NU HORIZONS ELECTRONICS CORP

Moderator: Richard Schuster
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3:15 p.m. CT

Operator: Good day and welcome to the Nu Horizons Third Quarter Fiscal Year 2007 conference call. Today's call is being recorded.

For the purposes of the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995, our statements today may include certain forward-looking statements that involve risks and uncertainties that could cause actual results to differ materially. Such statements are based upon, among other things, assumptions made with information currently available to the management, including management's own assessment of the Nu Horizons industry in competitive landscapes.

During the presentation, your line will be in a listen-only mode. At its conclusion, there will be a question-and-answer session. Instructions on how to signal for a question will be given at that time.

Now for opening remarks and introductions, I would like to turn the conference over to Mr. Richard Schuster, President and Chief Operating Officer of Nu Horizons Electronics Corporation. Please go ahead, sir.

Richard Schuster: Thank you. Good afternoon and welcome to Nu Horizons third quarter fiscal year 2007 conference call. I am Richard Schuster, President and Chief Operating Officer of Nu Horizons Electronics Corporation.

With me here today is Kurt Freudenberg, Chief Financial Officer. Also participating in the conference call from remote locations are Arthur Nadata, Chairman and CEO and David Bowers, President of Nu Horizons Distribution Division.

Kurt will give an overview of the financial results for the third quarter of fiscal 2007. I will give a brief market overview and synopsis of the industry, our company's performance, and then we will open the call to any questions you may have.

At this point, I would like to turn the call over to Kurt.

Kurt Freudenberg: Thank you, Richard. (Net) sales for the quarter ended November 30, 2006 were $186.1 million compared to $147.5 million for the comparable period a year ago, an increase of 26%. Our acquisition of DT Electronics generated $9.3 million of sales in the third quarter or 6% of the total Quarter 3 growth compared to the prior year. Net income for the quarter was $2.4 million or 13 cents per diluted share, as compared to a net income of $1.5 million or eight cents per diluted share for the third quarter of last year. Overall gross profit margin for the quarter ended November 30, 2006 was 15.6% as compared to 15.8% for the prior year quarter.

For the nine months into November 30, 2006, net sales increased to $567.3 million from $397.2 million in the comparable period last year, an increase of $170.2 million or 42.8%. Net income for the first nine months of this fiscal year was $9.0 million or 49 cents per diluted share, compared to net income of $2.8 million or 16 cents per diluted share in the prior year. Overall gross profit margin for the current nine-month period was 15.2% as compared to 16% for the comparable period last year.

For the third quarter, operating expenses as a percentage of sales showed improvement and decreased to 12.9% from 13.6% in the prior year. Operating expenses increased $3.9 million to $23.9 million for the three months ended November 30, 2006 compared to the same period one year ago, an increase of 19.7% included $1.1 million relating to our new acquisition, DT Electronics. For the nine months ended November 30, 2006, operating expenses as a percentage of sales also improved and decreased 12.1 percent from 14.3 percent in the prior year. Operating expenses for the current nine-month period ended November 30, 2006 increased $12.2 million compared to the year ago nine month period, an increase of 21.6%. Our balance sheet is strong. We have a current ratio of 4:30 to 1, our days sales outstanding are approximately 57 days, and we have over $80 million available financing on our bank credit lines at November 30, 2007. We have also reached preliminary agreement with the banks to increase our U.S. revolving credit facility from $100 million to $150 million.

Now I'll turn the call back over to Richard.

Richard Schuster: Thank you, Kurt.

While we showed solid revenue and financial improvements in Quarter 3 compared to the prior year, we were disappointed with the sequential trend from fiscal 2007 Quarter 2 to Quarter 3. There has been much industry discussion of late about a market slowdown in Asia-Pacific and the Americas, which begin in calendar Quarter 3 2006 and was expected to further negatively impact several industry leaders during calendar Quarter 4 2006. We observed both some positive and some negative trends in fiscal Quarter 3, and it's worthwhile to take a moment to visit both. I'll address four key components of our business.

1. The core Americas and Asia-Pacific semiconductor divisions of our Nu Horizons distribution business recorded revenue growth of more than 37% compared to the prior year third quarter and

over 4% compared to Quarter 2 fiscal 2007. Quarter 3 fiscal 2007 was the first quarter we began recording revenue and earnings of our newly-acquired entity in the U.K., DT Electronics. This acquisition is proceeding extremely well with strong supplier and customer support for Nu Horizons expansion in Europe. DT showed strong growth as well, and was accretive in Quarter 3. Giving effect to the acquisition, we saw a total semiconductor revenue growth rate of more than 47% over the same quarter one year ago and more than 11% from Quarter 2 2007. We believe that we once gained market share during the quarter. In addition, gross profit margins in our distribution business rose 60 basis points in Quarter 3 versus Quarter 2. Notwithstanding some short-term market softness in semiconductor sales, we remain quite bullish on this portion of our business. Our expansion of a little over one year ago is paying off. Our suppliers and customers are very supportive of our demand creation model and are also supportive of our global expansion. We continue to see line card expansion in Asia-Pacific, strengthening our offering there, demonstrated by our expanded engagements with major suppliers Linear Technology, Tundra Semiconductors, SMSC Corp, Cirrus Logic and Exar in Asia-Pacific during Quarter 3 fiscal 2007. During that period, we also announced a new relationship with OSRAM Optical Semiconductors in the Americas and with Xilinx in the United Kingdom. All of these relationships substantially strengthen our business and our available market. We expect to be able to continue to strengthen our partner base in Asia-Pacific, as well as Europe, while we seek to continue our European expansion. Finally, we are continuing to win and hold substantial new customer engagements.

2. Many of the gains in our semiconductor distribution business were offset in the systems division of our Distribution business. Our revenue declined due to the loss of business from three major customers for systems products. We believe that our remaining systems distribution business is stable and, due to adoption of new systems products from Sun Microsystems, we believe that the decline in our systems business has bottomed out. Nonetheless, we have begun an extensive review of our systems distribution business.

3. NIC's passive components business was basically flat year over year and down in sales from fiscal Quarter 2. The downturn was precipitated by lower-than-expected sales to several large customers in the consumer electronics sector and some inventory buildup at EMS customers. Bookings for fiscal Quarter 3, however, were positive, and we believe that several new product offerings show solid potential. Specifically, NIC's sales into the growing inductor market doubled from last fiscal year. This product line, along with several other NIC series, are targeting the growing power management field of applications. In addition, NIC has bolstered its circuit protection components portfolio with new higher technology products. We believe that NIC sales are improving and gross profit margins will remain stable.

4. Finally, our Titan business unit bore a short-term quarter-to-quarter revenue decline due to the temporary loss of one major customer. Due to the re-engagement of that customer, we expect that revenue and profit contribution from Titan will be back to recent prior levels in Quarter 4.

Although disappointed with our sequential results for fiscal Quarter 3, overall we remain extremely encouraged. Our year-to-year improvements in revenue and profitabilty are unprecedented in our industry. Nearly every investment we made, to take advantage of our industry consolidation, has generated positive returns for us. We cannot be completely immune from market forces and are concerned about the current general negative trends in the market, but we believe these trends will be relatively short-lived. We believe that the global market acceptance of our semiconductor distribution model is strong and sustaining and that our gains in market share for this business will continue as we demonstrate our leadership in technical sales, service and support to an increasing number of customers.

Thank you, and now we’re going to open the call up for any questions you may have.

Operator: Thank you. The question-and-answer session will be conducted electronically. If you would like to ask a question, please do so by pressing star one on your touch-tone telephone. If you are using a speakerphone, please make sure that your mute function is turned off to allow your signal to reach our equipment. Once again, that is star one to ask a question.

Our first question will come from Matt Sheerin with Thomas Weisel Partners.

Matt Sheerin: Yes, thank you. Just a few questions here. Starting with the systems business and the shortfalls that you had there, could you tell me what's left or what percentage of revenue makes up systems, and what's your strategy concerning that business going forward? It sounds like it's a lower-margin business, so have you thought about maybe just focusing on semis and components right now?

Arthur Nadata: Well Matt, this is Arthur. How're you doing?

Matt Sheerin: Hi Arthur.

Arthur Nadata: No, we are definitely committed to the systems business and our plan is to actually grow it. You know, part of the issue, which we mentioned in the script for three customers, one particular, quite large, customer was an end-of-life deal that we expected to run out over a period of time. And actually the customer took all the product at one time, and it ran out very quickly. And that kind of fell off the cliff. But in general, the two customers that have slowed down – I mean, we see them picking up again, and we see the business, you know, as definitely a strong growth area for us, and actually we're looking to expand it with a lot of other suppliers that complement this side of the systems business.

Matt Sheerin: OK, how big is that business now, approximately?

Arthur Nadata: It's about – for us, about – running about $75 to $85 million.

Matt Sheerin: OK. Thanks. And then on gross margin, which improves sequentially, you talked about the strength in the core semi business. Are you seeing that an increase in design wins and volume shipments are related to design wins and do you expect margin expansion to continue?

Arthur Nadata: Well, as we said on many calls, the more demand creation we do, the higher the margin, so the Sun business does bring – the systems business does bring our margin down substantially. And our demand-creation business as a percentage was higher last quarter. So we can continue to see the margin of being strong in the demand-creation side of the business – and actually last quarter was a very strong quarter for us as far as new customer engagement. We probably had one of the best quarters, bringing in and generating some very strong tier one customers into the company, and we look forward to them becoming a significant partner with us.

Matt Sheerin: OK. Great. And then the question on the interest expense which, essentially, doubled quarter to quarter, while inventories were, I think, down a little bit …

Arthur Nadata: Yes.

Matt Sheerin: Could you give us an idea of what we should expect for our interest expense going forward?

Kurt Freudenberg: I don't think that – this is Kurt. I don't think that the interest expense will be anything unusual going forward. It's following our normal growth pattern. There's nothing that sticks out.

Matt Sheerin: OK, but given that the – you're still growing faster than the market, but you are – the growth is slowing, so would you expect interest expense to sort of level out in a one to 1.3 million range or so?

Kurt Freudenberg: Should.

Matt Sheerin: OK. And then on just – on the expenses, which sounds like it was up only because of the DT Electronics acquisition, are you continuing to invest, Arthur, in Europe, and should we expect to see SG&A go up maybe faster than the rate of sales because of investments, or are you pretty much done there now and should start to see returns increasing?

Arthur Nadata: No, we're absolutely not done there. We are targeting Germany now. We plan on being in Germany by the beginning of April, depending on how things go. No announcement yet of we're going to get there, whether it's greenfield or through an acquisition. But we also see a lot of potential lines joining us immediately and, you know, helping us with some immediate revenue, which should offset some of the investment and expenses. But we are committed to open up and continue in Europe.

Matt Sheerin: OK, and then investments in Asia and the U.S., has that slowed then and you're just, you know, hoping to reap the benefits of all the investments that you've made?

Arthur Nadata: I would say in North America it's pretty solid. We still have a little bit going in Asia-Pacific. It's really minimal at this point. We may be opening in Vietnam and one or two other locations, but the investment should be quite small.

Matt Sheerin: OK. Thank you.

Arthur Nadata: You're welcome.

Operator: And once again, that is star one if you would like to ask a question. We'll go next to Rob Damron with Twenty First Century Research.

Rob Damron: Well hi guys. Wanted to ask you another question about this – the systems business. Is there any trend in the industry that more of this business is going direct? Are they seeing less value from the distribution channel? Could you just give us a little bit of a feel for, you know, what are the longer-term trends in that segment?

Arthur Nadata: I'll answer part of it now, but I'll let Dave kind of chime in. But I would say you've seen some of the larger distributors making some significant acquisitions into that space in the last couple of quarters. So I think that kind of speaks for itself. Alot of that business will continue to grow through distribution. It is a different business, a different sell, and certainly a different type of investment, but it's a growth area and it's something that we're definitely committed to.

Dave, you want to add to that?

David Bowers: Just generally speaking, with Sun and with some of the other major systems vendors, we have seen a bit of a trend on their largest customers to attempt to service that business direct, but in terms of overall trend, moving towards direct, no not really. Many of the acquisitions we've seen are in the value-add area of large resellers, etc., and we do intend to step up investment in integration in order to help us some on the margins side.

Rob Damron: OK. And then I also wanted to ask about a question about the overall market conditions. Certainly, it does appear that there's been some weakness in the market. Maybe you could drill down for us a little bit more and let us know where you've seen most of that weakness, and is there some expectation that maybe the market gets better over the next quarter or so?

Arthur Nadata: Dave, you want me to take that? Are you …

David Bowers: No, I'll take it – thanks. So, the softness really started in earnest in September, October in terms of booking rates. We ran, by the way, for last quarter as little bit less than one-to-one books bill on semiconductors, not substantially, but there was decrease in bookings.

We've seen, to be honest, activity pick up a bit on a daily basis since the first of the year, although it's very, very early. And, in talking with our suppliers, we're not surprised to see the pre-announcements that we've seen over the past couple weeks and wouldn't be surprised if there aren't a couple more. And then general expectation is that it's not continuing to get softer from where we are now.

From an industry standpoint, communications with probably the biggest culprit. EMS is pointed to quite a bit, and we see that as well in terms of over-inventory at the largest EMS companies.

Arthur Nadata: Hey Rob, if you were at the CMS show – I don't know if you were there, but I understand it's very, very active. Incredible technology on display and very, very positive mode.

Rob Damron: OK, that's great and then just one last question, just on DT Electronics. I mean, it looks like, at least relative to the run rate when you bought that company, the revenues are up pretty nicely. I just was wondering, what's driving that? Are you already starting to see cross-selling synergies? Is that one of the main reasons for the additional growth or what else are we seeing with that segment?

David Bowers: Definitely cross-selling …

Arthur Nadata: And a combination of some new lines that have been added and obviously, having the visibility for our inventories and our systems. I think that's helped quite a bit. So it's a combination of a lot of positive things.

Rob Damron: OK. That helps. Thank you very much.

Operator: And as a final reminder, that is star one if you would like to ask a question. We'll go next to Eliot Glazer with Dupasquier.

Eliot Glazer: Happy new year, everyone.

Kurt Freudenberg: Happy new year.

Arthur Nadata: Same to you.

Eliot Glazer: As we all know, the main question in the electronics, semiconductor business over the past 90 days is whether this slowdown in the September-to-December period is going to last longer. We all know it has to do with Christmas sell-through of consumer electronics items, and some of us fear that the inversion of the yield curve may be forecasting, as it has six out of seven times over the last 30 years of an impending recession. It's a difficult question.

Maybe Kurt can give his view on it. Do you feel that the industry as a whole, that the slowdown and slight pickup may only – not pick up the way we're hoping for the next quarter? Could there be a second quarter to this malaise?

Kurt Freudenberg: Do you want to take that one or …

David Bowers: Well, I'll take it quickly and then anyone else can add.

Eliot Glazer: Yes.

David Bowers: That's a legitimate concern. We are not – so – a lot of people will think 2001 when they see the slowdown, but we're not seeing, to be honest, any of the indications of dramatic fallouts in bookings. Bookings dropped and have stabilized – our bookings. So the information – or based on the information that we have on end market consumption, etc. is not off substantially. So, it's possible. We think it's very unlikely.

Eliot Glazer: I think that's a good answer.

Operator: And we'll go next to John Lopez, OTA.

John Lopez: Hi, can you hear me?

Kurt Freudenberg: Yes.

John Lopez: Hi, great. Thanks for taking the question, I appreciate it. I have two. Just quickly, do you guys have cash flow from operations number and a depreciation and amortization number for nine months?

Kurt Freudenberg: I can get that back to you'd if you like. I don't have that handy.

John Lopez: Or yes, or I can follow up offline if you don't have it.

Kurt Freudenberg: The depreciation and amortization is not going to be a material number. There's nothing unusual that's happened there from normal property depreciation.

John Lopez: OK.

Kurt Freudenberg: That's pretty much flat with where it's been.

John Lopez: OK, it's, like, 300,000, in that range?

Kurt Freudenberg: Exactly, there's the 253,000.

John Lopez: And do you have a ballpark on the cash flow number?

Kurt Freudenberg: Not at my fingertips, but I can give that you after the call.

John Lopez: OK. And the second question is I was wondering, just from your description, could you just explore one thing that I think I heard you say, and I may have heard it wrong, but your passive business, you said, declined quarter to quarter, and you said there was some lower demand there, principally from consumer electronic guys and EMS, and yet, at the same time, your semi distribution phase grew sequentially. So, I guess, I'm just wondering, what between those two businesses, do you think sort of differentiated the performance, you know, i.e., passives weak, yet semis strong?

Richard Schuster: This is Richard Schuster. On the passive side, NIC participates directly with several large consumer electronics companies, whereas you would find a Nu Horizons semiconductor business is more weighted toward industrial, telecom, medical, etc. And I think some of those specific customers had over-forecasted, and our fiscal Q3 had pushed back seeing that they had over-forecasted.

In addition, there was some over-capacity that showed up in some areas of passives, capacitors specifically that did affect our sales and bookings for that period. We have seen that the bookings were still positive in the third quarter while sales were down, and we have seen some of those, specifically consumer electronics companies, contrary to what some of the other industry information is suggesting, show that their sales for Christmas were on target or even a little more robust, and they're coming back with some additional purchasing for again beefing up their inventories.

So little bit of difference in the businesses in terms of end customers.

John Lopez: Got you. OK …

David Bowers: The other comment – by the way, it's Dave Bowers, on the semiconductors side is that the semiconductor growth is not market-related in terms of overall market. So 40 percent year-over-year growth is not what the market is seeing. It's directly because of the consolidation investments that we made and the consolidation a year and a few months back and market share gains driven by that.

John Lopez: Yes, yes, absolutely. And the last question is do you guys know what the percent of your revenue to EMS customer base in aggregate is? Or can you ballpark it for me?

Kurt Freudenberg: We don't disclose that.

John Lopez: OK. Super. Thanks for all your help. I appreciate it.

Operator: We'll go next to Matt Sheerin with Thomas Weisel Partners.

Kurt Freudenberg: Hi Matt.

Operator: Mr. Sheerin, your line is open if you do have a question.

And hearing no response, once again as a final reminder if you would like to ask a question, please press star one.

Go to Joe Hosler of OFII.

Joe Hosler: Hi you guys.

Male: Hi.

Joe Hosler: Quick question. If you could elaborate a little more on the Titan customer that you said went away and then is coming back.

Arthur Nadata: Yes, we can't mention a name, but there was a customer of one of our supplier customers, and we can't – not privy to mention the name, but we have re-engaged with that business.

Joe Hosler: OK, could you give an approximate magnitude of that deal?

Arthur Nadata: It's millions of dollars. I can't give you an exact number on that, but it's pretty substantial.

Joe Hosler: OK. Thank you.

Arthur Nadata: You're welcome.

Operator: And there appears to be no further questions at this time. I'll turn the conference back over to the speakers for any additional or closing comments.

Arthur Nadata: OK, we'd like to thank everyone for participating on this conference call and we welcomed your questions and look forward to our next conference call. Thank you and have a good day.

Operator: And that does conclude today's conference. There will be a replay available for today's event beginning at 7:00 p.m. Eastern time today and it will be available until January 15th by dialing 888-203-1112 or 719-457-0820 and using passcode 7383419.

We do appreciate your participation. You may now disconnect. Have a great day.

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