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TESS - Q1 2018 TESSCO Technologies Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Q1 2018 TESSCO Technologies Incorporated Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to turn the conference to over Mr. David Calusdian from Sharon Merrill Associates. Sir, you may begin.

David Calusdian - *Sharon Merrill Associates, Inc. - IR*

Good morning, everyone, and thank you for joining TESSCO's Q1 2018 conference call. Joining me today are Murray Wright, TESSCO's President and Chief Executive Officer; and Aric Spitulnik, the company's CFO. Please note that management's discussions today will contain forward-looking statements about anticipated results and future prospects. Forward-looking statements involve a number of risks and uncertainties and TESSCO's results may differ materially from those discussed today. Information concerning factors that may cause such a difference can be found in TESSCO's public disclosures, including the company's most recent Form 10-K and other periodic reports filed with the Securities and Exchange Commission. With that introduction, I'd like to turn the call over to Murray Wright, TESSCO's President and CEO. Murray?

Murray Wright - *TESSCO Technologies Incorporated - CEO*

Thank you, David, and good morning, everyone. This was a solid quarter for TESSCO as the sales momentum that began in the second half of last year continued. We began fiscal 2018 focused on growing our top line and improving profitability and we made good progress toward both of these goals this quarter. We achieved year-over-year revenue growth for the third consecutive quarter and year-over-year EPS growth for the second straight quarter. Our improved top line results primarily were driven by a 60% increase in sales to the public carrier ecosystem that we -- showed year-over-year sequential growth in every market except for government.

In my first 9 months with TESSCO, we've implemented a number of new initiatives. We incorporated these initiatives into a sound operating plan, and as you can see from our performance in the first quarter, we are executing on that plan. As we look to continue to deliver improved results, we are measuring our progress against the 4 priorities we discussed on previous calls. Number one, optimizing our go-to-market strategy to increase sales; number two, enhancing our e-commerce and electronic tools to improve the customer experience and productivity; number three, improving our product and vendor management engagement; and the fourth, increasing our operating margins through diligent expense management. Under our go-to-market optimization priority, we have made significant progress on the regionalization of our sales team, bringing in our sales professionals closer to our customers, driving efficiencies and forging stronger relationships. This success we are experiencing in our public carrier market is evidence that we are beginning to win more business. As an example, TESSCO has been selected by Verizon as a supplier to provide distribution of a broad array of wireless network products throughout the Verizon network. TESSCO and Verizon have executed a multi-year contract in support of this program. As part of the program, TESSCO will also support Verizon's general contractors with similar programs. This award is the culmination of many months of increased partnership between TESSCO and Verizon.

Under our e-commerce priority, we made two significant enhancements during the quarter. First, in May, we launched the upgraded tessco.com, which provides our customers with an enhanced online experience. Initially, we are targeting everyday buyers in the VAR and retail markets. The new tessco.com has moved many of our key functions to the cloud, laying the foundation for more advanced functionality, which we plan to introduce later this summer. We've also incorporated a responsive, mobile-friendly site for accessibility on tablets and smartphones. When customers visit our site, they will now see pricing and inventory status within their search results, more focused search results and a simplified checkout progress -- process. This major site upgrade is the result of months of hard work by our marketing and IT teams, and it is a crucial step toward providing a best-in-class customer experience. We will be transitioning more customers onto this new tessco.com in the quarters ahead.

We have also added new leadership to our Technology group with the appointment of Joe Cawley as Vice President and Chief Information Officer. Joe will be responsible for elevating TESSCO's technology offer and implementing strategic technology projects, including a refresh of our B2B e-commerce tools. Joe already is making an impact across the business. His track record of success in innovation will be a driving force behind our future e-commerce success and we are excited to have him here.

Our third priority is to improve our product and vendor management engagement, and we have made significant progress. We have completed the realignment of our product professionals, which I discussed last quarter, we have implemented a number of system enhancements to improve efficiencies in our supply chain and we have worked closely with our manufacturer partners to provide larger order discounts, various volume incentive rebate programs and stronger collaboration to jointly address opportunities in the marketplace.

Under our fourth priority, increasing operating margins, we continue to optimize our entire organization to make us more productive to improve expense control. Examples include the reallocation of order entry and sales support roles in multiple markets to increase efficiency and productivity. Additionally, we completed a conveyor system hardware and software upgrade in our main distribution center, which improves our operational efficiency. We expect these and other actions to increase our operating leverage and to improve profitability as our sales trajectory increases.

In the past few months, TESSCO has undergone a significant amount of change. We have brought in many talented leaders, repositioned and promoted some of our existing leaders, reorganized and revitalized our sales organization, improved our sales compensation plans to incentivize portfolio growth and regionalized our sales force. We also introduced new electronic tools to enhance customer engagement and developed better, stronger relationships with both new and long-standing customers and vendor partners. And we have proven to ourselves that we can change and adapt and, most importantly, execute at the same time. We do expect the changes we have made and continue to make will result in some fluctuation in our results during the remainder of the 2018 fiscal year. We remain confident that we will see growth in revenue and earnings in fiscal 2018. I look forward to updating you on our progress as we move forward.

Now I'd like to provide a brief overview of our markets. This is a good time to remind you that the Public Carrier market is really an ecosystem that includes not only 1 -- the large Tier 1 carriers like Verizon and AT&T, but also the contractors, integrators, program managers and tower owners that support these carriers. As I mentioned, we increased public carrier market sales significantly from a year ago. This was the direct result of changes we are making in our go-to-market strategy. Our sales, product, supply chain and program management teams are working together to uncover and win new opportunities. We are also working with our vendor partners to ensure product offer and pricing is well positioned to be successful. While public carrier gross profit also improved by double digits from a year ago, we experienced a gross margin decline as several larger, lower-margin customers accounted for much of the sales increase. We are gaining market share in the carrier ecosystem and we're also optimistic that opportunities such as FirstNet, the new Verizon program and the future 5G rollout will continue to produce accelerating revenues and profits in this market over the next several years.

In the Government market, sales were down double digits and gross profit was down single digits from a year ago. This variance related to multiple onetime large projects which were shipped in Q1 of last year. Many of the Federal government budgets and projects were pushed from Q1 to Q2, and state and local spending slowed this quarter as many states awaited to see the impact of FirstNet over the next few months. We continue to drive more opportunities in this market and we're confident about our potential growth in the upcoming quarters.

In the Commercial Dealers and Resellers or VAR market, revenue was up slightly from a year ago while gross profit was down slightly. We experienced strong performance from our network VARs toward the end of the quarter as our regionalization efforts began to take hold. While our market share in this market is still very low, we have a significant opportunity to do more business with local and regional VARs, and our strategic sales team is working hard to develop stronger relationships with the large national resellers.

In the Private System Operator market, revenues and gross profit grew slightly from a year ago. With the exception of the utility vertical, all other verticals saw significant growth year over year. We have made progress in our transportation sector, addressing upgrades to communication networks and some mass transit organizations. And additionally, we have gained market share in the oil and gas sector.

Turning to the retail market. Sales increased modestly the year-over-year. The launch of Samsung's Galaxy 8 phone during the quarter contributed to the growth in retail sales, as did increased sales to our repair center customers. Gross profit in the retail market increased double digits from a year ago, primarily as a result of product mix, including a significant increase in Ventev sales. Ventev, which includes both mobile device accessories and infrastructure offerings, grew 22% over the last year and totaled 15% of the overall revenues during the quarter as both sides of Ventev remained very strong. The increase on the accessories side of the business was driven by continued strong demand for the high-quality power products Ventev offers for a variety of wireless devices. Ventev launched its first wireless charging product during the quarter and this has been highly popular with retail customers and media members. The growth in Ventev infrastructure sales was driven primarily by Ventev WiFi business. We have continued to develop new WiFi projects in hospitality, Fortune 1000 and entertainment customers through strong partnerships with key solution providers.

Before I turn the call over to Aric, I wanted to give you a recap of our TESSCO ONE event, which was held in early April. TESSCO ONE is our annual conference and technology showcase that brings together manufacturers, integrators and wireless professionals from across the industry. This is the first one that I've attended and this was our largest and best event to date. TESSCO ONE showcases to the entire industry why TESSCO is the destination of choice for the wireless industry by providing information, knowledge and training. We really believe that this helps differentiate us from our competition and highlights our value proposition for the wireless industry. The event strengthens our relationships with our partners and is a great vehicle to develop new opportunities for the year ahead.

And now, I'll turn the call over to Aric for a discussion on the financial results. Aric?

Aric Spitulnik - *TESSCO Technologies Incorporated - CFO,*

Thank you, Murray, and good morning, everyone. Before I dive deeper into the results, I wanted to review some changes in the presentation of the numbers. As we mentioned before, effective on the first day of fiscal '18, we reorganized our sales and product organization. Now our commercial sales and product groups roll up to Charles Kriete and our retail sales and product groups roll up to Liz Robinson. Accordingly, we now present our results in 2 operating segments: commercial and retail. Since we've always presented the retail market as additional information, this change isn't very significant but we wanted you to be aware of it. Second, as a result of the reorganization, a few significant customers moved between markets. Most significantly, the repair center customers are now managed and reported in the retail market and not the private systems market. Finally, the last change is on the balance sheet. In accordance with an update to U.S. GAAP, we have reclassified licenses purchased from third parties for internal-use software from PP&E to intangible assets. These intangible assets are being recorded within other long-term assets on the balance sheet. Prior year numbers have been adjusted in yesterday's filing to reflect the above changes.

Now on to the results. In the first quarter, revenues were $140 million compared with $129 million in the first quarter a year ago. As Murray mentioned, this our third consecutive quarter of year-over-year top line growth. The increase in revenues resulted largely from a significant increase in sales to the public carrier ecosystem but we are also encouraged by the growth in most of the other markets as well. Gross margin was 20.8% of revenue compared with 21% a year ago. The slight decline in gross margin was largely the result of the significant increase in sales to the lower margin public carrier market. The decline in gross margin was mostly offset by a 22% year-over-year increase in sales of higher margin Ventev products during the quarter, especially in the retail market.

SG&A expenses increased $900,000 from a year ago, primarily as a result of increased variable costs associated with higher sales as well as increased accruals relating to our performance-based reward programs. As a percentage of sales, SG&A was 19.9% compared with 20.9% of sales in the first quarter a year ago. Largely as a result of the increase in revenue and gross profit, operating income increased to $1.3 million from $150,000 a year ago. Net income for the first quarter increased to $700,000 or $0.08 per share compared with $81,000 or $0.01 per share in the first quarter of last year.

Moving on to the balance sheet. As we mentioned in the release, we invested in working capital this quarter to support the growing public carrier business. Both inventory and accounts receivable increased significantly and we ended the quarter in a borrowing position of $8.3 million. As Murray mentioned, we are taking a more aggressive approach to capturing share in the carrier market. These customers generally require higher dollar inventory investments and cause higher receivables to be held on our balance sheet for a longer period. In the near term, this means we're taking on more inventory and holding it longer in order to service this market. Therefore, we expect to see some fluctuation in cash flows as we work through these changes.

During the first quarter, sales to the public carrier market increased 60% over last year and 26% over the sequential fourth quarter. We believe the long-term benefit from serving these carrier customers more than offsets the investments in cash required to support this business.

Finally, we remain committed to our dividend program and set our dividend at $0.20 per share with a record date of August 9 and a payment date of August 23. We're executing on our plan to grow the top line and improve profitability and we are on track to accomplish both of these goals in fiscal 2018. We do anticipate some fluctuation in our financial results this year as we implement a number of strategic changes across the company. At the same time, we are encouraged by our early progress, and we look forward to sharing additional accomplishments with you on future calls.

With that, operator, we'll open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Anil Doradla from William Blair.

Anil Doradla - *William Blair - Analyst*

So I had a couple of questions. So we'll go through it. So, Murray, you talked about -- obviously the numbers prove the commercial pickup, the public carrier and everything. Can you share your thoughts? How much of this was driven by changes done internally to your sales organization go-to-market strategy versus the demand environment?

Murray Wright - *TESSCO Technologies Incorporated - CEO*

Yes, Anil, that's a very good question, and that's part of the reason that we describe this as an ecosystem with the public carriers. I think in the past, it's often been determined that when the public carriers start spending that there is going to be an overall lift, which is true. I don't believe we're in that kind of a scenario today. I think what's happening is the second point that you were making, that we've reorganized and targeted going after parts of the business where we believe our value proposition is very strong. And I think the example that I used to reinforce that message was the Verizon win. And so that opportunity is differentiating us from many of the other choices that they have in the marketplace and that's really been a strong sales effort by our team.

Anil Doradla - *William Blair - Analyst*

So let's talk about the sustainability of this pickup that you talked about. Verizon is a big customer. I suppose you've just scratched the surface there. Now we've also had couple of key headwinds in the public carrier space last year or last couple of years where some of these build-outs have paused. So can you talk about the sustainability? I understand it's more driven by you rather than the end market, but once you get into the space and once you're an approved vendor, why should this trend not be sustainable, say, over the next multiple quarters?

Murray Wright - *TESSCO Technologies Incorporated - CEO*

Well, I think it should be. I mean, that's part of what the message is both internally to our team and externally is, as we are reorganizing, Anil. We're showing up in more of the ecosystem in the public carrier market than we have in the recent past. So we're being more aggressive there and delivering our value proposition. In addition, when you think about some of the large projects that are pending as well, such as 5G, perhaps that will be next year, we'll start to see some impact of that, and FirstNet. And I think that TESSCO can participate in those significant changes to the wireless industry. And we're working on some of those initiatives right now, but they're not going to deliver any results for us in the short term. Day to day, though, it is more like, I call it, hand-to-hand combat, Anil, and I think that we can win more of those daily battles. And I think our sales team is very energized right now. And Q1 is just an example of some things that I think we can see in the future.

Anil Doradla - *William Blair - Analyst*

So you mentioned 5G and Verizon. So can you help us understand a couple of things? Where are we on the 5G build-outs across North America? And how much of this pickup was driven specifically by 5G?

Murray Wright - *TESSCO Technologies Incorporated - CEO*

Yes, I think you're probably in a better position since you are more plugged into that marketplace to know the answer to that. But I don't think we see any real activity from 5G, and I don't think we're going to see anything significant until some point in the future. From what I've been told by our team and our customers and our vendors is, really we're probably not going to see any uptick until sometime late next year.

Anil Doradla - *William Blair - Analyst*

Okay, good. So that leads me to the next question on the gross margins. I mean, in the opening commentary, you talked about large customer exposure. Given the outlook over the next, call it 3, 4 quarters, if we do not see a pickup in 5G deployments, which I believe would be a big catalyst for you guys, is it fair to say that the gross margins hit kind of a bottom from here? And then we should start seeing some level of expansion in the public carrier market leading to the overall gross margins, or do you feel otherwise?

Murray Wright - *TESSCO Technologies Incorporated - CEO*

I think it's a mix. Our -- we've got a mix of products and we've got a mix of markets, and it's our job to try and figure out the mix so that we have a good, blended gross margin. I don't think we can point to just 1 area. And I'll say, for instance, Ventev grew 22% year over year. It's 15% of our business. So Anil, that's one of the other strategies, the gross margins in Ventev are very strong. As we become better and stronger in Ventev, it allows us to be more aggressive in other parts of our business as well. So that's the way I'm looking at it is that we have a collection of markets and customers of various different sizes and market opportunities that -- it's up to us to figure out how to blend that to improve our gross margins overall. Does that make sense?

Anil Doradla - *William Blair - Analyst*

Yes, yes, it does. So switching to kind of the retail side. Clearly, the Ventev has also played, but before we jump into that, the 15% of sales, can you give us a sense of the breakdown between the commercial and the retail? Now commercial is a new product line you guys have launched, so is -- of the 15% of sales, how much is retail and how much is the commercial?

Murray Wright - *TESSCO Technologies Incorporated - CEO*

It's about 50-50.

Anil Doradla - *William Blair - Analyst*

Okay. And the -- and was the growth -- 22% growth largely driven by the Galaxy launch? Or was it kind of evenly spread across the 2 segments?

Murray Wright - *TESSCO Technologies Incorporated - CEO*

It was split. I wouldn't say evenly. It was a little more growth on the retail MDA products.

Anil Doradla - *William Blair - Analyst*

And on the margin profile, are they very comparable from when you look at Ventev on the retail commercial or there is a difference?

Murray Wright - *TESSCO Technologies Incorporated - CEO*

I'd say they're very comparable. Yes, yes.

Anil Doradla - *William Blair - Analyst*

Now the Galaxy launch, obviously, unlike the past several years, some of these launches are shorter in their product cycle. Given Galaxy 8 has been out there, it's doing well I suppose, but how do you look at the -- this cycle, the Galaxy cycle from your point of view?

Murray Wright - *TESSCO Technologies Incorporated - CEO*

Well, it -- every time they release a new phone, it's good for us. So I think the Galaxy 8 is meeting expectations from our perspective. I think there is -- I think the more interesting conversation as well is, what's beyond now for the balance of the year? What other releases will occur with Samsung, and Apple for that matter?

Anil Doradla - *William Blair - Analyst*

Do you expect to see similar benefits with an Apple launch? Or you guys are more geared towards the Galaxy platforms at this stage?

Murray Wright - *TESSCO Technologies Incorporated - CEO*

Well, I think you know that Apple keeps things very close to their chest on releases of product and so on. I'd say that we are anticipating, if the past predicts the future, we're anticipating that there will be opportunities for us with the launch of either future Samsung phones or future iPhones.

Anil Doradla - *William Blair - Analyst*

Okay. Now switching to the SG&A. How should we be looking at the remainder of the year? As we get into the second half obviously, given that we saw some level of pickup in the second half of fiscal '17, should we be looking at sequential growth rates in the SG&A? Or -- I was just trying to get a qualitative sense of the trajectory of the spend for the remainder of the year.

Aric Spitulnik - *TESSCO Technologies Incorporated - CFO,*

Yes, I think as we look at the second half of the year, expenses definitely grew throughout the year last year but we also did some adjustments to SG&A, mostly in the fourth quarter of last year. So we'll see the benefits of those more from a year-over-year basis in the second half of the year. So I think we'll see some of the variable expenses higher in the second half of the year with things like freight and some of the commission plans as we hopefully continue to grow the top line. But I think the fixed costs and the general number of people, we'll actually see it slightly down from where we were in the second half of last year.

Anil Doradla - *William Blair - Analyst*

So, Aric, what are you saying? Is that a percentage of revenues or is it absolute dollars? Second half would be lower than the second half of last year?

Aric Spitulnik - *TESSCO Technologies Incorporated - CFO,*

Percentage of revenues because of the variable impact.

Anil Doradla - *William Blair - Analyst*

Okay. But in -- and can you give us a sense of the changes in the variable component for some of these sales guys? I mean, you don't have to give numbers, but qualitatively, can you give us a sense if 70%, 80% of their sales -- I mean, their -- the compensation was fixed, the variable was 30%. I mean, is it more like 50-50 now or how has it changed?

Aric Spitulnik - *TESSCO Technologies Incorporated - CFO,*

It's -- right now, it's close to a 70-30 split. I think it was -- it wasn't a dramatic change there. It was more that the way that we calculate it is very different now than it was then. We're now much more focused on growth than we were in the past. So you could have a smaller portfolio and grow it a lot and make some good money, as opposed to in the past it was more about having big accounts and whatever they did, regardless of whether they grew or not, you did really well. Now you really need to grow to continue to increase your earnings.

Anil Doradla - *William Blair - Analyst*

And, Murray, final question. I mean, as I said, congrats on turning the company around and getting back into growth. Now is the focus -- when you look at your priorities, I mean, growth will be -- always be a focus. But in terms of the time you're spending in your -- the energies that are -- you're consuming, is it now more on the margin side? Continuous alignment of the workforce? Where are you spending your -- most of your efforts right now?

Murray Wright - *TESSCO Technologies Incorporated - CEO*

Well, it's really, Anil, we're focused on the 4 initiatives that I talked about earlier. And I'd say that there is a balanced approach to making sure that the changes that we're implementing in the company, we referenced this -- I referenced this earlier, is that it's going to take more time this year for this to truly settle in, to hit the plan that we are expecting ourselves to hit with regard to the regionalization of the sales organization, coverage, our e-commerce tools, our engagement with our vendor partners, and then the expense management piece. If we do a good job, focusing on those 4 areas, which is where I'm spending my time through the balance of the year, I'm confident we're going to see improved performance in the company.

Operator

(Operator Instructions) And our next question comes from the line of Bill Dezellem from Tieton Capital.

William Dezellem - *Tieton Capital Management, LLC - Analyst*

Two questions. First of all, in the past, Murray, you have talked about an increase in the level of expenses that you will incur as you move the company to a more sales-oriented culture and some of these 4 priorities will require some spending. And yet, one of -- your fourth priority is to improve margins. And I think that you had mentioned that later this year, you would expect to see some margin expansion. Would you kind of pull all of those 3 things together? Number one, the increased spending that you had referenced in the past, the fourth priority to be improving margins and then the comment that later this year, you should be able to improve margins. It seems like a couple of those might be a bit in conflict. And I'd just like some clarification to understand better, please?

Murray Wright - *TESSCO Technologies Incorporated - CEO*

Sure, Bill. Thank you. I don't ever recall talking about increasing the overall spending in the company. What we are doing and what we have been attempting to do, and are in the midst of doing is rebalancing how we spend and what we spend our money on. So if the reference was, we're trying to spend more money in sales, that's part of the squeezing other parts of our business to improve productivity and process improvements so we can invest in the sales organization to help us accelerate growth in the company. That would be the context of spending -- increasing spending is, there are parts of the business, the IT organization is another one where we're going to invest in IT. But the other parts of our business, we're really very focused on just improving process and improving productivity to allow us to fund some of the investments that we know will deliver benefits to the company longer term. And as a result of that, if we get the lift in the top line and we hold our margins or enhance our margins through expense control, that's where you're going to see margin improvement overall as we go through this transformation process in the company.

William Dezellem - *Tieton Capital Management, LLC - Analyst*

That's quite helpful. And then relative to the carriers, I don't want to overstress them, but you did mention that you do -- you have not seen a pick up in their overall spending levels, but you may, like, next year see 5G lead to a pick up. I'm going to ask, broadly speaking, when do you think the carriers will see a pick up in their spending? And will it be specifically related to 5G? Or do you see other things coming that will lead to that carrier pickup? And when you answer the question, if you could leave FirstNet out of it, given that, that's kind of a whole other opportunity in of itself.

Murray Wright - *TESSCO Technologies Incorporated - CEO*

I think that the overall lift from the carriers, the point that I wanted to make and that I want our shareholders and potential investors to understand, is that the ecosystem inside of the carrier market today, there's not anything in particular that's driving an accelerated amount of growth. I think the important point is that we are showing up and winning based on our value proposition. The upside for us will be when some of these big initiatives start to land. As you know, many of these carriers, they're investing and buying new companies. They're focusing on content. Verizon just purchased -- they closed the deal for Yahoo! So Verizon is spending money, there's no question, but the build-out, as it was typically expected, I think it's morphing or changing a little bit. However, 5G is an obvious -- it's an obvious opportunity for the entire ecosystem. And we're positioning ourselves in a better way with the carriers and with the ecosystem of carriers because we do see the general lift in wireless, on-time access, anywhere, anytime access for wireless. We think that that's going to continue to grow but perhaps look a little different than it has in the past, until you get to the conversation around what's 5G going to being -- bring. And I would come back to FirstNet because we do know that that's a $6.2 billion spend over the next 5 years that's going to start sometime towards the end of the year or early next year.

Operator

And our next question comes from the line of Bentley Offutt from Offutt Securities.

Bentley Offutt - *Offutt Securities, Inc. - Analyst*

I have a question relating to the significant increase of your need for new money, and the fact that you mentioned in there you're seeking to either expand your -- I assume your credit line, your revolver. Can you give us more feel as to what your goals are in that area?

Aric Spitulnik - *TESSCO Technologies Incorporated - CFO,*

So what we're trying to do there is just to make sure that we have the capability to continue to participate in these carrier spends. As we've talked about, there's some -- a lot of uncertainty as -- and to timing of when the carriers are going to be spending. FirstNet is coming, this Verizon program is coming. And we -- what we're doing is trying to be diligent and making sure that when we need to have access to that capital to buy inventory that we're able to do that. So we're just trying to be very diligent on the front end and not get caught in a situation where we don't have enough dry powder to go to, to access money for inventory when we need it. So just trying to be on the front end of things and being proactive.

Bentley Offutt - *Offutt Securities, Inc. - Analyst*

Well, basically, you would be working off of your receivables, some sort of a line on the size of your receivables or...?

Aric Spitulnik - *TESSCO Technologies Incorporated - CFO,*

Yes, the way our line currently works is it's a borrowing base that currently is focused on receivables. We have the ability to also add in inventory there. So that's one of the things we're looking at with the banks, is to substantially add inventory to increase the capacity of the line.

Bentley Offutt - *Offutt Securities, Inc. - Analyst*

But your relationship, I -- you didn't mention how long this contract that you had signed with Verizon? You said it's multi-year, can you tell us a little bit more about that?

Aric Spitulnik - *TESSCO Technologies Incorporated - CFO,*

Not really. It's a -- it's just a longer-term, multi-year arrangement, but it's not something that we can get into the specifics on at the moment.

Bentley Offutt - *Offutt Securities, Inc. - Analyst*

You had mentioned at a recent conference call or a presentation that you had, that the importance of FirstNet and also of IoT. And your relationship with Verizon IoT. Can you comment on, first, the size of FirstNet, from what I gather, when you add the government along with the investment from AT&T over a 5-year period, this is more than $6 billion.

Murray Wright - *TESSCO Technologies Incorporated - CEO*

Well, you're probably right about that, Bentley. This is Murray. And thanks for the question on the IoT piece as well. This is the -- a part of the business I think you're aware that we already are in the machine-to-machine communication business and we're taking steps right now to build-out our vendor partners and our go-to-market strategy in IoT. The Verizon example in our AgTech solution has been in pilot mode for a while now, and so the sellers of that solution are the Verizon sales organization. And so we're working closely with them to just try and accelerate that business.

Bentley Offutt - *Offutt Securities, Inc. - Analyst*

Isn't the margins on that IoT business significantly higher than your current risk margin base?

Murray Wright - *TESSCO Technologies Incorporated - CEO*

It can be. If you're only in product sales, probably not. But if there are services and solutions that you're wrapping around IoT, then for sure there is significant margin improvement. That's why we're interested in participating in this marketplace to a greater extent than we do today. We think that there is opportunities there, and we think we're really well-positioned to capitalize on some of the opportunities that are coming together. We needed to build out more of our portfolio before we can really go to some of our VAR customers and integrators with that fully integrated solution. But we're -- it's work in progress, so there's been some good progress occurring on that.

Bentley Offutt - *Offutt Securities, Inc. - Analyst*

So when -- you had mentioned earlier that you're -- I'm not sure exactly, it was said that basically parts of the puzzle, parts of the overall line of products would be variable during the year, they're not straight up. Are you talking about the overall performance of the company? Or are you talking about parts of the puzzle -- of the overall product line?

Aric Spitulnik - *TESSCO Technologies Incorporated - CFO,*

I think you're asking -- we said our results might vary from quarter to quarter, and are you asking whether that's going to be in specific product lines or across the board? Is that the question?

Bentley Offutt - *Offutt Securities, Inc. - Analyst*

Yes, yes.

Aric Spitulnik - *TESSCO Technologies Incorporated - CFO,*

So I think -- what I think Murray was really talking -- what we were really talking about there is, distraction isn't the right word but there's a lot of moving parts in the business right now with some of the new leadership, some of the new reorganizations and I think that would really impact really all of the business. The carriers, in particular, are certainly going to have some spikes up and down here over the next couple of quarters, based on the timing of their individual purchases quarter-to-quarter. And we've always seen retail being very spiky, especially in our Q2 and our Q3s, related to the Apple phone launches, which we think will come sometime in the fall but not sure when yet and for the -- of course, the holiday season which is always big. And then of course, the lower Q4, post-holiday. So those are some of the more traditional spikes in the business. But I think what we were really referring to is, to some of the changes that's -- that are going on in the organization that will have a little bit of an impact from a quarter-to-quarter basis.

Bentley Offutt - *Offutt Securities, Inc. - Analyst*

Getting back to FirstNet and this is my last question. Back to FirstNet, that should be having a significant impact on the company within the next year, perhaps the next quarter or 2...

Murray Wright - *TESSCO Technologies Incorporated - CEO*

We're not anticipating, Bentley, it to be the next quarter or 2, but certainly by the end of the year. The states have to either make a decision to opt in or opt out by the end of October. So if you think about a trigger, the states have until that day, and you know how things work. I mean, everybody waits till the last minute for the most part. But I think there's only been 1 state, in fact, that's made a decision to opt in at this point and that doesn't mean that the other states haven't -- they just haven't made any decision. So that doesn't really start to get interesting until after that becomes more clear.

Operator

And I'm showing no further questions, and I would like to turn the call back to Murray Wright for any further remarks.

Murray Wright - *TESSCO Technologies Incorporated - CEO*

Well, thank you, Brian, and thank you to everyone for joining us today. We're encouraged by our execution and continued momentum, and we really look forward to new successes throughout the year. We appreciate your interest in TESSCO and we look forward to speaking with you again on our next earnings call in late October. Thanks. Have a great day.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes today's program, and you may all disconnect. Everyone, have a great day.