

THOMSON REUTERS STREETEVENTS

# EDITED TRANSCRIPT

IMN - Q1 2015 Imation Corp Earnings Call

EVENT DATE/TIME: MAY 06, 2015 / 2:00PM GMT



## CORPORATE PARTICIPANTS

**Scott Robinson** *Imation - VP, CFO*

**Mark Lucas** *Imation - President, CEO*

## CONFERENCE CALL PARTICIPANTS

**Eric Martinuzzi** *Lake Street Capital - Analyst*

**Mark Miller** *Benchmark Company - Analyst*

## PRESENTATION

### Operator

Good day. My name is Kayla, and I will be your conference operator today. At this time, I would like to welcome everyone to the Imation First Quarter Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator Instructions) Thank you. I would now like to turn the call over to Mr. Scott Robinson, CFO. Please go ahead sir.

---

### Scott Robinson - Imation - VP, CFO

Thank you, Kayla. Good morning, everyone, and thank you for joining us today for our first quarter 2015 earnings call. I am your host for today's call and I'm joined by Imation's CEO, Mark Lucas. We will review our first quarter results and progress on our strategic transformation.

Before that though, I'd like to remind everyone that certain information discussed on the call, that does not relate to historical information, may be deemed to constitute forward-looking statements within the meaning of the Private Securities Litigation Act of 1995.

Such statements are subject to risks and uncertainties that could cause results to differ materially from any projected results. Risks factors that could cause results to differ are outlined in the press release issued today, as well as our files with the SEC.

With that, I will turn the call over to Mark Lucas, Imation's CEO.

---

### Mark Lucas - Imation - President, CEO

Thank you, Scott, and good morning, everyone. Earlier today, we reported our first quarter results, which demonstrate that our efforts to transform Imation into a global leader in data storage and security is working.

We are confident the foundation we have laid for long-term profitable growth over our multi-year transformation process will continue to yield results, positioning Imation well for a successful future. It's important to highlight that we have made significant progress towards our goals of driving revenue growth in our storage and security businesses and delivering continued positive operating cash flow in our legacy optical and tape media businesses.

We saw another quarter of year-over-year growth and improving margins in our Storage & Security Solutions business; operating cash flow in our legacy optical tape and media business; reduction in operating expenses and investments in growth businesses. And our Consumer Storage & Accessories segment continued to produce strong cash. We have taken a number of meaningful strategic steps to reposition Imation for long-term growth and success. These steps were all part of a planned process that is showing encouraging results, and we continue to believe that we are on the right path to return to a long-term profitable growth.



Before I turn the call over to Scott, to go through the numbers in detail, I would like to provide an update on each of our businesses, starting with TSS, our Data Storage & Security business. This business achieved 17.5% year-over-year growth in sales while improving margins. This achievement reinforces our commitment to our multi-year strategy to return to being a pure-play data storage and security company. Our growth occurred globally, including increasing revenues from new partners in Europe, Middle East and Asia Pacific.

Our legacy media business continues to decline in line with expectations, and we are maintaining our market share. In addition, we introduced our Secure Data Movement Architecture or SDMA, which leverages our IronKey and Nexsan product portfolios to provide mid-sized organizations with a solution to safeguard their high value data files. SDMA is creating a unique value proposition that differentiates Imation from traditional data storage offerings and as we see positive feedback from industry analysts, reseller partners and end-user customers.

Since announcing SDMA in early March, we have trained our reseller partners, identified opportunities with strategic ecosystem providers, announced Imation Lock & Key for secure storage administration, and continued solicited marketing feedback on the architecture. A recent survey from Enterprise Strategy Group or ESG reported that information security initiatives are the top IT property for 2015. In fact ESG stated, "Imation is uniquely positioned to lead the way forward for the industry with its pedigree in storage and security, its Nexsan family of data storage solutions and its IronKey mobile security solutions."

In the last 12 months, we have increased our Nexsan reseller base by approximately 20%, adding 250 new reseller partners worldwide. We have also added approximately 800 new end-user customers for our Nexsan portfolio, and 200 new customers for IronKey Windows To Go solutions. These customers include five U.S. and international government agencies, 13 Fortune 100 companies, several large media and entertainment organizations, hospitals and hundreds of mid-size organizations.

We expanded our product offering both Nexsan and IronKey during the first quarter. The Nexsan NST2000 was announced in February, and is our entry-level solution targeted applications that require high-performance and scalable capacity. In addition, we announced SDMA and Imation Lock & Key. We also introduced the IronKey S1000, a secure USB 3.0 Flash Drive.

As we mentioned last quarter, we are focusing our efforts on key vertical markets, including media and entertainment. In the first quarter, we continued our momentum in the media and entertainment industry, winning several new strategic opportunities and post-production applications, including NBC Universal, who installed our Nexsan data storage solutions in their environment.

Now let me touch upon Imation's Consumer Storage & Accessories segment or CSA. As we have discussed throughout our strategic transformation, we continued to manage this secular decline in our legacy media businesses to generate meaningful cash flow. Our optical businesses performed as expected, and we continued to maintain our market share. As with our TSS business, we see an incredible proliferation of data at the consumer level. This drives the need for storage solutions.

We continue to carefully introduce new higher-margin and innovative LINK family of products, one of the industry's first products that provides both, additional storage and power for the ever-expanding smartphone and tablet markets. A great example is the debut earlier this year of our LINK Power Drive, our first mobile storage product that provides additional storage and power for iOS compatible devices. The new additions to our product portfolio have been well received, and this new family of product reflects our commitment to deliver innovative higher-margin products at retail.

While we execute our strategic plan, we also continue to work with our financial adviser, Houlihan Lokey, in aggressively exploring all available and actionable strategic alternatives to maximize shareholder value. I am pleased to report, there has been significant progress and interest to-date and we look forward to sharing the results and our recommendations with you in the coming weeks.

So to summarize, Imation is focused on delivering products and solutions that help enterprises and individuals store, protect and connect their digital content. As I stated earlier, we have made significant progress in our transformation. We are driving revenue growth in our storage and security businesses and delivering continued positive operating cash flow in our legacy optical tape and media businesses. The year-over-year growth in improving margins in our storage and security solutions business demonstrates that our plan is working.

We remain focused on maximizing operating cash flow in our legacy optical tape and media businesses, and judiciously investing in growth businesses to position Imation for a return to sustainable long-term growth.

Lastly, as you are likely aware, we have our Annual Meeting in a few weeks and there is an active proxy campaign. Our comments on today's call are focused on our results for the quarter, not the proxy campaign. Anyone on the call with question on the election of Directors should refer to our proxy materials or contact our proxy solicitor.

I'll now turn it over to Scott to take you through the numbers in greater detail. Scott?

---

**Scott Robinson - Imation - VP, CFO**

Thank you, Mark. Let me start by echoing that we are encouraged by the positive momentum in our storage and security portfolio. In Q1, it posted year-over-year revenue gains, as we expected it to, based on momentum that had begun last year. We positioned it as a significant growth business through strategic acquisitions, new products and expanded resources.

Total company revenue in Q1 of \$154.5 million, was down 13.1% from the same period last year, reflecting the decline in our legacy businesses that was partially offset by the rise in our growth businesses. As we have noted in the past, this stems from the fact that our legacy media businesses are in secular decline.

During the quarter, consumer storage media revenue declined 26.3% and commercial storage media declined 6.8%. Similar to what you've heard from other global companies, foreign currency exchange rates had a negative effect on our revenue. FX reduced overall revenue by 6.5% or \$11.7 million in the first quarter, compared to the same period last year.

Looking at revenue by segment. TSS came in at \$80.2 million in Q1 2015, an overall increase of 1.6% versus a year-ago quarter. Very importantly, we made significant progress in storage and security solutions. Here, revenues grew in total by 17.5% year-over-year and exceeded analysts' expectations. Commercial storage media also performed above expectations posting only a single-digit decline.

CSA segment revenues decreased 24.8% from the same quarter last year, due to the ongoing secular declines in optical media products that we have talked with you about before, as well as the impact of foreign currency exchange. As anticipated, our legacy consumer storage media was down 26.3% from last year, consistent with industry trends, as we have successfully maintained our optical market share. Within our mobile storage, our LINK product line, a growth area for us, continued to perform well.

Next, I'll move to gross margins. We are pleased that total gross margins for the first quarter were 21.9%, up 3.1 points from Q1 2014. This increase includes a reversal of \$2.8 million accrual for copyright levies stemming from a favorable court ruling in Germany. CSA margins increased to 23.7%, up from 19.3% in the same period last year, reflecting the levy benefit. Importantly, TSS segment margins rose by 1.9 points to 20.2% due primarily to higher margins in storage and security solutions.

One of the critical components of our strategy is to increase our gross margins, which we have been successfully executing on, as evidenced by our continued improvement over the last few years. As you know expense control continues to be a company wide priority. Since 2012, we have reduced our corporate and legacy costs by approximately 45% or \$103 million. SG&A totaled \$41 million for the quarter, down year-over-year and sequentially.

Research and development costs came in at \$4.8 million, up \$500,000 from the same period last year, as we made careful and key investments in differentiated, higher margin products in our secure and scalable storage portfolio, while we are significantly reducing R&D expenses in connection with our legacy media products.

We continued aggressive efforts to monetize non-core assets, in a manner that ultimately enhances shareholder value. Imation's corporate headquarters' real estate is for sale. Also we are pleased to report that we have a prior manufacturing site currently under contract to be sold.

Further, we have just recently monetized a group of non-core magnetic tape patents for \$500,000. More on all of these to come as we continue to actively pursue our non-core asset monetization efforts.

Total special charges in Q1 were \$1.2 million, down \$900,000 from \$2.1 million in the same period last year. This quarter's charges were primarily related to severance. The overall operating loss in Q1 2015 from continuing operations was \$13 million, compared to last year's loss of \$16.1 million. Excluding the impact of special charges, adjusted operating loss would have been \$11.8 million in Q1 2015, compared to adjusted operating loss of \$14 million in Q1 2014.

Income tax expense was \$100,000 in Q1 2015, compared with no income tax expense in the same period last year. Discontinued operations had no effect in Q1 2015, compared with an after-tax loss of \$700,000 in Q1 2014.

Ultimately, we incurred a net loss of \$0.35 per diluted share from continuing operations in Q1 2015, compared to a loss of \$0.41 per diluted share in the same period last year. Excluding the impact of special charges, adjusted loss per diluted share from continuing operations would have been \$0.32 in Q1 2015, compared with a loss per diluted share of \$0.36 in Q1 2014.

Moving onto the balance sheet. We continue to actively manage our legacy business to generate significant cash flows. A number of budgeted and planned factors contributed to the first quarter reduction in cash, but these are related to first quarter seasonality and will not be ongoing. These budgeted factors include increased inventory levels from year-end low, seasonal year-end payments related to customer incentives, employee variable compensation, as well as currency impacts. We ended the quarter at \$96.2 million in cash, which was down \$18.4 million from Q4 2014.

In summary, we are committed to completing Imation's strategic evolution into a pure-play global leader in data storage and security solutions. Our Q1 results show positive revenue gains in our higher margin storage and security solutions area. We are exercising ongoing expense control and generating cash flow from our legacy businesses. We will continue to invest in our growth drivers, at the same time, we explore all available strategic alternatives to maximize shareholder value.

Now, we would be happy to take your questions.

---

## QUESTIONS AND ANSWERS

### Operator

Thank you. (Operator Instructions) We'll pause for just a moment to compile the Q&A roster. Your first question is from the line of Eric Martinuzzi with Lake Street Capital.

---

### Eric Martinuzzi - Lake Street Capital - Analyst

I have a question. You just finished talking about the cash. That's probably one of the numbers that stood out to the negative this quarter I wasn't expecting that big of a drawdown. You mentioned four factors; the inventory, customer incentives, employee variable and FX. Just curious to know versus what we had a year ago, because I would imagine a lot of those are kind of similar timing year-in year-out. Do we get a reversal here on Q2 with any of those? Is there something special about why it was so dramatically down? Just that \$20 million decline in the net cash caught me off-guard.

---

### Scott Robinson - Imation - VP, CFO

Hi Eric, it's Scott. So the first quarter, as we noted, we had some seasonal payments that we make. It was a little bit larger this year than first quarter last year. We noted at the end of the call for the fourth quarter that our inventories were a little bit lower and that we had expected those to increase. We will expect going forward that we won't have these seasonal factors and therefore the impacts will be lessened.



**Eric Martinuzzi** - *Lake Street Capital - Analyst*

Okay. And then just shifting back to the revenue line here. I was surprised to see audio and accessories down year-on-year. I know it's a relatively small as far as your revenue sub-segments go, it's a small contributor, but it had been a nice little growth part of the business. Why was that down year-on-year?

---

**Mark Lucas** - *Imation - President, CEO*

Good morning, Eric, it's Mark. There are two primary reasons. The biggest one is the impact of foreign exchange. About two-thirds of the consumer business is done outside the United States, and so that impacted it tremendously. The other thing is, in the United States, the retailers ended the year with some heavy inventories. So our inventory was low. Their inventory was high. And that's affected the sell-through of our business in the first quarter.

---

**Eric Martinuzzi** - *Lake Street Capital - Analyst*

Okay. Do you expect that to be a growth business for 2015?

---

**Mark Lucas** - *Imation - President, CEO*

We do. It is -- we continued to make inroads, especially with our LINK Power Drive. We've had two major production runs of it, both have sold out immediately. We have just learned that we've got distribution in a large Japanese telecom retailer called Docomo, who want an awful lot of the product. Additionally, the Bluetooth wireless audio products are performing extremely well. I will remind you though that it's not a strategic business for us. It's important business to us, but it's not strategic. It's not part of our overall data storage strategy.

---

**Eric Martinuzzi** - *Lake Street Capital - Analyst*

Yes. And then shifting over to the TSS side. Commercial storage media was an outperformer. As much as -- I know you guys have highlighted your S&S, storage and security side. Commercial storage media was actually a bigger revenue beat versus my own projections there. It only declined, I think 7% or so year-on-year. What's going on there? Is this a one quarter anomaly inventory reload, or is there a potential lessening of the contractions we've been experiencing historically?

---

**Mark Lucas** - *Imation - President, CEO*

It was the results of a particularly strong quarter for both Oracle and IBM brands within our portfolio. I don't think it's a trend that's going to continue long-term. It was a bit of an anomaly. We may see the declined rates lessening some over the months to come. But at this point in time, it's premature to make that prediction.

---

**Eric Martinuzzi** - *Lake Street Capital - Analyst*

Okay. And then storage and security, the \$32 million, obviously up nicely versus a year ago. Was that 17%, 18% I think you guys said?

---

**Scott Robinson** - *Imation - VP, CFO*

Correct.

**Eric Martinuzzi** - *Lake Street Capital - Analyst*

Yes, that -- here again kind of the same question. This is obviously where you guys have been focusing a lot of the attention, whether it's on the development side, whether it's on sales, marketing, distribution. Here also -- Nexsan, you've got the brand out there. You've got the net new channel relationships. Is this something that's sustained? Can we talk about storage and security as a growth business on an annual basis?

---

**Mark Lucas** - *Imation - President, CEO*

Absolutely. This will be the second quarter in a row year-over-year growth in these businesses. Our pipeline has grown. It's extremely strong right now. We are selling more Assureon and NST products at higher margins, so the mix is moving in the right direction. And with IronKey, we are getting more and more Fortune 500 companies, global brand name companies that are moving to Windows To Go and they're just simply waiting for Windows 10 to be launched to launch themselves. And I will talk -- this includes major financial institutions, major commercial enterprises, as well as governments. We mentioned earlier this year that we won an award with the Japanese Ministry of Defense, with the U.K. Department of Health, with Department of Homeland Security and the list goes on. So there is a lot of momentum and pipeline building here. So we are very bullish on the future.

---

**Eric Martinuzzi** - *Lake Street Capital - Analyst*

Okay. Last question for me drops down to the gross margin line. Can you reeducate me on the levy accrual here, because I know I've been through it before, maybe a year or year and a half ago. But is this kind of a -- you've got the legal right to do this, so you take this levy accrual and it boosts gross margins in the quarter that it happens. Is that what happened here?

---

**Scott Robinson** - *Imation - VP, CFO*

Eric, this is Scott. So we have currently, at the end of the first quarter \$6 million of levies accrued on the books. At the end of the last year, we had \$9 million. So we reversed \$2.8 million. And those are accruals that based on court cases. In this quarter, it was Germany where we're not going to have to pay the amounts, and therefore our confidence was high enough in order to release the accruals. So it impacts gross margin in a positive way.

---

**Eric Martinuzzi** - *Lake Street Capital - Analyst*

Okay. Is there any cash impact here?

---

**Scott Robinson** - *Imation - VP, CFO*

No. I mean, it's a liability that we won't have to pay. So it will benefit future cash from operations, but it's not cash impact.

---

**Eric Martinuzzi** - *Lake Street Capital - Analyst*

Okay. Thanks for taking my questions.

---

**Scott Robinson** - *Imation - VP, CFO*

Thanks Eric.

---



**Mark Lucas** - *Imation - President, CEO*

Thanks Eric.

---

**Operator**

Thank you. (Operator Instructions) Your next question comes from the line of Mark Miller with Benchmark Company.

---

**Mark Miller** - *Benchmark Company - Analyst*

Good morning.

---

**Mark Lucas** - *Imation - President, CEO*

Good morning, Mark.

---

**Mark Miller** - *Benchmark Company - Analyst*

I was just wondering, several firms have reported enormously weak results in Europe, including a couple major data storage firms, and I know the euro of course played havoc. But factoring out the weakness of the euro, what the -- how did Europe look to you and how is looking? Is it improving? Just concern, I guess, because we saw a couple of data storage firms really report significantly lower results in Europe, even adjusted for the exchange effects?

---

**Mark Lucas** - *Imation - President, CEO*

Mark, this is Mark. We actually saw good growth in Europe and the Middle East as well. And that's even counting in the foreign exchange issue. However I would say this, is that, that's being one of our focal areas. We've added people. We've added emphasis into that area, new talent. We expect to grow even in downmarket in Europe, and we are succeeding in doing that. So we had a relatively strong quarter in Europe across all TSS products.

---

**Mark Miller** - *Benchmark Company - Analyst*

What's your sense about this quarter? Are things going well this quarter so far?

---

**Mark Lucas** - *Imation - President, CEO*

Yes. Things -- the pipeline continues to grow. We track our pipeline religiously on a daily basis. We track where we are within the sale process, where we are towards close, what the success rate is. And our pipeline in Europe, in Middle East, in Asia, and actually United States as well are all up significantly over year ago and we are feeling bullish.

---

**Mark Miller** - *Benchmark Company - Analyst*

Thank you.

---



**Operator**

Thank you. Ladies and gentlemen, that does conclude today's call. You may now disconnect.

**DISCLAIMER**

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2015, Thomson Reuters. All Rights Reserved.