

Kimball Electronics, Inc.

First Quarter Fiscal 2022 Financial Results

November 4, 2021

10:00 A.M.

Operator: Good morning, ladies and gentlemen, and welcome to the Kimball Electronics First Quarter Fiscal 2022 Earnings Conference Call. My name is Sylvia, and I will be your facilitator for today's call.

All lines have been placed in a listen-only mode to prevent any background noise. After the completion of the prepared remarks from the Kimball Electronics leadership team, there will be a question and answer period. To ask a question, simply press star and the number one on your telephone keypad.

Today's call, November 4th, 2021, is being recorded. A replay of the call will be available on the investor relations page of the Kimball Electronics website.

At this time, I would like to turn the call over to Andy Regrut, head of Investor Relations. Mr. Regrut, you may begin.

Andy Regrut: Thank you, Sylvia, and good morning, everyone. Welcome to our first quarter conference call. With me here today is Don Charron, our Chairman and CEO, and Jana Croom, Vice President, Chief Financial Officer.

We issued a press release yesterday afternoon with our results for the first quarter of fiscal 2022. To accompany today's call, a presentation has been posted to the investor relations page on our company website.

Before we get started, I'd like to remind you that we will be making forward-looking statements that involve risk and uncertainty and are subject to our safe harbor provisions as stated in our press release and SEC filings, and that actual results can differ materially from forward-looking statements.

All commentary today is focused on adjusted non-GAAP results. For the first quarter of fiscal 2022, this excludes a one-time after-tax income totaling \$1.1 million or \$0.04 per diluted share associated with non-operating items. Reconciliations of GAAP to non-GAAP amounts are available in our press release.

This morning Don will start the call with a few opening comments. Jana will review the financial results for the quarter and guidance for fiscal 2022, and Don will complete our prepared remarks before taking your questions. I will now turn the call over to Don.

Don Charron: Thanks, Andy, and good morning, everyone. I'm proud of our people, our company, and the results for Q1, considering the difficult operating environment caused by issues in the global supply chain.

Component shortages, which are impacting companies worldwide, continue to make it challenging to keep pace with strong market demand. We were disappointed by the lack of improvement in the overall situation in the September ending quarter, when we were actually expecting some level of recovery.

In fact, conditions deteriorated during July, August, September period due to increasing infections in Malaysia and the resulting restrictions, and the worsening of the backlog in U.S. West Coast ports. In addition, during the last week of the period we were faced with the challenge of power outages at our China facility. The outages continued into Q2, however, we have identified a solution that will mitigate our risk to further production.

As a result of these issues, our lost absorption was more significant than original estimates. It is important to note we are committed to retaining our workforce around the world, as we see these disruptions as a short-term issue, and our funnel of new product introductions remains strong. For the past 10 months, our teams have been working tirelessly to navigate these challenges, and we continue to experience a shift in a significant portion of our shippable backlog as customer demand exceeds parts availability.

As supply constraints ease, we are well-positioned to ramp up production on our record backlog and support our strong

funnel of new product introductions. In fact, we're preparing to run at maximum capacity on several production lines across the company. We function as a single source for many of our customers, who are relying upon us to deliver on our contractual agreements once parts become available.

We are reiterating our guidance for fiscal year 2022, although the bifurcation between the first and second half of the fiscal year will now be more pronounced. Longer-term, the outlook for our company continues to be strong, and the team we have in place to execute on a variety of growth opportunities is up to the challenge.

Pivoting back to the first quarter, net sales were down 12% compared to the same period last year, with declines in three of four vertical markets. Automotive was the only major vertical market with sales increasing in Q1, up 9%. Based on customer demand and our backlog, this result could have been much stronger if we had the materials needed to fill these orders, but unfortunately that was not the case.

The Q1 growth in automotive resulted from popular vehicle models designated as high priority by our customers and the OEMs receiving an allocation of components from the limited worldwide supply. When the global supply chain issues subside and industry-wide volumes normalize, we are still bullish on the growth prospects of this vertical market.

Electronic content per vehicle continues to increase, with advanced technologies and expanded operating systems being added to most vehicles. As I've mentioned in previous calls, the applications and architecture for these systems are largely the same for both electric vehicles and vehicles driven by internal combustion engines and the stringent production standards in the automotive industry align well with our core competencies, which gives us confidence in the growth potential of this vertical market in the years to come.

The medical vertical market was down 33% in Q1. As you will recall, our sales were strong last year with our support of respiratory care products needed to combat COVID-19 during the early months of the pandemic. This, combined with raw material shortages and logistical challenges, made for a difficult quarter-over-quarter comparable.

Elective procedures are still below pre-pandemic levels. And while we're starting to see improvement as more of the population gets vaccinated and physicians' offices and hospitals are able to resume these activities, the recovery has been gradual. Longer-term, we continue to believe the megatrends in the healthcare industry, with an aging population and increasing access and affordability to care, decreasing device sizes and connected drug delivery systems, are an excellent set up for growth.

Turning to the industrial vertical market, which was down 9% in the first quarter, the decline resulted from lower sales in our climate control and smart metering products, both again largely related to parts shortages.

And finally, sales in public safety were \$11.1 million, down 16% from the first quarter of the prior year, again largely driven by part shortages.

I'll now turn the call over to Jana to discuss our Q1 results in more detail and review our guidance for fiscal year 2022. Jana?

Jana Croom: Thanks, Don, and good morning, everyone. Net sales in the first quarter were \$292.7 million, a 12% decrease compared to \$331.7 million in Q1 last year. Foreign exchange rates favorably impacted sales by 1% in the first quarter of fiscal 2022.

Our gross margin rate in Q1 was 5.3%, a 390 basis point decrease from the first quarter of last year. The decline was driven by a combination of factors. First, certain costs have increased this year, including wage inflation and other labor costs, and inbound freight.

Second and more importantly, we were challenged by lower volumes related to the continued global parts shortage. This impacted our absorption rate, as fixed costs and required labor levels to support the back half of our fiscal year and beyond

created margin pressure. We expect this to abate in the coming quarters and into the future as the part shortage subsides and we are able to return to normal sales volumes based on our funnel of future growth.

Adjusted selling and administrative expenses were \$12.3 million or 4.2% of net sales in the first quarter. This compares to \$12.6 million or 3.8% of net sales in Q1 last year. The increase in the expense rate, that is expenses as a percentage of sales, is resulting from the lower sales volume in Q1 this year as compared to last.

Adjusted operating income for the first quarter was \$3.3 million or 1.1% of net sales. This compares to adjusted operating income of \$18 million, or 5.4% of net sales in the first quarter of fiscal 2021, with the decrease resulting from lower sales volume and the corresponding loss absorption that Don noted in his opening comments.

Other income and expense was expense of \$1.2 million in the first quarter, which compares to income of \$2.1 million in Q1 of fiscal 2021. This change was mainly due to the impact of FX gain/loss due to foreign currency remeasurement.

The effective tax rate in Q1 was 27.4% compared to an effective tax rate of 15.7% in the first quarter last year. The lower effective tax rate in the prior year quarter was favorably impacted by a discrete tax benefit from a state tax valuation

allowance and a favorable mix of earnings within our various tax jurisdictions.

Adjusted net income in the first quarter of fiscal 2022 was \$1.5 million or \$0.06 per diluted share compared to adjusted net income in Q1 last year of \$16.6 million or \$0.65 per diluted share.

Now turning to the balance sheet, cash and cash equivalents at September 30th, 2021 were \$89.3 million and cash flow used for operating activities during Q1 was \$8.2 million. Cash conversion days for the quarter ended September 30th, 2021 were 73 days, representing a three day improvement from Q1 2021. However, it is a nine day increase from last quarter.

We saw a significant increase in inventory in the amount of \$62 million in the quarter, a result of the current part shortage. In several cases, the majority of parts were available and arrived on time, only to be held up from being released to production due to a few critical parts not arriving on time.

This has caused a shift in our inventory build specific to the current environment. There is a notable correlation between the inventory build we experienced in the quarter and the absorption rate that Don noted, which resulted in lower OI margin. As the part shortage of abates and we work down the backlog of open orders, we will likely see inventory levels normalize.

Capital investments in the first quarter were \$12.7 million, largely for expansions at our Thailand and Mexico facilities and to support new business awards. We anticipate higher levels of CapEx over the remainder of FY '22 as we continue these expansions and support our strong organic growth opportunities.

Borrowings on our credit facilities at September 30th, 2021 were \$72.6 million, down substantially from \$110.5 million at September 30th, 2020 and up slightly from \$66.2 million at June 30th, 2021. Our short-term liquidity available, represented as cash and cash equivalents plus the unused amount of our credit facilities, totaled \$182.8 million at September 30th, 2021.

There were no shares repurchased in the first quarter of fiscal year 2022. Since October 2015, under our board authorized share repurchase program, a total of \$79.7 million was returned to our shareowners by purchasing 5.3 million shares of common stock.

As Don highlighted, we are reiterating our guidance for the full year of fiscal 2022. As a reminder, we estimate net sales will be in the range of \$1.4 billion to \$1.5 billion, an 8% to 16% increase over fiscal 2021. Operating income margin is expected to be 4.5% to 5% of net sales, and we expect to invest \$60 to \$70 million in capital expenditures in the fiscal year.

Finally, I want to call your attention to the investor relations section of our corporate website. We have recently refreshed the site to improve the navigation and increase the availability of information, and hope you will find these enhancements helpful.

I'll now turn the call back over to Don.

Don Charron: Thanks, Jana. Before we open the lines for questions, I'd like to share a few thoughts in closing. The operating environment we are facing today is unlike any other I've experienced in my 35 plus year career.

The impact of the pandemic and the resulting materials shortages, coupled with global logistics issues and rising cost, is presenting a unique set of challenges for companies in a wide variety of industries around the world. I think that it is important and apparent that, when realizing our company reported a record fiscal year in 2021 during the height of the pandemic, only to face this incredibly challenging operating environment when the pandemic appears to be subsiding.

There are many imbalances within the global supply chain that need to work themselves out before we can return to some type of normalcy. But as I referenced in my opening comments, we have a long-term perspective when running our business, and view these headwinds as short-term in nature.

Our backlog of open orders is at record levels, and we are prepared for a significant ramp-up in output in the second half of fiscal year 2022. Throughout this period of uncertainty, we have never lost sight of the fact that our number one priority is the health and safety of our people. Our protocols have minimized disruptions to the business and allowed us to maintain excellent customer support.

We're well-positioned for the future, and I'm so proud of the team and their efforts to deal with the challenges from this tough operating environment. We are truly focused on creating quality for life.

As previously announced, our annual meeting of shareowners will be held at 9:00 A.M. Eastern time on Tuesday, November 9th. This meeting will be an in-person only event at our world headquarters here in Jasper. We appreciate the support of our shareowners and look forward to seeing any that can attend. If you are unable, a copy of the presentation from the meeting will be posted to our corporate website in the investor relations section.

With that, I would like to open the lines for questions. Sylvia, do we have any analysts with questions in the queue?

Operator: As a reminder, to ask a question please press star-one on your telephone keypads.

Your first question comes from Anja Soderstrom from Sidoti.

Anja Soderstrom: Hi, and thank you for taking my questions. So, first, is there any--can you put any number around the backlog?

Don Charron: Well, yeah. Last quarter, Anja, we reported-- at the end of the June 30 quarter, we reported that open orders--backlog of open orders rose to \$749 million, which was up 78% from the same period the prior year.

And we'll update those numbers when we issue our Q, but up substantially, obviously, and I think, you know, coincides with what we've been talking about. We've got a lot of orders that we would like to ship, that we need to ship to our customers once these parts arrive.

Anja Soderstrom: And how--to what extent do you view these orders as nonperishable? Is there any risk that they will--you will lose some revenue?

Don Charron: We haven't seen signs of the demand going away or--diminishing or going away altogether. We have not seen those signs. Our customers are indicating this demand is real. They need it. They want to build it and ship it.

And in our case, many of the contracts that we have with those customers, we are the sole source for those products for them. And so, yeah, we--that's why we are preparing hard right now to make sure, in the second half of the fiscal year, we can run at run rates that are 30% to 35% higher than what we're

running at today just to keep up with the demand that we're facing.

And again, that demand includes catching up to orders that we should have shipped in prior quarters and new product introductions. We have been very successful winning new business, and getting material in to support those NPIs in the second half is also very critical to our plan.

Anja Soderstrom: So, what's going on, it doesn't--hasn't--so, what's going on now in the current environment hasn't really slowed down your ability to win new programs or caused any concerns among your customers, or hesitation?

Don Charron: It has not. We feel very fortunate, the success that we've had to grow with existing customers by winning new programs, and we've also won new programs from new customers. So, we're very pleased with our new business wins during this last period.

Anja Soderstrom: Okay. Thank you. And then in industrials, you said it was largely muted due to the component shortages. But how has the climate controls, the components there, trended in Europe? Do you see the demand coming back there, or is it still a bit challenging?

Don Charron: You know, I think overall in climate controls for both North America and Europe, the demand is there.

Especially here in the U.S., our climate control customers would take everything we can produce.

The one area that's still sort of in a gradual recovery mode, we would say, is smart metering in Europe, which is not part of climate control necessarily, but that is an area that's still just gradually recovering from the pandemic.

Anja Soderstrom: Okay. Thank you. And then how do you work around the inflationary impacts?

Don Charron: Well, we--first and foremost, we want to make sure we're well aware of those inflationary impacts, and making sure we're doing our homework to try our best to understand which ones are temporary in nature and which ones really need to be thought about as a new part or an increased part of our cost structure. And so, we have teams that are studying that very closely.

To the extent it's a permanent part of our cost structure that we can't offset by other, let's say, cost innovation projects, etc., then we will pass those through to our customers. Our customers have been very reasonable during this period. And even in cases where we've had premiums we've paid for material or premiums we've paid for logistics, our customers have been very reasonable partners with us in--you know, in reconciling all that and passing it through when needed.

Anja Soderstrom: Okay, that's comforting. That was all for me for now. I'll jump back in the queue. Thank you.

Don Charron: Thank you, Anja.

Operator: Your next question comes from Mike Morales from Walthausen.

Don Charron: Hello, Mike.

Jana Croom: Morning, Mike.

Mike Morales: Hey, good morning. Good morning, folks. Thanks for taking the questions. So, first of all, Andy, Don, and Jana, congratulations on the refreshed IR website. I'd like to say, you know, with the improvements that you folks have made to the presentation materials over the last few quarters, I really think it's making the story more accessible, both for, you know, existing holders like us and prospective holders. So, keep up the good work there.

Andy Regrut: Thank you.

Jana Croom: Thank you.

Mike Morales: So, hey, you touched on this a little bit, Jana. I'd like to circle back to kind of some of the moving parts in supply chain in the quarter, because I think it's kind of meant different things for different companies. And, you know, Don, you had mentioned that it sounds like the parts availability issues were much more of a headwind versus, you know, port congestion or shipping issues. Is that accurate? And

then any way you can maybe quantify that or, you know, just help us think about the different moving pieces between supply chain, shipping, and then maybe some of these facility specific issues in China that you mentioned?

Don Charron: Yeah, I'll start and then I'll let Jana build on my comments, Mike. You know, I would start with looking at, you know, the inventory growth during the quarter of \$62 million. It doesn't jump off the page as much when you think about production days, supply on hand, although it was a significant increase sequentially from where we ended just a quarter ago in days as well as dollars.

But I think that'll give you sort of an idea of how much we were planning to ship in the quarter and what we actually shipped, because recall last quarter I talked about trying to align our scheduling with the supply base and our customers with reality of the situation and what material would be available.

And so, when we said we were disappointed by the fact that there was a lack of improvement, there was no improvement. It got worse, and it got worse because the infection rate's rising in Malaysia, which brought on restrictions. As you know, in that part of the world, Southeast Asia in general, you know, many semiconductors rely on that geographic region in their value streams, especially the back ends of their processes.

And so, when those restrictions when into place, it was immediate and impacted us in the way of what we thought we would get, which was still restricted supply. It was not as if we thought we were going to get to full recovery mode. We were expecting it'd still be restricted supply, but it actually got worse. As we work through not only those restrictions that those suppliers had in Malaysia, the government's reaction to the increase in infection rates is what led to those restrictions.

But ultimately, we also were impacted by the growing backlog at--you know, at the U.S. West Coast ports, which I know you're well aware of as well, significant backlog. And whether it's ships waiting to dock or trucks waiting to pick up the offload, it was a problem all quarter long.

The power outage in China is a little more later in the quarter, less of an impact. But when you take those other factors I mentioned, developments in the quarter, things got worse, not better.

And again, I would just point to the \$62 million increase in inventory. You know, that--we maybe not--we were maybe not expecting to ship all of that in the quarter. Some of it might've been part of our Q2 recovery plan, but a significant portion of that we were expecting to go out the door. And hence, you know, we had the people, the machines, you know, the processes set up to start that recovery. So, it was

disappointing to us, and we wanted to make that clear to all of you.

Jana Croom: Yeah. The only thing that I'll add to that is we are paying close attention to our working capital needs and will be over the next 18 months, because it's the balance of, as Don indicated, inventory sitting waiting on a certain part to come in so that we can ship, as well as the inventory build that we need to support the launch of our Thailand facility that's anticipated in January, and then our Mexico facility that's happening in June.

And so, the timing of those, the corresponding inventory builds required for that, all of those new product introductions that are be going into those facilities, as well as the backlog of orders, is going to create a working capital dynamic for probably the next, I would say, six to 12 months. And so, we're-- (unintelligible)--.

Mike Morales: --Jana, you read my mind--.

Jana Croom: --To cash. Yeah, it's just--it's--it is the strangest thing, in that I can't give you, for the next 12 months, clear line of sight into working capital needs. What I can tell you is I've got a balance sheet built for it, which I'm very, very grateful for, and we will certainly manage through it.

And then in terms of forecasting for the future, it's really going to be about NPIs, expansions, etc. But right now it's really just out of sorts.

Mike Morales: Understood. So, maybe directionally, is it fair to say that longer--medium to longer term inventories probably settle somewhere between--you know, if I think about the commentary the last couple of quarters, lower than where you would have liked versus where we are today, somewhere in between those two points considering the higher demand levels and the working capital needs on these new facilities--or expansions, rather. Is that fair?

Jana Croom: You've got it, yes.

Mike Morales: Understood. Great. Maybe switching gears, you know, in the past, you've spoken about high utilization across the footprint. And obviously that informs the decision on the facility expansions you've mentioned. And thank you for mentioning the timing as well, Jana, on those again.

I'd like to dig into a little bit more on how you guys are thinking about the implied ramp in the second quarter there, and maybe give you folks the opportunity to speak more your decision on maintaining staffing levels and how that'll support that ramp. And, you know, Don, thinking about your experience, is this ramp going to be meaningfully different than ramps you've seen in the past when there has been tightness like, say, MLCCs

a couple years ago? Just help us understand how you're thinking about that.

Don Charron: Yeah, really good question. You know, I think it--you know, to answer the last part of that first, you know, it does depend on how fast the supply chain recovers, how fast the suppliers recover. If it's more of a step function, you know, recovery--which I doubt it will be. I believe it'll be a gradual steady improvement from the supply base, and I think we are well equipped to handle that. A step function would be much more difficult to handle.

But, look, Mike, I think when you do the math on what we're seeing--you know, what we're saying and what we're seeing in terms of reiterating our full-year guidance, you know, we got to be running at \$400 plus million quarters, you know, to keep up with the demand and work a little of this backlog off.

So, you know, again, we're expecting gradual but steady improvement in the quarter we're in. So far, we've seen some bright spots, but it's gradual. It seems to be better than the September ending quarter. We'll see as we get further into it, and obviously the pandemic subsides and suppliers are able to, yeah, recover their operations to pre-pandemic levels and beyond.

So, you know, I think we do see that strong bifurcation from a \$300 million run rate kind of thing to \$400 million run

rate on a quarterly basis. We can do that. We--you know, we--I--as I mentioned, I'm so proud of our teams around the world. We've talked to so many customers. We've talked to so many suppliers. And many of them have not only material shortages, they have worker issues that they're facing.

And, you know, we feel very fortunate that, you know, our workers are engaged. They're committed. We're staffed to handle this ramp up, and they're ready for it. If we can get them the parts, they're ready for it. And I think that's just a strong testimonial of the people we have around the world on our team and their commitment. And it's a strong testimonial, really, to our company culture.

And so, while we don't have an answer for all the part shortages right now, we expect them to get better, we have focused our energy on our people, making sure we've got the capacity to get to these new run rates. And I feel confident we'll be able to keep up with the recovery on the supply base side with our operations producing at these higher levels.

Jana Croom: You know, so, Mike, you have to make a trade-off and a decision point as a leadership team to say am I going to impact gross margin in the current quarter by retaining my skilled workforce, knowing what I've got coming not just for the back half of this year but for the future, just period. And

that's an easy decision to make, right? You run your company for the long-term.

It takes a while to onboard a worker, train them, get them, you know, certified and up to speed. And so, when you've got that workforce in place, knowing what we're staring down, you keep that workforce. You know, we did not have one part that didn't ship due to a shortage of workers, and I know not every company can say that, right? Ours was purely parts.

Mike Morales: Understood. And all of that's helpful, you know, kind of understanding how you guys are thinking about the long-term and hopefully continuing strong demand that you're seeing. And maybe my last question on that point, you know, thinking about the new square footage that's coming up via the facility expansions, the first question is, I guess, is any of the demand that's in backlog right now expected to be served via those facility expansions?

And maybe just in a broader sense, you know, in the past, you've spoken about difficulties with high utilization on walking a customer through or a potential new customer through the facility, and it's difficult to sell that if you can't point to where their line is going to go and you have that available space. So, as this square footage comes online, how do you balance utilizing the new space between existing business versus

saving some and earmarking it for new business that maybe you've been trying to win or expecting to win? Thanks.

Don Charron: Good question. You know, we are--when we make those expansions, we are sort of looking at birds we feel like we have in hand and birds we're still out there hunting. So, it's a mixture of both.

We are talking with our customers, who truly are our partners, and asking them to make soft commitments so we can make soft allocations to future capacity needs. And we're out three to five years in many cases in those conversations with those customers. And so, it's a mixture.

How much of our current backlog is pointed at plants that aren't built or expansion plans aren't finished, the good news is both expansion plans, both expansions themselves, the construction is on schedule, if not a little ahead of schedule. So, we feel good about where we're at in terms of having occupancy available in time to put NPIS in place in those expansions that are targeted for those new expansion areas. So, it's fairly well aligned and tightened up.

You know, we're going to be in a better position with more white space to sell into. It is--as I've said in the past, it is a challenge to convince especially a new customer to award you business when they can't see where their production lines will go. It's just as simple as that.

And--but once you start those expansions, for example, once the board approved those expansions in Thailand and Mexico and you can talk more definitively about, you know, the--breaking ground and, you know, the actual timeline for when you expect to get occupancy, it alleviates that--a lot of that pressure. And so, we benefited, you know, going back a few quarters ago when we actually approved and launched those expansions.

And, you know, as we ended fiscal year '21, without those expansions we were approaching some of the highest levels floor space utilization we've ever had in the history of the company. And it was really in all regions, you know, Europe, North America, and Asia. And so, I think for the, you know, short-term and sort of medium-term, we--you know, we're--we feel like we're in good--pretty good shape for Asia and North America.

Europe is going to be next, as we look at sort of available space to support our business development efforts. We've been very successful there in winning new programs. You know, you know Poland was practically full to the rafters. That's why we did Romania. And now five, six years into Romania, it's nearly full as well. And so, that's a good news sort of challenge that we have.

But we have to look at our footprint in Europe, and we have also been very successful in China, especially supporting customers that are supporting the electric vehicle market there

in China. So, you know, that'll be something maybe a few years out but on our horizon.

And so--yeah, so I--you know, I'm not a big fan of, you know, average sales per square foot or average annual sales per square foot. But we kind of look at that and--as at least a proxy to, you know, how much square footage do we think we'll have to have somewhere the world, somewhere in our footprint, to have a path way to get to \$2 billion in annual sales.

Mike Morales: Understood. Don and Jana, thank you both so much for taking all the questions and all the color. Looking forward to speaking soon. Be well.

Don Charron: Thank you, Mike.

Operator: At this time, I would like to remind everyone, in order to ask a question, please press star-one on your telephone keypad.

Your next question comes from Hendi Susanto from Gabelli Funds.

Hendi Susanto: Good morning, Don. Good morning, Jana.

Don Charron: Hello, Hendi.

Jana Croom: Morning.

Hendi Susanto: Don, would you share how you rank the levels of parts shortages and expected recovery timing among different verticals? Like in other words, like which verticals

saw great levels--greater levels of parts shortages and which ones may see recovery sooner than others?

Don Charron: That's a good question. You know, with the quarter we just finished, it seemed like the parts shortages just spread across all verticals and all product categories. It was hard to find an example where there were no parts shortages, really, as we exited the September ending quarter, Hendi. It's really across the board. I think some may take longer to recover.

You know, I believe the automotive vertical overall has probably experienced the longest period of shortages as a vertical. And there are some sort of reasons why that is the case. I won't go into those. But the fact that they have been at it longer means they've been working longer at the real solutions, getting at the real sort of root causes and the real solutions. And so, you know, I think that, you know, we'll see how that vertical recovers.

And I--you know, I think the other part of that story with automotive is I think those OEMs, those carmakers, had to make harder decisions about shutdowns than other verticals. And what I mean by harder decisions about shutdowns, I mean there's, you know, sort of unprecedented consecutive days in a row of car plants being down.

And even amongst the most popular nameplates and brands in the world, they've almost all had to announce some reduction in their production plans and then--and some sort of shutdown of their car making plants. And I think that they were very careful and thoughtful about how they did that. And so, you know, as those car plants are coming back online and running, building cars at the levels they were intended to build at, they're--you know, we--that recovery, we'll see.

That recovery, I think, is going to get some more traction here as we go into the January, February timeframe, provided again that the pandemic doesn't come at us again with a new variant and a new infection rate. I think it seems like that's structurally ready to happen.

Inventory levels are very low. I think carmakers are going to be willing to build up those inventory levels because the demand is there. And so, I expect even, you know, after--the supply to catch up to demand on the component side, you know, it's not only just the run rate of the market, it's replenishing inventory levels there.

So, that one's, to me, is looking a little bit different than, let's say, the medical vertical, which we're also very bullish on. You know, it's an important part of our growth plans going forward and restricted by components, but also restricted in other areas outside of components. I--you know, we mentioned

again, you know, elective procedures, elective surgeries, and really may be a better term would be scheduled procedures.

I think McKinsey did a study not too long ago talking about the backlog of these elective procedures that was created by the pandemic. And I think over a million--the number they estimated is over a million surgeries didn't happen that should have happened. And how do you catch up on that, you know, given, you know, the capacity of healthcare here in the U.S.? For example, doctors, facilities, hospitals, other healthcare workers, how fast can they get back to pre-pandemic levels, and then how can they get above that to work down that--the number of patients who just simply didn't get that care during the pandemic.

That might be gated on that side of the recovery plan. I mean, in other words, parts could catch up but, you know, our customers--and, you know, we're in the value chains of several of those medical customers, you know, the Stryker or a J&J or--you know, or a Smith & Nephew. We're in their value chains, so at least we've got insights into what they're thinking about and how they're planning a recovery of sorts. But that--again, that could be gated on how fast that backlog can be made up along with parts shortages. So, just a couple of different examples there.

Overall, I think though it's--you know, the whole supply chain, the disruption, the shortages is wide enough I can't

really speak definitively about one vertical getting better faster than the other.

Hendi Susanto: And then, Don, I'm sorry if I missed this. You talk about the inflationary impact. Don and Jana, would you be able to quantify the impact of higher component and freight costs on your operating margin? And do you plan to introduce price increases?

Don Charron: We can't give you specifics on what the freight impact increase is due incoming freight or outgoing freight, Hendi, because, again, you know, our customers have been really good partners to us. And, you know, they have been very reasonable and rational in terms of helping us through these higher than normal costs, you know, especially, you know, while we're trying to figure out is it going to be a permanent change in the cost structure or is it going to go back to where it was.

And so, we're working with them to pass through a lot of those exceptional situational--situations. And we've passed it on to them either in a separate invoice or an increase to the selling price of what we produce. And we're still working through all that with each customer. We're at a different--slightly different place depending on, you know, how significant some of those cost overruns could be.

So, I can't give you a specific number as to the impact on the quarter, and just really want you to know we're working with our customers, who are our partners, on those increases that are going to be here for a while and that need to get passed through the selling price.

Hendi Susanto: Got it. Thank you, Don. Thank you, Jana.

Don Charron: Thanks, Hendi.

Jana Croom: Thanks, Hendi.

Operator: As I show no further questions at this time, I would like to turn the call back to Mr. Don Charron for any final remarks.

Don Charron: Thank you, Sylvia. And that brings us to the end of today's call. We appreciate your interest and look forward to speaking with you on our next call. Thank you and have a great day.

Operator: Ladies and gentlemen, this does conclude today's conference. Thank you again for your participation. You may now all disconnect.