Operator

Welcome to the PCTEL second quarter Earnings Release Conference Call. At this time, all participants are in a listen-only mode. At the conclusion of our prepared remarks, we will conduct a question-and-answer session. As a reminder, this conference is being recorded.

I will now turn the call over to John Schoen, the Company's CFO.

John Schoen

Thank you for joining us on today's conference call to discuss PCTEL's second quarter financial results. With me today is David Neumann, the Company's CEO.

Before we begin, let me remind you that this call may contain forward-looking statements. While these forwarding-looking statements reflect PCTEL's best current judgment, they are subject to risks and uncertainties that could cause actual results to differ materially from these forward-looking projections. Risk factors that could cause PCTEL's actual results to materially differ from its projections are discussed in the earnings release which was issued today and in our most recent annual report on Form 10-K, both of which are available on our website.

Additionally, our commentary will include reference to the following non-GAAP measures: non-GAAP EPS; adjusted EBITDA, and free cash flow. We believe these non-GAAP measures facilitate comparability of results over different periods. A full reconciliation of these non-GAAP measures to our GAAP basis measures is included in our quarter earnings press release that was issued earlier today.

With that, it's now my pleasure to turn the call over to David Neumann.

David Neumann

Good afternoon and welcome to our call. I will make a few comments about our business, then John will discuss our financial results.

In our last earnings call, we mentioned revenue risk related to wireless operators reducing their spending on legacy systems in preparation for the capital expenditures required for 5G deployments. This reduction in capital expenditures impacted our test and measurement business in North America. As a result, RF Solutions revenue was down 22% in the half. This reduction in capital expenditures, together with the uneven nature of the Connected Solution segment's project-driven demand, created revenue and earnings challenges in the quarter. Revenue was up incrementally in Connected Solutions for the half but did not meet our expectations. We believe the weakness in test and measurement for the RF Solutions segment and the slowdown in deployment of macro small cells for the Connected Solutions segment will negatively affect our business for the remainder of 2018. John will provide updated guidance later.

In RFS, we remain confident in the long-term opportunities to provide 5G test and measurement equipment to wireless operators as they begin deploying 5G infrastructure. In fact, we recently delivered our first HB*flex* scanning receivers to our major OEMs for integration into their drive test systems. HB*flex* scanning receivers are used for legacy and 5G measurements in the sub 6GHz and millimeter wave bands. The HB*flex* scanning receiver will be commercially available this quarter.

To support gigabit LTE speeds in 4G, operators in the US and Southeast Asia are deploying License Assisted Access, or LAA. LAA is a mobile technology upgrade for LTE that increases capacity and speed by combining one or more data channels in the 5GHz unlicensed spectrum with LTE in a licensed band. Like our recently released Narrow Band IoT testing capabilities, LAA is a software upgrade for new or existing IB*flex* scanning receivers. This is another example of PCTEL protecting our customer's investment in our Software Defined Radio-based tools while capturing a higher margin revenue stream. We believe that scanning receivers are the ideal tool for benchmarking and troubleshooting legacy and 5G networks as the RF complexity increases across multiple technologies, applications and bands for licensed and unlicensed spectrum.

In Connected Solutions, enterprise Wi-Fi revenue grew in the second quarter driven by a large US Wi-Fi antenna project and deliveries for a Wi-Fi mesh network solution. Although 5G gets more attention in the press, it is important to note that that more than half of the Internet traffic is expected to be carried by Wi-Fi by 2021 using current and future “ac” and “ax” versions. PCTEL is actively developing antenna and radio solutions for this growing market, such as our recently released VenU 802.11ac panel antenna.

We believe small cell antenna deployments will begin to shift from outdoor macro sites to indoor throughout the remainder of the year. We started shipping embedded antennas for indoor small cells, which is significant given most wireless usage is indoors. We remain confident in the long-term global growth of small cells for indoor and 5G applications.

As many of you know, a majority of our 4G small cell antenna sales are made to large network equipment manufacturers throughout the world. Recently, one of our largest customers reduced their demand for small cell antennas for the remainder of the year. Our teams are working closely with the customer to determine the specifics of this reduction, but we have taken this reduction into account in lowering our guidance for 2018.

Approximately 10% of our annual antenna revenue is impacted by the recent 301 tariffs on certain imports from China, which apply to our GPS and multi-band antennas and a limited number of related components. We instituted price increases to offset the impact of the tariffs. We don’t foresee trade issues related to our deliveries in China, but there is a longer-term risk to revenue if China-based customers decide to source more from non-US manufacturers.

Although we are disappointed in our year-to-date results and reduced guidance for 2018, we are committed to technology leadership and returning PCTEL to acceptable revenue and margin levels. For example:

- Our investments to prepare for 5G, industrial IoT and next generation enterprise Wi-Fi are generating intellectual property for our performance-critical wireless solutions.
- We completed a restructuring of our human resources to align skillsets with the demands of our targeted vertical markets.
- We're de-emphasizing low margin kitting business and low volume antenna SKUs to improve the overall margin profile and efficiency of our operations.

We plan to return to positive cash flow generation and it is important to note that the Board is fully committed to maintaining the dividend.

John and I will be attending the Midwest IDEAS Investor conference on August 29, in Chicago. We look forward to meeting with investors at the conference. With that, I will now turn the call over to John Schoen for a closer look at our second quarter, as well as third quarter and annual 2018 guidance.

John.

John Schoen

Thanks, David.

I will be addressing the results from continuing operations for the second quarter and the first half of 2018, comparing them to the same periods last year. Revenue was $21.6 million in the quarter and $43.3 million in the half, unchanged in the quarter and down 3% in the half compared to last year. Gross profit margin was 36.1% in the quarter and 36.2% in the half, down 560 basis points in the quarter and 520 basis points in the half. Adjusted EBITDA margin as a percentage of revenue was 2% in the quarter and the half compared to 8% for the same periods last year. Non-GAAP EPS was break even in the quarter and a loss of $0.01 in the half compared to income of $0.05 in the quarter and $0.10 in the half last year.

Now I will review the results for each segment.

For the Connected Solutions segment, revenue was $17.5 million in the quarter and $35.2 million in the half, up 4% in the quarter and 3% in the half compared to last year. Gross profit margin was 29% in the quarter and the half, down 620 basis points in the quarter and 360 basis points in the half. The segment saw significant revenue growth in enterprise Wi-Fi applications in both the quarter and the half. However, those revenue gains were largely offset by pricing pressure we experienced in small cells, which also impacted gross profit margins.

For the RF Solutions segment, revenue was $4.1 million in the quarter and $8.1 million in the half, down 11% in the quarter and 22% in the half. Gross profit was 66.6% in the quarter and 66.7% in the half, down 250 basis points in quarter and 310 basis points in the half. As David discussed earlier, the North American market generated lower revenue. Gross margin was lower as a result of less leveraging of fixed costs on lower revenue.

Now let's turn to 2018 guidance. The Company is experiencing revenue pressure in both segments, as David discussed earlier. We believe this will continue for the remainder of 2018 for both segments, and into the first half of 2019 for test equipment. We expect third quarter revenue will be between $19 and $20 million, gross margin between 40% and 41%, and non-GAAP earnings per share of negative $0.06.

The Company is revising its annual 2018 revenue guidance to $82-$85 million, approximately $65-67 million for Connected Solutions and $17-18 million for RF Solutions. In response, the Company reduced its fixed manufacturing and operating costs in July through a reduction in force. The annualized cost savings is approximately $1.8 million. We do not expect these cost savings to impact 2018 because the $700,000 cost savings for the remainder of 2018 is about the same as the one-time costs associated with the reduction in force; however, the full effect of these cost savings will positively impact 2019. Giving effect to the new revenue guidance and the costs of the reduction in force, we anticipate the full year non-GAAP earnings will be between a loss of $0.04 to $0.07 per share.

Before we take questions, I would like to turn the call over to David to make a few closing remarks.

David Neumann

Thank you, John.

We believe the reduction in revenue and earnings are short-term issues and we remain fully committed to our long-term strategy to provide antennas, radios and test and measurement systems that solve complex RF problems. In addition to investing in performance critical solutions, we are improving our operations and focus to return PCTEL to our expected revenue and margin levels.

This is a team effort and I would like to thank our global PCTEL staff for their dedication, effort and contributions.

With that, John and I are available to answer questions.

Operator?