. Our non-GAAP earnings over the past two quarters suggest a run-rate of approximately \$.30 on an ongoing annual basis. Higher revenue certainly helps us but we have also made substantial progress in streamlining costs. Our

operating costs have settled in at about \$32 million a year and we are doing a much better job of managing our inventory and reducing Excess and Obsolescence expenses. Last quarter we predicted that this quarter would be about the same; this quarter we are forecasting that fourth quarter will be somewhat stronger than the third quarter, ranging between \$24.5 and \$25.5 million.

As John mentioned, Rishi Bharadwaj and David Neumann are on the call today. They will each separately describe the highlights and prospects for their separate business segment. I want to make a few general observations on the quarter before turning the call over to them.

This past quarter we saw the benefit of our focus on small cell, in-building, and Distributed Antenna Systems (DAS). While DAS has slowed in recent months, it is clear that operators, venue owners, and the infrastructure vendors are migrating toward small cell solutions. It is in this vertical market that PCTEL brings to bear all of its assets: antennas, test and measurement solutions, and engineering services. It is also the space that affords us the opportunity to acquire and maintain customers that generate multi-million dollar revenue opportunities. On our recent trip to China in which we visited the major operators, our strategic customers, and our own design and manufacturing facilities, we learned more about the deployment of small cells and the urgency with which operators are dealing with the data densification associated with the Internet of Things (IoT). Small cell deployment is not an option, but a necessity.

This past quarter, we recorded record antenna shipments inside a \$17.1 million quarter for Connected Solutions. Rishi's team delivered higher margins, reduced inventory, expanded capacity in Tianjin and renewed their focus on small cell and their large infrastructure customers. We see great potential for growing that business over the next few years and we will see another strong quarter to end the year.

While RF Solutions had somewhat lower than anticipated results, it is important to note that scanning receiver sales did extremely well in China and Asia Pacific regions and that our direct sales into North American carriers were robust. Sales were temporarily impacted, however, by InfoVista's acquisition of Ascom's test and measurement operation. We expect the organizational dust there to settle down in the fourth quarter allowing us to return to our historic run rate with the test and measurement business unit. The quarter was impacted as well by significant orders moving into the fourth quarter for both scanning receivers and our new Engage product. At the same time, we are pleased with the continued rebound in our in-building engineering services operation. We generated about two times the revenue that we generated in the first quarter for total engineering services.

As Rishi and David will elaborate on in their remarks, we see our growth fueled by five factors, two of which I have already mentioned.

1. Small cell, in-building, and DAS will leverage all of PCTEL's assets and it will run counter to the overall trend of flat to declining wireless infrastructure sales. We anticipate that growth in small cell antennas, in-building engineering services, and utilization of our scanning receivers and analytics will drive our business going forward and that will leverage all of PCTEL's technology and capabilities.
2. We will continue to develop large, meaningful customers. We have an opportunity to develop our first \$20 million revenue customer in 2017. These customers buy our antennas, scanning receivers, and services.
3. APAC, including China, has finally developed as both an important antenna and scanning receiver market for us. It is important for our investors to understand that in addition to driving product and vertical market growth, we have been driving regional growth with significant investments in China. We have a 200 person factory, a 15 person design center and significant sales personnel in China and APAC. This critical mass was essential to our business development efforts. We anticipate stronger results in the future.
4. We are now delivering solutions across both our business units. This is an evolution from our discrete product approach. We deliver sophisticated antenna configurations for a variety of markets, often associated with

engineering services. We deliver a combination of tools, analytics and engineering services to the small and macro-cellular environments. This will drive greater value for our efforts.

5. Finally, we will mine our balance sheet for additional investment resources. We have made progress in reducing our E&O and inventory and that capital will be put to use in growing our business.

This will be my last earnings conference call as Chairman and CEO. John and I did a quick count and this is the 60th earnings conference call that we will have done together and my 61st. While this will be my last earnings call, John will continue on and provide the same exceptional support to David Neumann next year. I want to thank John for all of his expert help in preparing for these calls and the guidance that he has provided to our executive team. He has been a great asset to me during my tenure as CEO and he has been essential to PCTEL's success over the past 15 years. I also want to acknowledge Jeff Miller, Biju Nair, and Jack Seller, who were all part of the initial team that transformed PCTEL from a wired analog modem company to a wireless enterprise.

With that, let me turn the call over to John. After his financial review, Rishi Bharadwaj will discuss Connected Solutions and David Neumann will discuss RF Solutions and some of his plans for the future as he pivots to his CEO role in January.

John, it's all yours.

JOHN SCHOEN:

Thank you, Marty.

Revenue

Revenues were \$24.7 million in the quarter, down seven percent from the same period last year. I will speak to the changes by reporting segment.

Connected Solutions revenue was \$17.1 million in the quarter, down \$300,000, or two percent, from the same period last year. The third quarter last year included \$700,000 of mobile tower revenue, a product line we discontinued at the end of 2015.

RF Solutions revenue was \$7.6 million in the quarter, down \$1.5 million, or 17 percent, from the same period last year. Both scanner and services revenue were down. Marty addressed the InfoVista impact to scanner revenue earlier. Within services, our in building services grew significantly while our relatively lower margin Subject Matter Expert services declined significantly.

Gross Profit Margin

Non-GAAP gross profit margin as a percent of sales was 37 percent in the quarter compared to 33 percent in the same period last year. I will speak to the changes by segment.

Connected Solutions gross profit margin as a percent of sales was 34 percent in the quarter, up seven percent of revenue from the same period last year. The change is attributed to manufacturing cost reductions implemented in the fourth quarter last year and the exit from the lower margin mobile tower business.

RF Solutions gross profit margin as a percent of sales was 44 percent in the quarter compared to 43 percent in the same period last year. The impact of lower scanner sales was offset by the decline in relatively lower margin SME revenue, leaving total margin percent for the segment slightly improved.

Operating Expenses

Now let's turn to Non-GAAP operating expenses. Operating expenses were \$7.9 million in the quarter. This is a \$900,000 decrease from the same period last year. The decline is attributed to the restructuring cost reductions implemented in the second half of 2015.

Non-GAAP Income Taxes

The Non-GAAP income tax rate remains at 18 percent.

Non-GAAP Earnings

Non-GAAP net income per share was \$0.07 compared to non-GAAP net income of \$0.01 in the same period last year. The increase was driven by cost reductions implemented in both manufacturing and operations during the second half of 2015.

Balance Sheet & Cash Flow

Now let us turn to the balance sheet.

Cash and investments ended the quarter at approximately \$31.2 million, about \$1.9 million higher than the previous quarter.

In the quarter, the Company generated free cash flow of approximately \$2.5 million, comprised of cash flow from operations of \$2.8 million and capital spending of \$300,000. The Company was able to reduce non cash & investments working capital approximately \$1 million in the quarter on higher sequential revenue primarily as a result of its ongoing inventory reduction program and improvement in accounts receivable days outstanding.

Depreciation in the quarter was \$814,000.

During the quarter the Company paid a cash dividend of \$866,000.

Income Statement Guidance Q4 2016

Now I would like to discuss guidance for the fourth quarter 2016.

We anticipate fourth quarter revenue to be in a range of \$24.5 to \$25.5 million and gross margin in a range of 37 to 39 percent of revenue. Operating costs are expected to be about \$8.2 million. Operating costs are seasonally at their highest for the Company in the fourth quarter.

The Non-GAAP effective income tax rate is expected to remain unchanged going forward at 18 percent.

The fully diluted share count in the quarter is expected to be about 16.3 million shares.

That concludes the financial review. I would like to turn the call over to Rishi.

RISHI BHARADWAJ

Thank you, John.

As Marty and John mentioned earlier, we had a very good quarter in Connected Solutions. We have developed momentum in small cells with our key OEM customers. We had good order inflow in the third quarter with shipments in China being particularly strong. Aside from the current product shipments, we have a healthy pipeline of new projects for PIM (Passive Inter Modulation) rated antennas with global LTE frequency coverage, multiband antennas with Wi-Fi,

and specialized GNSS (Global Navigation Satellite System) antennas for network timing. We have made additional investments in R&D and operations in China to support the opportunities in this area.

In the past, we have mentioned our design wins with two major North America utilities for Smart Grid. We had strong shipments of our specialized antennas for network infrastructure deployment in this area. In addition, we also assisted a new OEM customer complete their carrier certification for wireless power line sensors using our new custom integrated antennas. Utilities in North America continue to spend on upgrading their Smart Grid infrastructure; we expect this to be a multi-year opportunity for PCTEL. Outside of North America, we have some of the largest utilities in Europe who have started testing our antennas for fault detection and process automation.

In agriculture, we completed final production qualification and initiated production of our new multiband antenna platform with GNSS, Wi-Fi and LTE capabilities for a major agriculture equipment manufacturer. We are working with multiple agriculture OEMs to provide specialized antennas systems that enable machine control, semi-autonomous driving, in-cab entertainment and sensor communications. Besides applicability in agriculture, our new antenna platforms are also ideal for Industrial IoT, rail, commercial fleet and other heavy equipment automation applications.

In the third quarter we expanded our VenU[®] product line for high density applications with release of additional configurations of 802.11ac MIMO directional panel antennas at Cisco Live. Our recently released multiband Trooper antenna platform was also selected by a major public safety OEM and by a fleet OEM for launch with its new cellular router platforms.

We'll be displaying our industrial wireless antenna products and design services at SPS IPC Drives process automation tradeshow in Nuremberg, Germany in November.

Now I would like to turn the call over to David.

DAVID NEUMANN

We were pleased with the development of our RF Solutions business in China, Japan, and other regions within APAC this quarter. We continued to make progress with Verizon and AT&T in the U.S. and we launched several products that leverage our strong IBflex[®] base. We also saw a significant rebound in our engineering services business.

Let me expand upon these themes. Third quarter is typically our weakest quarter for scanning receivers, but in both China and Japan we experienced significant sales, and we are forecasting a similar fourth quarter. We are making progress with our Engage product and anticipate strong sales as we build upon

momentum from the third quarter. Our focus this quarter, with respect to Engage, is further integration into our engineering services group to simplify data collection and report generation.

We announced the release of our latest SeeHawk[®] Touch application about two weeks ago, which addresses a pressing customer need to simplify and reduce the cost of commissioning small cell and DAS networks. SeeHawk Touch collects RF data from our IBflex scanning receiver and compares that data against the network design provided by iBwave Mobile Planner. This automated approach reduces the cost to commission an in-building network significantly.

The integration of Engage, which captures user experience, is central to our overall engineering services strategy. We are integrating the Engage-generated data with our IBflex and Touch to support our small cell verification tools. This new configuration (*where IBflex captures network information, Engage captures user experience, and Touch aggregates the user and network information*) permits us to deliver a complete network profile in in-building networks. In upcoming months, we will build upon this capability and automatically store these profiles in the cloud and deliver dashboard reports to our customers. All of these reports will be automatically generated and delivered to our customers within minutes. This is an important element of our continued investment in SeeHawk Analytics.

As we move forward in RF Solutions, we will continue to leverage our two greatest assets: our large installed base and the technological leadership. We are far along in our preparation for 5G, the enhancement of our Wi-Fi capabilities and – perhaps most importantly – the application of the *IBflex* to utilities, rail, and public safety. We were encouraged by our Connected Solutions segment's recent antenna sales into LA RICS and we anticipate a strong demand for test and measurement tools as public safety shifts to LTE and other carrier-based protocols.

I mentioned the recovery in engineering services. To give you a general idea of our activity, we provided engineering services to over 150 venues in the third quarter. We anticipate that our core in-building engineering services will remain at current levels while our lower-margin drive testing services may experience a decline. Increasingly, we see an opportunity to collect, analyze, and immediately display cloud-based data to our customers. Within that context, the real-time dashboard and reporting through our SeeHawk Analytics platform that I just mentioned will be important to the growth and profitability of our services operation. Automated analysis will decrease the time it takes to provide results to our engineering services customers, allowing them to make decisions more quickly. We will be presenting these solutions and our products, including our in-building antennas, at the European DAS and Small Cell Congress in Munich at the end of November.

Finally, I wanted to comment briefly on the upcoming succession in January. As you know, Marty announced that he is retiring during 2017 and stepping down from the Chairman and CEO role in January. I am honored that the board and Marty have demonstrated confidence in me to lead PCTEL. I am looking forward to the challenge and I have great confidence in the future success of PCTEL largely because of the strength of the management team that will be supporting me. Rishi, who has done an outstanding job leading Connected Solutions, will continue to lead that business and Jeff Miller will take over the leadership of RF Solutions. Their experience and leadership coupled with the unbelievable support from the executive team – specifically John Schoen, Shelley Bacastow and Les Sgnilek – bodes well for our future.

MARTY SINGER

That concludes our formal comments on the quarter and what we look forward to over the next several months. We will now take your questions.

Operator?