Spartan Motors, Inc. [SPAR]
Q2 2019 Earnings Conference Call
Thursday, August 1, 2019, 10:00 AM ET

Company Participants:
Juris Pagrabs, Group Treasurer and Director of Investor Relations
Daryl Adams, President and Chief Executive Officer
Rick Sohm, Chief Financial Officer

Analysts:
Justin Clare; Roth Capital Partners
Steve Dyer; Craig-Hallum Capital Group
Steve O'Hara; Sidoti & Company

Presentation:

Operator: Good morning and welcome to Spartan Motors 2019 Second Quarter Conference Call. All participants will be in a listen-only mode until the question-and-answer session of the conference call. This call is being recorded at the request of Spartan Motors. If anyone has objections you may disconnect at this time.

I would now like to introduce Juris Pagrabs, Group Treasurer and Director of Investor Relations for Spartan Motors. Mr. Pagrabs, you may proceed.

Juris Pagrabs: Thank you, Danielle. Good morning, everyone, and welcome to the Spartan Motors 2019 second quarter earnings call. I'm Juris Pagrabs and joining me on the call today are Daryl Adams, our President and Chief Executive Officer; and Rick Sohm, our Chief Financial Officer.

For today's call, we've included a presentation deck, which will be filed with the SEC and is also available on our website at spartanmotors.com. You may download the deck from the Investor Relations section of our website to follow along with our presentation during the call.

Before we start today’s call, please turn to Slide 2 of the presentation for our safe harbor statement. You should be aware that certain statements made during today's conference call, which may include Management's current outlook, viewpoint, predictions, and projections regarding Spartan Motors and its operations, may be considered forward-looking statements under the Private Securities Litigation Reform Act of 1995. I caution you that, as with any prediction or projection, there are a number of factors that cause Spartan's actual results to differ materially from projections. All known risks that Management believes could materially affect the results are identified in our forms 10-K and 10-Q filed with the SEC. However, there may be other risks that we cannot anticipate.

On the call today, we will provide an overview of the second quarter along with a brief business update followed by a more detailed review of the second quarter results and an update on our outlook for the remainder of the year before proceeding to the question and answer portion of the call.

At this time, I'm pleased to turn the call over to Daryl for his opening remarks, which begin on Slide 3.

Daryl Adams: Thank you, Juris. Good morning, everyone, and thank you for joining us on our second quarter conference call.

Before we start, you may recall in June we brought on a new COO, Todd Heavin. Todd is a proven multi-site operations and lean manufacturing leader with significant Tier 1 automotive supplier experience, and brings global and domestic operational leadership to the Spartan team. In the short time that Todd's been here, his emphasis on operational metrics alongside the implementation of the lean manufacturing and continuous improvement principles of the Spartan production system is refreshing. We look forward to Todd's contributions and welcome him to the management team.

I want to start by saying how pleased I am with the team's hard work in Q2. We have laid the foundation for improved performance over the past several years and those efforts are yielding strong results as our business gains momentum. Revenues for the second quarter rose 35% to $248 million from $184 million a year ago. The strong growth at FVS continued in the second quarter as sales were up 80%, driven by the USPS truck body order in Ephrata, Pennsylvania, and higher last-mile delivery vehicle demand. The strength in FVS is poised to continue in the second half of the year due to accelerating demand. ER had posted solid growth, up 15% to $68 million as the segment benefited from increased deliveries and pricing actions. SCV sales reflect higher contract manufacturing, including Reach production, partially offset by softer luxury motor coach chassis sales.

Now, please turn to Slide 4 and I'll provide an update on a few business highlights and exciting new developments starting with FVS. Broad customer demand across our entire vehicle class spectrum continues to be a driving force in propelling the growth of FVS. While we are pleased with the growing momentum of the FVS business, we continue to invest in new products and technologies that will drive future growth in that segment. In May, FVS reintroduced the Utilivan, a highly customizable commercial truck body designed to meet the rigors of varied demands of commercial product and service delivery. In June, we introduced several new innovations for linen and laundry service providers at the Clean Show in New Orleans. This is the latest example of our work-driven design approach that enhance the safety, efficiency, and productivity for our fleet customers.

Please turn to Slide 5 for an update on our recent acquisition. As we look at future growth and new business opportunities, we are focused on meeting customer demand. Following the recent expansion of our East Coast production facilities, in June, we announced the acquisition of General Truck Body. The purchase immediately expands our truck body manufacturing operations into Southern California. This addition, combined with the existing FVS facilities,

provides coast-to-coast production and distribution capabilities for our fleet and commercial truck body customers.

Please turn to Slide 6 and we'll discuss a significant development for the ER business. In keeping with the objective of optimizing operations and enhancing efficiencies to drive consistent profitable growth, last month we announced the launch of Detroit Truck Manufacturing. This new operation will serve as a vertically integrated supplier of fabricated aluminum cabs for the ER business. We expect this initiative to provide improved costs, flexibility, and quality while mitigating potential risk in our broader supply chain. The facility is located in Southeast Michigan, a short drive from Charlotte, and has the capacity to fabricate our current needs.

Please turn to Slide 7 and I'll continue with Specialty Chassis and Vehicle segment. Despite SCV's revenues being down 12% year-over-year reflecting lower luxury motor coach sales as a result of dealer adjusted inventory levels, we saw our EBITDA margin grow 300 basis points to over 12% during the quarter. The margin expansion was driven by favorable mix and increased manufacturing throughput from contract manufacturing, including the Reach vehicle. To further diversify revenue base in SCV segment, SCV entered into an exclusive U.S.-based assembly agreement with Grande West Transportation Group to assemble their Vicinity, a mid-size bus. This agreement leverages SCV's U.S.-based contract manufacturing and opens a new addressable market for the segment.

With that, I'll turn the call over to Rick to discuss Spartan's financial results for the second quarter, as well as revised outlook for the remainder of 2019.

Rick Sohm: Thank you, Daryl. I'll turn to page 9.

Our Q2 results highlight growing demand for last mile delivery and our continued effort to drive profitability across our company. We expect revenue and profit growth to accelerate in the second half of 2019, driven primarily by a last-mile delivery demand which allows us to raise our full year outlook.

Q2 adjusted EBITDA grew 7% to $9.5 million from $8.9 million a year ago. Adjusted EBITDA margin declined to 3.8% from 4.8% a year ago due to the USPS truck body order and a favorable mix due to a nonrecurring upfit order, higher material costs, and approximately $0.7 million of upfit ramp-up costs. Adjusted net income grew 19% to $5.1 million from $4.3 million a year ago while adjusted EPS grew to $0.15 per share from $0.12 per share in the prior year. Additionally, Q2 operating results include $0.8 million or $0.02 per share of setup costs relating to DTM compared to $0.3 million or $0.01 a share a year ago.

Our backlog at quarter-end, excluding the one-time multiyear truck body order, grew to $465.8 million, up 46% from $319.8 million in the prior year.

Now, we'll look at each operating segment beginning with Fleet on Page 10. Fleet reported revenue of $141.1 million compared to $78.4 million a year ago for growth of 80%. The higher revenue reflects $36 million of pass-through revenue from the truck body order and growing last-

mile delivery demand compared to $8 million of pass-through revenue a year ago. Adjusted EBITDA declined $0.5 million to $7.9 million from $8.4 million a year ago largely due to unfavorable mix. Adjusted EBITDA margin declined to 5.6% from 10.7% a year ago due to unfavorable mix relating to a 2018 upfit order that did not reoccur and pass-through revenue that was up significantly in 2019. There were startup costs of $0.7 million for all three upfit centers and beginning to relocate truck body to Charlotte, Michigan, from Bristol, Indiana. Excluding the above, Q2 '19's normalized adjusted EBITDA margin was 7.5% compared to 6.3% a year ago. Excluding the one-time multiyear truck body order, fleet backlog grew $135 million or 123% to $244 million compared to $109 million a year ago.

Moving to Page 11 and ER, second quarter 2019 revenue grew 15% to $68.3 million, up from $59.6 million a year ago. The growth was due to increased volume and improved pricing. Adjusted EBITDA in Q2 improved $0.9 million to a profit of $1.1 million from $0.2 million in the prior year. The improvement was primarily the result of pricing, volume and mix, and certain acquisition-related adjustments partially offset by higher supplier material costs. Our ER backlog grew $14.1 million or 8% to $190 million compared to $176 million in the prior year.

Moving to Page 12 and SCV, revenue was down 12% to $41.7 million from $47.5 million primarily due to an $8.5 million decline in luxury motor coach volume, driven by weaker demand in our segment of the RV market. Despite the decline in revenue, adjusted EBITDA grew 16% to $5.1 million from $4.4 million a year ago, driven by favorable mix and higher manufacturing throughput. Adjusted EBITDA margin grew nearly 33% to 12.2% from 9.2% a year ago. Backlog at the end of Q2 grew 11% sequentially to $32 million from $29 million at Q1 2019.

Turning to our balance sheet on Page 13, our overall financial profile will provide ample flexibility to meet all of our long-term growth requirements. During the quarter, we paid down $5 million on our revolver and our total liquidity at the end of the quarter was $101 million, reflecting $18 million in cash and $83 million of borrowing capacity.

On Page 14, I'll review our outlook for the remainder of 2019. With the strength of our backlog and momentum in key markets while taking into account additional launch costs to meet higher last-mile delivery demand, we're updating our outlook with the following: Revenue midpoint up 10% to a range of $960 million to $990 million; net income up 20% at the midpoint to a range of $24.1 million to $26.4 million; adjusted EBITDA midpoint of 14% to a range of $43.3 million to $46.2 million; EPS midpoint up 20% to a range of $0.68 to $0.75 a share assuming 35.3 million shares outstanding; adjusted EPS midpoint up 21% to a range of $0.70 to $0.77 per share.

I'd now like to turn the call back over to Daryl.

Daryl Adams: Thanks, Rick.

Please turn to Slide 15. Spartan's strong performance in the first half of 2019 positions us well to capture additional growth in the long term. Increasing broad customer demand across our entire product portfolio and improving backlogs are expected to drive second-half revenues and profitability growth.

The Spartan team remains focused on executing our overall strategic plan and will continue to invest in new products, innovation, and manufacturing footprint to expand our leadership position in the markets we serve. Through the efforts of our entire Spartan team, we will continue to drive results that will ultimately benefit our employees, customers, and shareholders.

Operator, we're ready to take questions.

Questions and Answers:

Operator: We will now begin the question-and-answer session. [Operator Instructions] The first question comes from Justin Clare of Roth Capital Partners. Please go ahead.

Justin Clare: So I guess I first wanted to start off with guidance. So your updated 2019 guidance for revenue and adjusted EBITDA suggests that you anticipate improving EBITDA margins in the back half. Just wondering if you could comment on where you expect to see improvements in terms of which segments and then just how you anticipate the margins evolving in each segment as we move through the year?

Rick Sohm: Yes, Justin, I think a big driver is last-mile delivery demand. So I would expect that the majority of the improvement in the second half will come from Fleet. If I look at their current margin, it will improve significantly in the third and fourth quarter. If I look at ER, I would expect some improvement there in the margin. And with Specialty, I think they were at 12.2% in Q2. I think I would expect that to be the kind of high watermark in Q2, and we would see Q3 and Q4 more in line with where they were earlier in the year.

Justin Clare: Okay, great. That’s very helpful. So last month you announced a meaningful order with a leading e-commerce customer that you’re working with. It included a minimum volume for walk-in-vans to be delivered in the back half. I know it’s still early, but could you comment on the potential to supply more than the minimum? What kind of capacity do you have to do that and then what demand are you seeing? And then is any upside included in the guidance range that you provided today for your revenue?

Daryl Adams: Hi Justin, this is Daryl. I’ll take this one. We’re seeing, as I said, broad demand at the FVS group through all of our vehicle segments 1 through 7. That was one order, right, that we talked about only because it was material and we needed to let everyone know, but behind that we still get multiple orders from our traditional customers and some new ones. But, I’ve talked about it before, the e-commerce demand and the closing of brick and mortar stores is driving demand again through all our segments and through all the traditional last-mile delivery customers. So we don’t know, right, how many orders we’re going to continue to get, but all I can tell is if you read the economics you understand the brick and mortar stores closing and e-commerce growth, it’s bound to continue to grow. And that’s what’s exciting to us.

You also asked about capacity. So we’ve added some capacity, last year three plants on the East Coast. We have capacity we’ve added in the West Coast now. We do have some flexibility here in Charlotte with the Reach build ending. We are moving some truck body out of Bristol into Charlotte. We’re also moving Bristol truck bodies into Pennsylvania, and we’re having good

feedback from our truck body customers on the acquisition of General Truck Body out in California. So the capacity will not be an issue. We have that and, if you remember, the majority of our plants are on one shift. Some of them are a little bit into the second. So we can also ramp up multiple shifts if we need to.

Justin Clare: Okay. That's very helpful. Then, one final question for me. There's been some improvement in commodity pricing recently, but at the same time we've got another increase in tariffs with the List 3 tariffs being moved to 25% from 10%. I was wondering if you'd just comment on generally how these two different factors are affecting your cost structure and whether you're able to mitigate any of the effect of the increase in tariffs.

Daryl Adams: I'll take it again, Justin. If we go back to the previous calls that we've had, we put in actions to mitigate what we could see at the time. We've re-sourced products that would've caused us some heartburn in the second half of last year due to the tariffs into different regions of the world, some back into the U.S., like others did. So right now, we're comfortable with where we're at on the tariffs. We don't see any impact at this point into the numbers that we're presenting. Now, again, if something happens with additional tariffs that we don't know about that will be something we'll have to take into account and understand it. But the ones that we know of we've taken actions and we feel comfortable with the guidance we've given.

Justin Clare: Okay, that's it for me. Thanks guys.

Operator: The next question comes from Steve Dyer of Craig-Hallum. Please go ahead.

Steve Dyer: Congratulations on the results. I guess just a couple things first with FVS. The order you announced here subsequent to the end of the quarter, is that included in your FVS backlog or is that above and beyond as of 6/30.

Rick Sohm: We would have that in our backlog at the end of the quarter, correct.

Steve Dyer: Okay. So it was just a couple week delay in announcing it basically.

Rick Sohm: Yes.

Steve Dyer: Okay, okay. Just looking at the Ephrata facility. I guess, as you're working your way through the USPS order, are you able to share sort of how is it going in terms of procuring more business from them or how are feelings about sort of finding things from other customers in a way that sort of keeps that plant running at a similar level next year and in the future?

Daryl Adams: Steve, this is Daryl. I'll answer that for you. So I think we mentioned last quarter that we are seeing orders coming in from one of our larger fleet customers that we typically would have. We like the location. We're seeing some momentum on the local dealers asking for trucks. That was part of the announcement with the Utilivan that we launched. That was their request in addition to regular truck bodies. So we're seeing good momentum. And we're starting to see good dialogue too among some of our fleet customers with all three locations now. One of our customers would only give us a third of the order because we could

handle the Midwest. Now, we're starting to hear dialogue about the complete order, which we've talked about in the past we couldn't get. Now, we're going to get it because of the California location, Ephrata location, and then Bristol or Michigan where we're building truck bodies. So we're seeing a nice backlog at the Ephrata plant when this ramps down at the end of Q3.

Steve Dyer: Got it. That's very helpful, thanks. I guess sort of broadening out as some of the Class 8 guys and dry van guys have reported. They've talked it seems a little bit of a slowing expected in that industry Q3, Q4, into next year and so forth just with the economy. I suspect what you're seeing in final mile sort of bucks that trend pretty significantly. But I guess beyond this year what are you seeing there, or what do your conversations suggest, just in terms of how cyclical is this space or how might it not be not cyclical at all.

Daryl Adams: Again, Steve, I talk about the growth in e-commerce. You can Google it, right? It's a double-digit multiple. And the brick and mortar stores are closing, we continue to talk about that, it's in the press. I don't know what the slope of that curve is in next year or the year after, but I don't see how it's going to slow down. And it may slow down [on the] Class 8, but we're well positioned with our Class 1 through 7 to fulfill the needs. And I think we've talked before, multiple customers are coming to us. We've expanded into, I think, 6 or 7 now that are buying the Eurovans Class 2, moving into walk-in vans, and then also moving into truck bodies. And we're picking up parts and service with them and field service. So as these trucks continue to put miles on, with our 1 through 7 we feel we're positioned. We're actually looking at some business in Class 1 now. It would be into the smaller Eurovans that are coming in and that's exciting. And I think it just goes to show that the strategy we put in place a few years ago to move down the segments and fulfill one-stop shop for our customers is starting to take hold.

Steve Dyer: Got it. Okay, one last for me and I'll hop back in the queue. Just in terms of specialty chassis, not an area a lot of people talk about much, but what are you hearing sort of from your luxury motor coach customers just for expectations in the second half of the year and maybe early visibility into next year just around that cycle?

Daryl Adams: Now, that's a difficult question. We continue to probe there, as you can imagine, trying to figure out as well. At this point, we don't have any solid direction or guidance. We're monitoring it as close as we can. The team is meeting with them. And, again, they're trying to understand why. There are some changes they're making quick to the vehicle size in order to bring us new customers, but we're, again, with the technologies we're putting in, moving down in the less than 400 horsepower -- are some of the things that are helping us buck a little bit of the trend. But hopefully next quarter we'll have some additional opinions on it, but right now we don't have anything solid that we can share.

Steve Dyer: Got it. Okay. Congrats again, guys. Thanks.

Operator: The next question comes from Steve O'Hara of Sidoti and Company. Please go ahead.

Steve O'Hara: Just in terms of the acquisition profile or the acquisitions that you've made so far, I think I heard you say that you're kind of coast to coast in terms of your build-out within that business. Is that the case or is there more to come in terms of being able to source customers throughout the country if, let's say, Frito-Lay needs trucks on the West Coast or something like that or the South? Are you guys fully built out on that yet or where does that stand?

Daryl Adams: Yes. Good question, Steve. Maybe we could've added some more clarity to it. So before 2018, before Ephrata, we were isolated just to the Midwest because each of these vehicles do take a driver and the cost to get to the East and West Coasts deteriorates our margins and doesn't make us competitive. Now, with that said, because we're in Ephrata doesn't mean we can fulfill the need all the way up and down the coast, but the majority of the population is up in the Northeast and that's why we went there first. Some of the data tells us that 15% of the entire truck-buying market is sold in two states, which is Pennsylvania and New York. Then, on the West Coast, right, we're in Southern California, which is the most populated area. So we feel we're pretty good in the Northeast and the Southern California.

Our strategy, as we've talked about before, is eventually, we're not built out yet, , with the location in North Charleston, South Carolina, the plant is large enough to start building truck bodies there. Once we get the ramp-up completed with the Eurovans [from] the Sprinter, we'll be focused on that. And then we're actually looking for some space in north of Pompano Beach, probably the mid-Florida, for some more property to put a facility up there. Once we get that capacity, we'll have space in that facility also to build truck bodies. So we can handle most of the customers, but for the fleet side on the commercial side the build-out over the next probably 18 months is going to help us with that growth. And that's why we see the momentum growing, is that we're following our strategy. We're disciplined. We're sticking with it and we're seeing the growth in Class 1 through 7.

Steve O'Hara: Okay, that's helpful. And then, I guess, on the other thing, I mean I can't recall off the top of my head, but I recall you guys talking about kind of long-term goals for 2020 and I think it was something in the neighborhood of $1 million dollars in revenue and 10% EBITDA margins. It seems like you're getting close there in terms of the revenue side and I think you caveated that in the past given some of the tariff issues, about needing acquisitions. So you're almost there on the revenue side. What needs to happen to kind of help close the gap? It seems like this year is going to be significant progress over last year, but what pieces remain in terms of getting there, not necessarily by 2020 but getting there eventually?

Daryl Adams: We didn't come down on our number. We just delayed it. We have not put a timeframe on that, so it is still in our sights. But you're correct. We'll see the revenue side sooner because of the tariffs. And, again, for us to put a target out there we need to get some stability in the tariff market both with NAFTA, that's not approved yet, which is USMCA still hanging out there, and then the activity with the tariffs into China. To put a timeframe on it, it wouldn't be fair for me to do that to the team or to the shareholders. But it is still a goal. We see it and then, especially with Todd Heavin on board, we see some positive momentum on the operational improvement side. So we're going to attack on all fronts and make that our goal.

Steve O'Hara: Okay, just, I mean, without putting a timeline on it in terms of the business profile that you have now, the customers that you have now, is getting the margins up maybe something that's more doable now than it was maybe 6 months ago or a year ago? Or do you feel more confident that it seems like you're on the right track in terms of that process and will continue to kind of march forward?

Daryl Adams: Yes, we feel comfortable. We're just going to march forward. Most of that was internal costs, right? And some of our orders, if you recall, were pretty tough to go back to municipalities and increase prices on a contract that's been sourced. So we had to let some of that run through. We talked about that on previous calls. ER should be clean, I think, Q3 sometime.

Rick Sohm: By Q4 probably.

Daryl Adams: So there's some drag-on effect, Steve, that we see cleaning up maybe late this year and into next year, and that's as long as there are no more tariffs. So we're okay on the customer and the pricing side. It's more of the material and operational side that we think we're going to make positive inroads on.

Rick Sohm: And one other thing. I thought in our push to 10% we had assumed that we could go overseas or into Mexico and explore opportunities there. So not only did we not get any savings domestically but last year made going overseas impossible.

Steve O'Hara: Yes; no, that makes sense. Okay. Thank you very much.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to Mr. Pagrabs for closing remarks.

Juris Pagrabs: Thank you, Danielle. Thanks everyone for joining us this morning. We'll be at a couple conferences coming up in August, Jefferies next week and Seaport at the end of the month. We look forward to keeping you updated on our progress for the rest of the year, and I think our next earnings call will be scheduled end of October or early November. Thanks again and have a great day.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.