

***Transcript of  
TechPrecision Corp  
Third Quarter 2020 Earnings Call  
February 13, 2020***

---

**Participants**

Jeff Stanlis – Hayden IR  
Alex Shen – Chief Executive Officer  
Tom Sammons – Chief Executive Officer

**Analysts**

Aaron Warwick – ES Capital  
Ross Taylor – ARS Investment Partners  
John Hardison – Private Investor

**Presentation**

**Operator**

Good day, ladies and gentlemen and welcome to your TechPrecision Third Quarter 2020 Earnings Call. All lines have been placed in a listen-only mode and the floor will be open for your questions and comments following the presentation. [Operator instructions].

At this time, it is my pleasure to turn the floor over to Jeff Stanlis with Hayden IR. Sir, the floor is yours.

**Jeff Stanlis – Hayden IR**

Before we begin, I'd like to remind our listeners that management's remarks may contain forward-looking statements which are subject to risks and uncertainties and management may make additional forward-looking statements in response to your questions. Therefore, the company claims the protection of the Safe Harbor for forward-looking statements as contained in the Private Securities Litigation Reform Act of 1995.

Actual results may differ from those discussed today and therefore we refer you to a more detailed discussion of risks and uncertainties in the company's financial filings with the SEC. In addition, projections as to the company's future performance represent management's estimates as of today, February 13, 2020. TechPrecision assumes no obligation to revise or update these forward-looking statements.

With that out of the way, I'd like to turn the call over to Alex Shen, Chief Executive Officer, to provide opening remarks. Alex?

**Alex Shen – Chief Executive Officer**

Thank you, Jeff. Good day to everyone and thank you for joining us. Our third quarter results were negatively impacted by learning curve related cost overruns that resulted in negative margins and loss provisions on a very limited number of new projects, which for the most part were not the same projects as in the prior quarter. These new projects are an opportunity to demonstrate technical excellence and the custom know-how of complex fabrication and complex machining. In addition, these new projects represent an entry point into new business prospects.

We expect improved margins going forward as these projects approach completion, costs stabilize, and other new profitable projects come online. Our sales order backlog reached its highest level in over three years, increasing to \$17 million at December 31, 2019, as approximately \$15.3 million of new orders were booked over the first nine months of fiscal 2020. We believe this strong backlog, along with increased order activity, should provide for a steady revenue stream and profitable margins in fiscal 2021.

In December 2019 we signed an agreement to increase our available credit under our revolver loan by \$2 million, and subsequently in January 2020 used \$1.1 million of available cash to pay in full our capital equipment loan, providing increased borrowing capacity and financial flexibility going forward as well as reducing our future interest expense.

I'd now like to turn the call over to Tom Sammons, who will tell us more about our third quarter financial results. Tom?

**Tom Sammons – Chief Financial Officer**

Thank you, Alex. Net sales were \$3.7 million for the third quarter ended December 31, 2019 compared to \$4.3 million in the third quarter ended December 31, 2018. Cost of sales for the third quarter was \$3.4 million or \$54,000 higher compared to the same quarterly period a year ago. The increase was due in large part to a \$317,000 charge during the quarter for potential losses on certain customer projects, primarily the new projects referred to by Alex.

Selling, general and administrative expenses increased by \$31,000 in the third quarter, mainly due to increases in professional fees. Interest expense decreased by \$16,000 in the third quarter as we continue to amortize debt principle to maturity. Net loss for the third quarter was \$320,000.

For the nine months ended December 31, 2019, net sales decreased by 8% to \$11.1 million from \$12 million when compared to the nine months ended December 31, 2018. Our cost of sales for the nine months' ended December 31, 2019 were \$9.2 million compared to \$8.9 million in the same period a year ago. Gross profit was 16.6% or \$1.3 million lower due to primarily \$850,000 of charges for potential losses on certain customer projects.

Total SG&A expenses for the nine months ended December 31, 2019 increased by approximately \$32,000 due primarily to increase in professional fees, which were offset by a decrease in compensation expense. Interest expense decreased by \$43,000, again as we continue to amortize our debt principal. For the nine months ended December 31, 2019 our net loss was \$390,000 compared with net income of \$563,000 for the nine months ended December 31, 2018.

Moving to the balance sheet, we had \$2 million in cash and \$5.4 million in working capital at December 31, 2019. Cash provided by operating activities was \$0.6 million for the nine months ended December 31, 2019. Net debt at the end of the third quarter of fiscal 2020 was \$1.7 million.

As Alex mentioned, in December 2019 we signed an agreement to increase the amount available under our revolver loan from \$1 million to \$3 million and decreased our interest rate on the revolver by 50 basis points. In January 2020 we paid off in full our remaining debt obligation of \$1.1 million on the higher interest rate capital equipment loan. This payment reduced our total debt obligations to \$2.6 million at January 17, 2020 from \$3.7 million at December 31, 2019.

With that, I will now turn the call back over to Alex. Alex?

**Alex Shen – Chief Executive Officer**

Tom, thank you. TechPrecision is proud and honored to serve the United States Defense industry, specifically naval submarine and aircraft carrier manufacturing through its Ranor subsidiary. We continue to replenish our backlog and will seek out other new opportunities in the defense and industrial markets in the next 12 months and beyond.

I would now like to open up the call for Q&A.

**Operator**

Thank you. The floor is now open for questions. [Operator instructions]. We'll take Aaron Warwick [ph] from ES Capital as our first questioner. Please go ahead.

**Q:** Hello, guys. Thanks for taking my call. You mentioned some struggles in the quarter due to some of these new things. Do you believe at the end of it that you did demonstrate the technical excellence and the custom know-how to win this business going forward?

**Alex Shen – Chief Executive Officer**

I think your question was—can you repeat your question?

**Q:** Yes. So, you mentioned that you had some struggles during the quarter related to some new types of parts and a learning curve. You said it provided you more opportunity to demonstrate technical excellence for complex fabrication and complex machining. I'm wondering if, as you sit here today, do you think that you did demonstrate that despite the losses and that going forward this new type of business would be something that you'll earn?

**Alex Shen – Chief Executive Officer**

So, I was saying there's a negative part of this very limited number of new projects, the learning curve related cost overruns. That's the first point. The second point, these new projects represent an entry point into new business projects, because they are an opportunity to demonstrate technical excellence and custom know-how.

**Q:** And my question is, do you think you demonstrated that to the customer that they would award future business?

**Alex Shen – Chief Executive Officer**

Yes. They're an opportunity to demonstrate. We continue to demonstrate, and that's why I was telling you. I think you're just reaffirming that is it an opportunity to demonstrate? Yes. Yes it is, absolutely, yes.

**Q:** Okay. Thank you. Good, good. Speaking of opportunities, you've mentioned before the \$100 million over two years and I was just wondering where you sit with that now.

**Alex Shen – Chief Executive Officer**

That has not decreased.

**Q:** Okay. Another question I have kind of related to that obviously. You know, you did whatever it was, three-something this quarter. One hundred million over two years is going to require a lot more human resources and I know that's a concern throughout the industry about finding the number of people.

Obviously unlike Electric Boat or other big contractors, you're not looking for thousands of people, maybe I would think just looking through the past filings maybe 100 people more at most when this opportunity starts to come to actualization. Can you share with us a little bit what your plans are there in terms of recruiting the talent? Obviously, this is skilled work and you can't just pick up anybody off the streets.

**Alex Shen – Chief Executive Officer**

I will tell you that on this very public call that talking about our strategy and revealing these things to our competitors on an open line would probably not be the best idea.

Q: Okay. But it would be safe to say that you—go ahead. Go ahead.

**Alex Shen – Chief Executive Officer**

I would like to reassure all our listeners and our shareholders that I am fully capable of executing properly, whether the revenue goes down or goes up we will be able to flex ourselves to appropriately manage resources against demand. I will also point out the \$100 million opportunity that has not decreased looking forward, that is not equal to revenue. That's opportunity, just so we're all clear.

Q: Okay. Thank you for that. One other thing I wanted to mention, and I'll get back in the queue if other people have questions. There's been a lot of M&A activity in the defense industry as of late. Graham Corporation on their Q3 call late January noted that it's almost like an option type environment out there and that paying anything like 10 times forward EBITDA is impossible unless the business is broken. That was an exact quote from them.

They said that they're seeing people paying 15 times forward EBITDA which is basically about where your stock sits right now. Actually, I mean 15 times is on the trailing, not on the forward. So just wondered are you seeing this interest out there of people kicking the tires, interest in acquiring you guys?

**Alex Shen – Chief Executive Officer**

Tom?

**Tom Sammons – Chief Financial Officer**

I don't think that's a question we can really answer at this point.

Q: Okay. I'll go back in the queue. Thank you.

**Alex Shen – Chief Executive Officer**

Thank you.

**Operator**

[Operator instructions]. We'll move next to Ross Taylor with ARS Investment Partners. Please go ahead.

Q: Thank you. Thank you. Alex, has backlog grown since 12/31?

**Alex Shen – Chief Executive Officer**

I want to say yes.

Q: Okay. You can say yes, Alex. Okay. So, we'll take that as a yes and now we'll move to the next question. I'm not really used to the phrase cost overruns in any organization you're associated with. So, can you give us a little bit of background on what the technological hurdles and the like were?

You said these were new projects away from the prior one. Looking at the total on the last two quarters, do you expect that when all is said and done that you will win back business and more than make up the hit to the P&L side that's occurred because of the learning curve in these two efforts or these multiple efforts?

**Alex Shen – Chief Executive Officer**

So, the cost overruns were learning curve related. In the two quarters they were coming from a different set of part numbers than previous quarter. That is what I was trying to make sure that we all understood. It wasn't just continuous cost overruns on the same part number. That's not the case. It's a different set of part numbers that's causing the—that has more learning curve related cost overruns.

So, there's always the—we've never built it before. We make our best estimates possible to understand and get our arms around how much the cost is going to be. We run into unexpected areas of difficulty and that's what these are representing, two different sets of part numbers in the different quarters. Will I be able to make it back up moving forward? I fully expect myself to.

**Q:** Okay. And then you also then just addressed my next question which was these are new parts that you haven't made before. So, this would be new business on either Virginia Block V that you did not have on Block 4 or on carriers.

**Alex Shen – Chief Executive Officer**

Virginia Block V—Virginia period that I didn't have before or Columbia Class that I didn't have before or carriers. Yes, the three classes of boats, yes.

**Q:** Okay. With debt to cash—

**Alex Shen – Chief Executive Officer**

So that's really exciting. That's really pretty exciting because it really is an opportunity to demonstrate that we know how to do this very difficult work. Unfortunately, we ran into—haven't built this before and there were difficulties which caused to over [overlapping voices].

**Q:** But the key in the end is you did build it. When all was said and done you were able to successfully build it and you now have an understanding of how to build it going forward. Correct?

**Alex Shen – Chief Executive Officer**

Yes.

**Tom Sammons – Chief Financial Officer**

Correct. It was done well.

**Q:** Thank you. Yes.

**Alex Shen – Chief Executive Officer**

And for our CFO to actually say something like that is probably a key. He's usually pretty critical of me, you know.

**Q:** Well I appreciate his help. So, looking forward, the way you're setting this out, we're still seeing the \$100 million+, seeing these projects. You're beginning to see as you talked about Columbia Class, we're seeing Virginia Block V starting to come to fruition. You know, it's been a long time waiting. I think people have gotten very frustrated at the Virginia Block V in particular is running well-behind previous expectations of when the boats would be on the waves and under construction. Looking at all of that, it would seem that we're about to kind of roll into a cusp where we're going to start generating some pretty significant free cash flow going forward. Have you and the board discussed how you anticipate using or returning that free cash flow as you generate it to shareholders?

**Tom Sammons – Chief Financial Officer**

No, we have not. We continue to use some of the cash to pay down our debt.

**Q:** Right, but with debt where it is, quite honestly given previous comments made by a board representative on a call about the place for companies of TPCS's size in the public marketplace, it would strike me as there's a level of debt you don't want to go below because it becomes a suboptimal utilization of resources, particularly when debt is a one multiple or a minus one multiple to valuation for a company and the number of shares is a multiple of that. So, it would make sense at some point and we'd begin to return cash either through dividends or aggressive share buybacks as cash is generated because the value here is on these programs.

I think the Graham call, which was referenced earlier, they talked about this being a decades' long opportunity which is why valuations are so high in the space and why there's a bit of a feeding frenzy potentially occurring in the space. We would suggest that as you develop that free cash flow it'd be recurring to shareholders through buybacks.

Away from that, I want to get the idea and the feel. There's a lot of talk, recently the commander of the second fleet in a speech said that the Atlantic fleet needed to understand that it would be in contested waters the minute it left port because of the significant increase in Soviet submarine activity and the vastly improved quality of their boats.

It was recently highlighted in several defense publications that the US spent 10 days trying to find the most modern Soviet submarine in the North Atlantic and did not find it in those 10 days. That would strike me as a really compelling argument for significantly increasing the capabilities of our submarines, and the Block V does just that. Have you seen anything out there to indicate that there will be any slowing to the increase and to the build out for the Virginia Block V boats?

**Alex Shen – Chief Executive Officer**

I can only direct you to what's available in the public sector. You know, there's all kinds of stuff out there, I guess.

**Q:** Yes. I was actually saying I was shocked when I heard the comments by the commander of the second fleet, because I think it's been since the 40s early days of the Second World War that a US Naval Commander has indicated that ships needed to be prepared to be engaged the minute they left harbor.

Looking at all of this, it strikes me as you guys haven't said that you're excited. Are you more excited today than you were three months ago, Alex, when we last spoke?

**Alex Shen – Chief Executive Officer**

Am I more excited? I think my excitement was pretty high last time we spoke. I don't know how it can get higher. It's at the same high level. Seriously, the opportunity to demonstrate our excellence is going well. So, I'm able to maintain the high level of excitement.

**Q:** But you're seeing is that—I would assume that Ranor is—

**Alex Shen – Chief Executive Officer**

Ross, I'm not trying to downplay the fact that we had cost overruns, that we had negative margins, we had loss provisions and we lost money. I'm not trying to downplay that, but I am very excited to be able to maintain my level of excitement because these opportunities are real.

**Q:** Yes. And, Alex, quite honestly as your largest shareholder, I don't really care if you lose \$300,000 if it lets you make millions down the road. I think to me it's the price of getting into the game. You're building complex

systems. You're doing it with incredibly low level—the tolerances are exceptionally fine and it's not a business that I expect you guys to be able to—you know, this isn't pounding out widgets. It's not making cornflakes. It's making components to go in the vessels which quite literally live in the most exceptionally hostile environment in the world. So you know, the fact that you can get these things, you can learn, you can contain the losses and turn those into future revenue streams where you could make profits on them is a tradeoff that I'm willing to make as an investor.

Yes, and looking at all of that, it strikes that, as you say, that you are excited with the opportunities you see in front of you. We are in a space where it seems that we should be starting to see the fruition come to fruition all these things that you've been working on for the last couple of years. Is that an assumption I'd be safe in making?

**Alex Shen – Chief Executive Officer**

Yes. It's just this clunky timing is so hard to predict. Yes, it should be getting closer and closer. Absolutely. That's what—

**Q:** Okay. And I'm going to ask one last question before I pass on to others which is, it's very hard to determine what capacity is in your space. A question was asked earlier about human resources. But from everything I've been able to pick up, I believe—and I don't expect you to answer this in a specifically affirmative fashion—but what level of capacity are you at versus these potential businesses? When you're looking at \$100 million over two years, I would assume that you could produce some portion of that potential business with the resources, the facilities and the like that you currently have on-hand. Is that correct? And is that half of that? Is it two-thirds of it? Is it all of it?

**Alex Shen – Chief Executive Officer**

I can produce some of it. Yes, that's correct. How to categorize it any further would really—well first of all, it depends on what it is.

**Q:** Right.

**Alex Shen – Chief Executive Officer**

Because one type of part number uses a different set of resources than another type of part number. So, I think that part of it is highly dependent on the situation, on the part number and the characteristics of the part number. But yes, we can handle some of the uptake as is.

**Q:** Would it be safe to say do you see yourself being able to handle your expected uptake over the next 12 months? Do you need to do anything? If you get what business you think you're going to get—and I'm not asking you what that amount is because I know you won't answer it, but we have an idea of what it could be from what your projections are—if you get that business, can you handle that business without significant additional either capital expenditure or the need to bring in significant additional people?

**Alex Shen – Chief Executive Officer**

I'll have to do a combination of things. I think is the correct answer. The most direct answer is—so the stuff that I'm looking at, some of it requires some investment and some of it doesn't. So, it really depends on the releases how they actually come out. The capex addition and manpower addition and headcount addition will not be zero that's going to be needed. When it happens is highly dependent on the part numbers and the characteristics of those parts.

**Q:** Okay.

**Alex Shen – Chief Executive Officer**

I think I'm answering the question.

**Q:** Yes. It's an awkward question because, as I say, you're not pounding out widgets. You're looking at different things use different resources, take up different amounts of floor space and take up different human resources and the like. So, I understand it's a very complicated question, but trying to get the idea of—my assumption is that you are operating with excess capacity at this point in time which has probably been dampening somewhat the profitability of the company.

Going forward, you will be able to fully utilize that capacity you have in-house which should improve margins as we go forward. Then as you do that, you're going to need to bring in additional resources. I would assume that a lot of what you expect to get you have the capital equipment needed to that. You invested a fair amount of money in capital equipment in recent years, correct?

**Alex Shen – Chief Executive Officer**

We've invested in capital equipment in recent years, yes. Will we be investing some more? It's highly probable, yes.

**Q:** Yes. But you invest more as you win business.

**Alex Shen – Chief Executive Officer**

More or less, yes. It's hard to get it across the CFO's desk otherwise. He is kind of parsimonious here.

**Q:** Yes. Well that's his role in life. Okay. I will pass it back to others and perhaps come back in. Thank you.

**Alex Shen – Chief Executive Officer**

Thank you very much, Ross.

**Operator**

Next, we'll move to John Hardison [ph], a private investor. Please go ahead.

**Q:** Hello, guys. How are you doing?

**Alex Shen – Chief Executive Officer**

Good. How are you, John?

**Q:** I'm good. From public information that we know in the past a prime navy contractor had welding problems on missile tubes about a year-and-a-half ago, and I know you guys have not had welding issues. So, I would think that the navy and Electric Boat probably put a lengthy hold on all missile to welding work until they could add appropriate quality control procedures. So, I'd also think this work is now getting cleared to go ahead and that it'll dramatically increase your workflow of going forward. So, Alex, can you give us any additional color on that?

**Alex Shen – Chief Executive Officer**

That's a pretty specific question, John. Thank you very much. The problems that have been encountered outside of Ranor, our subsidiary, Ranor doesn't have that same—Ranor doesn't have the problems that were encountered. So, we are problem-free in the offending areas. So, I think to answer your question properly is that as demand gets released again, we are in a position to secure some of those orders.

**Q:** Thank you very much.

**Alex Shen – Chief Executive Officer**

There's more opportunity than less.

**Q:** Did it slow it down, though?

**Alex Shen – Chief Executive Officer**

More or less, yes.

**Q:** Okay. Thanks, Alex. I'll pass the call along.

**Alex Shen – Chief Executive Officer**

Thank you.

**Operator**

That does conclude our question and answer session for today. I'll turn it back over to management for any closing remarks.

**Alex Shen – Chief Executive Officer**

Thank you, everyone, for your attendance. Have a great day.

**Operator**

That does conclude today's teleconference. We thank you for your participation. You may disconnect your lines at this time and have a great day.