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IMN - Q4 2014 Imation Corp Earnings Call

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PRESENTATION

Operator

Good morning, my name is Rhonda and I will be your conference Operator today. At this time, I will like to welcome everyone to the Imation Corporation Fourth Quarter Earnings Release 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 like to turn the call over to Mr. Scott Robinson. Please go ahead, sir.

Scott Robinson - Imation Corporation - CFO

Thank you, Rhonda. Good morning everyone and thank you for joining us today for our fourth quarter 2014 earnings call. I am your host for today's call and am joined by Imation CEO, Mark Lucas.

We will read our fourth 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 Security Litigation Act of 1995

Such statements are subject to risks and uncertainties that could cause results to differ materially from any projected results. Risk factors that could cause results to differ are outlined in the Press Release issued today as well as our filings with the SEC.

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

Mark Lucas - Imation Corporation - President, CEO

Thank you Scott and good morning, everyone. Earlier today we reported fourth quarter and full year 2014 results which reflect the continued critical strategic investments in our business that will facilitate year-over-year revenue growth.

Today, we also provided an update on our transformation initiatives to position the company as a global leader in high security data storage and data security and device management which is where I will start today's comments.

Currently, Imation is focused on delivering products and solutions that help enterprises and individuals store, protect, and connect their digital content. During our strategic transformation, we have worked extensively with financial advisors to examine a variety of options available to us and have had numerous discussions with third parties.



We are currently working with Houlihan Lokey to review and explore certain strategic options to unlock embedded value within our Consumer Storage and Accessories business unit or CSA and our Tiered Storage and Security Solutions business or TSS.

The board is focused on maximizing value for shareholders. Imation's strategic transformation has been a multiyear dedicated process that has included critical acquisitions to strength our stored solutions and security offerings.

It's included a major restructuring and aggressive downsizing that created two distinct business units; a consumer centric unit and a commercial storage centric unit plus the divestiture of certain underperforming and noncore businesses.

During this time, the company has continued to generate and maintain a strong cash position which has provided the financial flexibility necessary to conduct this comprehensive review with strategic alternatives from a position of strength.

We believe that giving each business greater autonomy and control over its future will allow each team to focus on its own growth and product development and will maximize the value of each business unit and thus shareholders.

In 2014, we made significant progress towards our goal of driving revenue growth in our storage and security business and importantly, delivering continued positive and material operating cash flow in our legacy optical tape and media businesses.

The combination of this cash flow and our significantly reduced cost structure and I ask you to note that we've taken out over \$100 million in costs and legacy business since 2012, has allowed us to focus on improving gross margins, invest in data store and data security solutions and introduce new secure and scalable storage products.

These efforts have positioned Imation for a return to sustainable growth. Scott will take you through the numbers on a quarter and full year basis but I'd like to note that during the fourth quarter, we continue to see positive sales momentum in our storage and security portfolio with both sequential and year-over-year growth in our Nexsan hybrid storage solutions and IronKey mobile security products.

We plan to continue to invest appropriately in our TSS business unit. The declines in our consumer storage business moderated during the year in our audio and accessories business is continuing to show sequential and year-over-year growth due to the continued success of the TDK TREK line and new consumer storage devices.

Company gross margin in the fourth quarter from continuing operations excluding special and nonrecurring items improved over the same quarter last year and companywide gross margins generally showed improvement throughout the year.

Let me talk more specifically about the progress in our TSS business where we continue to appropriately invest in a robust new product pipeline and broadening our customer base to drive revenue growth.

Progress in our Nexsan business continues. We successfully launched our NST 4000 in the fourth quarter as planned and our newest NST offering which is targeted at lower capacity environments is on schedule to launch in the first quarter of this year.

Also, the global rollout of Imation's Nexsan Assureon line which could eliminate or greatly reduce size, cost and complexity of securely archiving primary and infrequently access data has been exceptionally well received.

In Q4 we continue to see demand growing for our storage solutions in a number of key industry verticals including media and entertainment, healthcare and video surveillance where customers are faced with managing an ever growing amount of data while simultaneously operating under constant budget pressure.

We believe this will drive demand for our combined E-Series and NST portfolios for high performance back-up solutions and the Assureon line for high value data archive solutions.

For example, in a media and entertainment industry, we want several strategic opportunities and post-production applications and develop partnerships with M&E solutions providers. Motion Picture Company which is a Technicolor company installed our solutions in their post-production environment.

At the same time NASCAR, a leading racing organization, implemented our Nexsan data storage solutions in their post-production workflows. One of our VAR partners, Chesapeake Systems, a premier media and entertainment solutions company leveraged our Nexsan storage solutions to accommodate the data growth resulting from new video production technologies for the NFL's Philadelphia Eagles.

The solution is the backbone of an in-game video package and other multimedia content the team produces to engage and inform its fans. We've also recently completed operations and performance testing with Bright Technologies which is another media and entertainment solutions developer and we have seen impressive results from the combined solution.

We're also working with Axle Video, a leading provider of Media Management Solutions to optimize our NST and E-Series portfolios and broaden our presence in the mid-size entertainment market.

We also continue to make progress in our mobile security group with additional Fortune 500 customers certifying our PC-On-A-Stick devices using Microsoft Windows To Go. We are excited about Microsoft's expected release of Windows 10 later this year as we believe its strong enterprise focus will drive our PC-On-A-Stick revenues.

We'll be announcing solutions that leverage flash USB 3.0 later this month. We anticipate that the majority of our near term revenue will come from our USB 2.0 products and we'll see the USB 3.0 business as incremental while providing the significant performance and enhancements of this technology and new devices.

For example, our Windows To Go platform will offer twice the speed of other flash USB 3.0 devices. Now let me touch upon Imation's Consumer Storage and Accessory segment or CSA. Our optical business performed as expected generating cash while maintaining market share.

Our audio and headphones business grew 17% in Q4 given by audio in the Americas region and headphones in the Asia-Pacific region with several new products on the shelves during the holiday shopping season.

We introduced the LINK power drive, one of the industry's first products that provides both additional storage and power for Apple IOS compatible devices. LINK power drive is available in both 16, 32, and 64 gigabyte capacities and is being sold by Amazon and many of our other global retail partners.

This new family of products reflects our commitment to deliver innovative, higher margin products at retail. As I conclude my comments, let me summarize. Fourth quarter came in as expected with legacy businesses generating positive cash flow in our storage and security portfolio returning to year-over-year growth.

As we progress in 2015, you'll see a number of feature upgrades launched in our storage and security solution business that are focused on expanding our efforts to address the market need for optimize and secure ways of managing sensitive data assets.

We continue to be very focused on cash generation in our legacy media businesses and remain confident that the current momentum in our storage and security solutions portfolio will continue.

Additionally, several new storage products will be launched at retail as our CSA business unit continues to lessen its dependence on optical media. I will now turn it over to Scott to take you through the numbers in greater detail. Scott?



Scott Robinson - *Imation Corporation - CFO*

Thank you, Mark. Overall, as Mark noted, we are encouraged by the positive momentum we continue to see in our storage and security portfolio. We posted both sequential and year-over-year revenue growth in our INT product line and our Nexsan hybrid storage solutions.

Our Consumer Storage and Accessories business again generated a positive cash flow and we have growth drives within our CSA segment with the TREK audio and accessories product line. Total company revenue in Q4 was \$197 million which was down 15.4% from the same period last year.

As we have noted in the past, this stems from the fact that our legacy media businesses are on secular decline. We are working hard to build revenues in our differentiated storage and security business and as some of you are hearing from other companies, foreign currency exchange rates had a negative impact on our revenue.

It reduced revenue overall by 4% in the quarter compared to Q4 2013. Looking at revenue by segment, TSS came in at \$90.6 million in Q4 2014, a decrease of 10.7% compared to the same period last year reflecting the impact of revenue declines and commercial storage media.

However, as I mentioned, this is partially offset by positive sales gains in our storage and security portfolio. Our Q4 2014 CSA segment revenues were \$106.4 million and decreased 19% from the same quarter last year.

This is due largely to our legacy optical business. Consumer storage media was down 23.4% from last year but this was partially offset by a 17.4% rise in revenues for our audio and accessory category.

The TREK product line of wireless speakers and audio accessories made strong contributions to the segment. This is a differentiated product group and has shown consistent growth over the past several quarters.

Next, I'll move to gross margins. Total gross margin for the fourth quarter up 20.1% were down compared to the prior year due to a one-time levy reversal of \$9.5 million that benefited margins by 4.1% in Q4 2013.

Excluding the impact of levy reversal, gross margins were up 50 basis points from Q4 last year. TSS segment margins versus Q4 last year increased by 70 basis points to 18.9%. Expense control continues to be a company-wide priority. Total SG&A was \$44.5 million for the quarter, up \$5 million from the same period last year.

This resulted from key investments in our storage and security portfolio which will ultimately accelerate our growth. Research and development costs came in a \$5.1 million, up from \$4.1 million in Q4 2013 and reflect Imation's targeted investments and priority TSS projects.

The operating expenses associated with our legacy businesses have decreased by over \$100 million in the last three years due to our [rigorous] cost reduction efforts. We have significantly reduced legacy SG&A as well as R&D expenses during our transformation.

As you likely are aware, we have our corporate headquarters real estate for sale. We recently had launched new marketing collateral which have generated interest among potential strategic and financial buyers.

We are currently moving through this process with a goal to sell the buildings as quickly as possible in a fiscally responsible manner. Total special charges in Q4 2014 were \$2.1 million compared to \$9.5 million of income in the same period last year.

Last year's income was primarily due to a \$9.8 million gain on the sales land and a previously closed facility. The charges are individually lifted in table six included in today's press release. The overall operating loss in Q4 2014 from continuing operations was \$12.1 million compared to last year's gain of \$21.1 million.

Excluding the impact of the special charges, adjusted operating loss would have been \$10 million in Q4 2014 compared to adjusted operating gain of \$11.6 million in Q4 2013. Last year's results also include the benefit of a levy reversal I previously mentioned which amounted to \$9.5 million.

Income tax expense was \$1.3 million in Q4 2014 compared to \$1.9 million in the same period last year. This continued operations were break even in Q4 2014 compared to the loss of \$2.5 million in the same period last year.

The prior year included the results of the sales of both XtremeMac and the Memorex consumer electronic business. Ultimately, we incurred a net loss of \$0.35 per diluted share in Q4 2014 compared to a gain of \$0.47 per diluted share last year.

Excluding the impact of special charges, adjusted losses per diluted share from continuing operations would have \$0.30 in Q4 2014 compared with a gain for diluted share from continuing operations of \$0.24 in Q4 2013.

Moving onto the balance sheet, it remains solid. Cash flow from operating activities was positive in Q4. We ended 2014 at \$114.6 million in cash which was up \$3.9 million during the quarter.

During 2014, the company repurchased 760,000 Imation common shares for a value of \$2.6 million and we are authorized to buy back up to 2.4 million additional shares. In summary, our Q4 results show positive cash flow from our legacy businesses.

We are encouraged by Imation's growth in our high potential storage and security portfolio and we continue to have a strong balance sheet and cash position. Looking ahead, we encourage our currency translation will continue to negatively impact our revenue comparisons.

We plan to continue to invest in our storage and security portfolio to support continued growth and we will maintain a relentless focus on the balance sheet and our cash position. Now, we would be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions).

Your first question comes from the line of Eric Martinuzzi from Lake Street Capital.

Eric Martinuzzi - Lake Street Capital Markets - Analyst

I'd like to talk about the strategic transformation that you've undergone here. Just as we think about the business and the four different segments obviously you're investing in the storage and security segment, is that to say then that there's nothing off the table for the other three lines of business?

Mark Lucas - Imation Corporation - President, CEO

Good morning, Eric, this is Mark. I would say we're going to absolutely explore all options here. You know, we've had very good efficiency within our consumer business. We have a wonderful global footprint there that's got tremendous strength.

We just introduced several new products. We're lessening our dependence on optical media although it's still generating positive cash for us. So I think there's lots of opportunities there and as well with our legacy tape business; continues to be a strong cash generation machine for us; opens Windows for us around the world.

We leverage our relationships across the other businesses so we're - we will leave no stone unturned.



Eric Martinuzzi - *Lake Street Capital Markets - Analyst*

Okay and if I - I guess that then would answer the next question because I was thinking, there's obviously - there's the real estate. There's the four different segments. There's the company in its entirety. Is all of that on the table?

Scott Robinson - *Imation Corporation - CFO*

Well, Eric, you know our focus here is to not sell the company in its entirety however. Obviously that is a potential ramification of this and so yes, we will consider everything.

Eric Martinuzzi - *Lake Street Capital Markets - Analyst*

Okay, as I look at the storage and security, some good success there in Q4; that's the part of the business that to me the enterprise side is obviously demand is a lot better there. As we look to you know we had a sequential growth.

We had a year-on-year growth. How do we think about that business in the coming year?

Scott Robinson - *Imation Corporation - CFO*

We expect those trends to continue, Eric. Obviously there's seasonality from quarter to quarter that changes things but overall, yes we expect those trends to continue.

Eric Martinuzzi - *Lake Street Capital Markets - Analyst*

Okay, and then within that 10% growth that we saw here in Q4 of 2014, as I recall I think the Nexsan business is about 2/3 or more of the business. What was it that drove the nice comp?

Mark Lucas - *Imation Corporation - President, CEO*

It was really across the board; the security business, Nexsan business, storage solution businesses. Everybody was up due to new product introductions, broadening base of customer transactions. It was - I wouldn't single out one particular area.

Eric Martinuzzi - *Lake Street Capital Markets - Analyst*

Okay, and then the profitability you're investing here I guess at but you know I did see maybe I was looking at a gap number but it looked to me like the actual margins were down for that business. Can you help us out there?

Mark Lucas - *Imation Corporation - President, CEO*

Yes, hand on a second. We're going to turn this over to Scott.

Scott Robinson - *Imation Corporation - CFO*

Sure, so if you look Eric on table three of our release, tiered storage and security solutions for the three months ended December 31, 2013 were 18.2%; three months ended December 31, 2014 were 18.9% so the margins were up just slightly.

Eric Martinuzzi - *Lake Street Capital Markets - Analyst*

Okay, maybe I was looking --

Scott Robinson - *Imation Corporation - CFO*

On table three.

Eric Martinuzzi - *Lake Street Capital Markets - Analyst*

Yes, I was thinking of the operating -

Mark Lucas - *Imation Corporation - President, CEO*

Yes, I mean while the margins in our growth businesses are continuing to improve, media is becoming more and more competitive and more challenged and you know media still represents the majority of our TSS volume.

Eric Martinuzzi - *Lake Street Capital Markets - Analyst*

Yes, let me rephrase the question. Within storage and security, how did margins trend if I look at it year on year?

Mark Lucas - *Imation Corporation - President, CEO*

Margins are trending up nicely.

Eric Martinuzzi - *Lake Street Capital Markets - Analyst*

OK and then lastly for me the you know there's obviously you're got a lot of balls in the air here but is there a - is there a desired outcome when this is all said and done, you know, it's six, it's nine months from now; what the company looks like?

Mark Lucas - *Imation Corporation - President, CEO*

As we've been saying Eric, this has been a multiyear transformation for us. This work that we're doing here was actually started many, many months ago as we're looking at different options for the company.

Our goal here is to unlock shareholder value and it's a little premature to predict exactly how that's going to structure itself going forward. That's why we're doing this analysis. I'm going to be reaching out to third parties as well.

You know we have worked with several investment bankers. We have worked with different consultants so this isn't something we've just started. To me it's part of the journey that we're going through and we will be diligent in this process and continue to look at getting shareholder value to its maximum state.

Eric Martinuzzi - *Lake Street Capital Markets - Analyst*

OK, thanks for taking my questions.

Mark Lucas - *Imation Corporation - President, CEO*

Sure, thank you.

Operator

(Operator Instructions).

Your next question comes from the line of Mark Miller with Noble Financial Capital Markets.

Mark Miller - *Noble Financial Capital Markets - Analyst*

Good morning,

Scott Robinson - *Imation Corporation - CFO*

Good morning, Mark.

Mark Miller - *Noble Financial Capital Markets - Analyst*

Good morning. I just was wondering if you could give us some color geographically were certain areas stronger than others.

Mark Lucas - *Imation Corporation - President, CEO*

Actually pleasantly this quarter once again we had pretty uniform growth around the world. Japan was particularly strong in the fourth quarter. Europe also had a good fourth quarter.

US surprised us to be honest with you. there was a little bit of a lull at retail going into Christmas time but between Christmas and New Year, retail picked up extremely strong in the United States.

Our mobile security business is working with large enterprise Fortune 500 customers so it's really an ongoing process within that's not at this point affected by the economy too much. The storage business seems pretty healthy.

Again we had good, good movement in Asia-Pacific, in the US, in Europe. Actually the Middle East is showing some significant growth signs as well so pretty uniform around the world.

Mark Miller - *Noble Financial Capital Markets - Analyst*

You mention you've been seeing positive momentum. Do you expect that to continue in Nexsan and R&T but there could be some seasonal effects. Will that momentum continue this quarter you think in those two units?

Mark Lucas - *Imation Corporation - President, CEO*

I think we're going to continue year over year growth. The absolute numbers in the first quarter are always smaller. It's just the seasonal nature and we'll have to see where that comes out but we continue to have - anticipate year-over-year growth.



Mark Miller - *Noble Financial Capital Markets - Analyst*

Taxes ticked up. Any possibility, any insight on tax rate for next year? As a percent, it ticked up.

Mark Lucas - *Imation Corporation - President, CEO*

Yes, Mark, this is Scott. You know I would expect our tax provision to be in the range that it was you know in the last few quarters. We have a full valuation allowance in the US and therefore we don't record a tax provision in the US such that the tax provision only relates to the income of our foreign location.

And that moves around a little bit based on the mix of that income in those countries. But I would expect that the tax provision would be in the range that it was this quarter.

Mark Miller - *Noble Financial Capital Markets - Analyst*

OK I was just curious also. Another think that ticked up even though sales were higher a year ago was SG&A. It was up by \$5 million on lower sales. I'm just wondering what went on there?

Mark Lucas - *Imation Corporation - President, CEO*

Yes, we have put some takes in there, Mark. So our legacy business is that we continue to take cost out of so SG&A and R&D and our legacy media businesses is down significantly.

But we have been investing both in R&D and SG&A in storage and security solutions portfolio. And so what you see here is a net increase in the expense budget because of that.

Mark Miller - *Noble Financial Capital Markets - Analyst*

Okay, I don't know if you can provide this but you have cash increase and you said you had positive cash iteration in your legacy businesses. What was the overall cash flow from operation.

Scott Robinson - *Imation Corporation - CFO*

\$3.9 million.

Mark Miller - *Noble Financial Capital Markets - Analyst*

Thank you.

Scott Robinson - *Imation Corporation - CFO*

Thanks, Mark.



Operator

At this time, there are no further questions.

Mark Lucas - *Imation Corporation - President, CEO*

Well, thank you all for your questions and participation on the call this morning. Let me reiterate that as part of our strategic transformation, Imation is continuing to appropriately invest in our growth businesses to put us on a path to become a significant player in high security data storage, mobile security device management, and other data storage areas.

Further, to enhance shareholder value, we have begun a process with an investment banker to explore options with our CSA and TSS business units. If and when we have an update on this process, we will inform you. Thank you very much.

Operator

Thank you, ladies and gentlemen, that does conclude the conference call for today. You may now disconnect.

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