Spartan Motors, Inc. [SPAR]
Q1 2019 Earnings Conference Call
Thursday, May 2, 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:
Matt Koranda; Roth Capital Partners
Steve Dyer; Craig-Hallum Capital Group
Steve O'Hara; Sidoti & Company

Presentation:

Operator: Good day and welcome to the Spartan Motors, Inc., First Quarter 2019 Earnings Results Conference Call and Webcast. All participants will be in a listen-only mode. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Juris Pagrabs, Group Treasurer and Director of Investor Relations. Please go ahead.

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

In 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 the 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 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 could 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 plan to provide an overview of the first quarter, a brief business update, as well as a more detailed review of the first-quarter results and our outlook for the remainder of the year before proceeding to the Q&A 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 as we discuss our first-quarter 2019 results.

I'm very pleased to report a solid quarter for Spartan Motors. This marks a positive start to the New Year. Revenues for this quarter rose 35% to $234 million from $173 million a year ago. Excluding impact for the one-time USPS order, FVS sales were up 37% due to higher truck body, walk-in van and up-fit center volumes. SCV also posted solid sales growth, as the segment benefited from higher contract manufacturing volumes, including truck bodies for FVS due to capacity constraints in our Bristol, Indiana facility and the continued strength of our luxury motor coach sales, particularly from the less-than-40-foot Class A diesel market. And in ER, while sales were down, we are starting to see positive momentum as we work through the disruption caused by the acquisition and begin to see our backlog grow, which is up 13% over the prior year.

For the first quarter of 2019 we reported net income of $1.4 million, or $0.04 per share, compared to a net income of $4.2 million, or $0.12 per share, last year. In last year's results we had an additional tax benefit of $1.4 million, or $0.04 per share, due to the share price appreciation for equity compensation, and $1.5 million, or $0.03 per share, of net working capital adjustment related to the Smeal acquisition. Excluding these items net income and EPS were essentially unchanged compared to prior year. Our ongoing performance has been driven by the strength of our team and our companywide efforts to promote operational improvement and profitability for the long term.

Now turning to Slide 4, I'll provide an update for a few business highlights and developments. We are pleased with the positive start to the year, as we are beginning to see the positive results for many of the initiatives we have implemented over the past year. The USPS contract accounted for approximately $41 million of revenues during the quarter, or approximately two-thirds of the total sales growth of $63 million.

Beyond the USPS truck body contract, we remain focused on meeting the needs of all customers focused on last-mile delivery. We are currently engaged with a major North American online retailer for the design of Class 3, 4 and Class 5 vehicles to facilitate their last-mile delivery needs. We also have a new order for UPS truck bodies that will be built at our Ephrata production facility. In addition to this contract, we have orders from Pepsi, Frito-Lay, Enterprise, FedEx and Verizon. Due to strong order flow, our first-quarter FVS backlog has increased 10% sequentially.

We continue to invest in new technologies to drive future growth in FVS. At the recent NTEA Work Truck Show in Indianapolis we introduced a temperature-controlled last-mile grocery delivery vehicle. This temperature-controlled truck features a fully customizable and configurable climate-controlled zone for refrigerated, frozen and ambient-temperature goods. We'll also build a new Cummins EV Reach chassis that will provide enhanced efficiency and productivity for the fleet operators.

In addition, our EV walk-in van chassis, powered by Motiv Power Systems, has a new one-piece windshield that will enable 360 degree camera technology. Our EV capabilities have the ability to produce vehicles across Classes 1 through 6 in gross vehicle weight ratings.

In addition to new innovations we have also strengthened our leadership team in the FVS segment to support our growth with the addition of a new business unit Vice President of Operations.

As we've told you in the past, expanding our geographic reach is at the forefront of our strategic growth initiatives. With the acquisition of Strobes-R-Us we have now completed our East Coast manufacturing footprint, having 3 production facilities located in Ephrata, Pennsylvania; North Charleston, South Carolina; and Pompano Beach, Florida, which will help support our customer delivery needs across our portfolio of products.

We are also in the process of securing additional manufacturing space near the Strobes-R-Us facility in Southeast Florida to increase our vehicle output capacity, as our entry into this segment has created increased interest and demand from new and existing customers.

Please turn to Slide 5 and I'll continue with the ER. We made progress on several strategic fronts that are shaping the ER business for profitable growth. The new President of ER, Todd Fierro, has hit the ground running, working alongside our dealer network and OEM customers. At the most recent FEIC Show in Indy, our dealers and OEMs expressed excitement at Todd's energy and extensive experience in manufacturing operations, including product development, sales and distribution. We look forward to Todd's contributions to help drive and improve the business unit long-term profitability.

At the Show we reintroduced our Ladder Tower 93-foot mid-mount platform that offers unparalleled performance in a compact package. It's one of the most maneuverable vehicles in Spartan's ER product line. The truck design allows for unmatched agility in tight urban and suburban environments.

We also unveiled a new pumper, the IPS-NXT, which offers first responders a powerful rescue/pumper combination with a compact design, making it one of the most versatile pumpers in the industry. The IPS-NXT is the ultimate solution for departments that demand a multifunctional pumper without compromising high-flow pump capacity.

We've also made significant progress in realigning our ER sales team, resulting in multiple new orders. The most notable are a 13-unit fire apparatus order from a large municipality in Texas, an 8-unit order from the City of Philadelphia and, most recently, an 11-unit order from the City of St. Louis. With a strong order intake the first-quarter segment backlog rose 13% from a year ago.

The ER team also made progress in expanding its dealer footprint by adding Georgia-based Peach State Emergency Vehicles, a division of Peach State Truck Centers, a sister company of Alabama Emergency Vehicles.

Turning to Slide 6, I'll continue with SCV. We saw a continued shift in demand in the North American luxury motor coach market, as consumers increasingly seek a balance of luxury and value with innovation and technology. As a long-term supplier partner in the industry, Spartan provides the quality, technology and innovative features that enhance the value of our customers' coaches for their consumers.

During the quarter we expanded our relationship with Entegra Coach with the launch of the new 2020 Entegra Reatta XL luxury motor coach at the FMCA in Perry, Georgia. The new model includes customized suspension components to provide a Reatta XL owner's best-in-class riding and handling in a more compact footprint. Additionally we launched a new chassis with NeXus RV on their Bentley Diamond 40-foot diesel motor home. These new products highlight Spartan's expanding presence in the sub-40-foot luxury motor coach market. Our work to expand our addressable market in the luxury motor coach space has helped us gain market share.

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

Rick Sohm: Thank you, Daryl.

While we reported better than expected top-line growth, we continued to deal with higher input costs that negatively impacted our profitability year over year.

Q1 adjusted EBITDA declined $1 million to $4.6 million from $5.6 million a year ago. Adjusted EBITDA margin declined to 2% of revenue from 3.2% a year ago, primarily driven by $2.3 million in higher tariff-driven input costs. Adjusted net income declined to $1.5 million from $3.3 million in the prior year, while adjusted EPS fell to $0.04 a share from $0.09 a year ago. The prior-year quarter included a $1.4 million, or $0.04 per share, tax benefit due to the appreciation in value of stock compensation vested during the quarter.

Without the impact of the one-time USPS order, backlog grew 5% to $359 million compared to $341 million the prior year. Our reported backlog at quarter end was $432 million, down from $555 million in the prior year due to the continued fulfillment of the one-time order.

Now I'll review the quarter by segment, beginning with Fleet on Page 9. Reported revenue more than doubled to $123 million compared to $60 million in the prior year, reflecting higher volume related to pass-through revenue of $32.5 million, higher walk-in van and up-fit volume, which was partially offset by lower Reach volume. Adjusted EBITDA grew $2.4 million to $7 million, from $4.6 million a year ago, largely due to the higher volume, partially offset by higher input costs and a shift in product mix. As a result, EBITDA margin declined to 5.7% of revenue from 7.7% a year ago. Again, excluding the impact of the USPS order, sequential backlog grew 10% to $115 million at quarter end compared to $105 million at year-end 2018. Reported backlog declined by $147 million to $189 million, reflecting the ongoing fulfillment of our one-time truck body order.

Moving to Page 10 and the ER segment, first-quarter 2019 revenue declined nearly $5 million to $62 million from $67 million a year ago. The decline in ER revenue is due to lower industry volume, our demand for higher-content vehicles and our ongoing dealer network realignment. Adjusted EBITDA in Q1 fell $3.5 million to a loss of $2.3 million from a profit of $1.2 million last year. The profit decline is due to lower volume and product mix, higher tariff-driven input costs, higher warranty expense, which was partially offset by higher pricing in 2018. Our ER backlog grew by 13% to $215 million compared to $190 million in the prior year, reflecting our reintroduction of recertified product and the progress we've now made in the realignment of our dealer network.

Turning to Page 11 and SCV, revenue grew more than 7% to $52 million from $48 million, on top of the 46% growth rate achieved in the first quarter of 2018. We attribute our growth to higher contract manufacturing and our continued share gain in the luxury motor home market. After more than doubling in 2018, adjusted EBITDA grew 61% to $5 million in Q1 from $3.1 million a year ago, driven by pricing, higher volume and improved manufacturing productivity. Adjusted EBITDA margin improved 48% to 9.6% from 6.5% in Q1 of '18. Backlog at the end of the quarter was $29 million, down 2% compared to a year ago.

Turning to our balance sheet on Page 12, our liquidity at the end of the quarter was $97 million, which is more than adequate to cover our working capital requirement and to fully support our M&A pipeline.

On Page 13, I'll review our outlook for the remainder of 2019. We're maintaining our previous revenue and adjusted EBITDA outlook and expect to have revenue in the range of $865 million to $905 million, net income between $19.5 million and $22.6 million, adjusted EBITDA of $37.1 million to $41.1 million, earnings per share of $0.56 and $0.64 and an adjusted earnings per share of a range of $0.57 to $0.65.

With that, I'll now turn the call back to Daryl.

Daryl Adams: Thanks, Rick.

Please turn to Slide 14 for my closing remarks.

Our entire team worked together to achieve the successful results posted in the first quarter. We overcame persistent tariff-related headwinds and remain focused on improving operating metrics. We continue to be opportunistic in increasing prices across our product lines and investing in new products and technology to secure future growth. We also continue to look at M&A opportunities to expand our footprint around the balance of the coastal region. The solid start to 2019 gives us confidence in our ability to achieve our financial targets for the year and increasing shareholder value.

Operator, we're now ready to take questions.

Questions and Answers:

Operator: We will now begin the question-and-answer session. [Operator Instructions] The first question comes from the line of Matt Koranda with Roth Capital Partners.

Matt Koranda: So just on the overall 2019 guidance reiteration, I just wanted to touch on the overall philosophy here. So pretty strong revenue in Q1. Does the maintained guidance just reflect the expectation that Fleet Vehicles is essentially ramping down on the USPS program over the remainder of the year in 2019? Or are there other segments that maybe we'll see revenue ramp down a touch for the remainder of the year?

Rick Sohm: Yes. I don't know, Matt, that I would view it as the ramp down in the USPS as the driver of our remainder of our outlook. But we have talked in the past about chassis availability. And I think as we ramp some of our build in Q3 and Q4 we still want to be cognizant of that. And overall we're pretty comfortable with that initial outlook.

Matt Koranda: Okay. Got it. I guess on chassis availability, since you touched on it, any headwind to call out from that during Q1? And what are your latest thoughts on the impacts to the remainder of the year?

Rick Sohm: Yes. I think there were no impact to Q1. But, again, as we ramp up to Q3 and Q4, we are cognizant that it could be an issue with the higher volume.

Matt Koranda: Okay. And then just staying with Fleet Vehicles for a moment and looking at backlog and the implied order flow, I get that backlog is up sequentially in that segment. But I guess if I look at implied order flow it's down a bit year over year in FVS. Is that just because you guys maybe pulled forward some order flow in the really strong Q4 that you had? And then I guess so just confirm that. And then also on that front, usually this is sort of the season in Q1, Q2 where a lot of your larger delivery fleet customers are going through their order process. So any update on their activity levels and sort of how that plays out for the remainder of 2019?

Daryl Adams: Yes. Matt, this is Daryl. I'm going to answer the second part of your question first. So I think we mentioned -- you're right, their budgets start kicking in and they start placing orders now. We mentioned a number of them in the deck, right, during the script. And I think the online, large online, North American online customer is very interested in more products. We continue to see ramp-up even in the [year-old] vans. So we don't see any issues there.

The one we keep talking about is the USPS, the large cost of the Peterbilt chassis that are basically pass-through. So as you'll see some of the revenue come down in Q4, we continue to mention that our goal is to replace the EBITDA of that business, not the revenue, because we're not buying the chassis for the rest of the customers. Like the UPS order that we're going to build there, UPS is buying the chassis. So we're going to continue to get the EBITDA and value-add, similar to what we're getting with the USPS. We just won't have the chassis pass-through. And there's still the opportunity for the USPS to add the carry-on order to that original contract. We're still in talks with them. But they haven't made a decision yet.

Matt Koranda: Okay. That's helpful. And then I guess just since you mentioned replacing some of the USPS business with incremental customers that are carrying the chassis, where does capacity sit in Ephrata? And do you need to spend money to boost that to deliver later this year? Or are you essentially waiting on the USPS program to wind down before delivering on the bulk of that new business?

Daryl Adams: The UPS order is going to be built there. We have a number of other orders that we're going to build there. And it's fulfilling the regional issues that we've had in the past we've talked about where if we're just in Bristol, Indiana we can't hit either one of the coasts. And this is part of the strategy. But being in Ephrata we're actually seeing orders coming in from the East Coast. So it's starting to fill the backlog. And if you remember from previous calls, we do have additional capacity there to build up to 12 trucks. Right now we're at 8. So we are going to salt and pepper some of the new orders in when we're required to. We can slow down the UPS, USPS build if we need to build more volume. So it's actually coming together nicely and the flexibility is very helpful for us.

Matt Koranda: Okay. I'd imagine that gives you a bit of control to toggle margins a bit more from quarter to quarter if you can thread in some of the non-USPS truck body business. Is that a fair assumption?

Daryl Adams: I don't know if we would say throttle it, I think it's more on the revenue side. I would say that the adjusted EBITDA side is going to be very similar. And that's what we focused on replacing. And obviously if we have additional [content] -- so the USPS is a pretty consistent truck. And we do really nicely when we have more complicated trucks. So as we continue to take orders and we get more complicated trucks we'll see the EBITDA move up in that location for sure.

Matt Koranda: Okay. Got it. And then last one from me. Since you mentioned Amazon I guess, any better visibility? I know that you didn't necessarily have the best of visibility into some of the up-fit business there. And then I think on the last call you guys had also mentioned there was definitely some interest in the higher-class vehicles. So just the latest sort of status update on that front in terms of your visibility would be helpful.

Daryl Adams: Yes. So the large North American online retailer that we talk about, we're currently building, I think there's a lot of Mercedes discussion when they came out with a commitment that they made with Mercedes. We're doing the sprinter vans currently. We're also doing transit vans. We're also doing ProMaster vans down in Saltillo. So we're hitting all three of our ship-through locations with that one customer. And they're also looking at Class 3, 4 and 5, as I mentioned in my part of the script. It's a nice business for us. We're continuing to work with them. And we're continuing to receive additional orders, which is positive. And I think as you continue to read what this customer is doing in the delivery area, it's going to fit right into our strategy.

Matt Koranda: All right. I'll leave it there. Thanks.

Operator: Next question comes from the line of Steve Dyer with Craig-Hallum.

Steve Dyer: I guess just to pick up on that line of questioning, the large online retailer, a lot of the sort of feedback, or I guess suspicion that I've gotten from investors over time is maybe that's weighing on margins. I think you've sort of broken out the raw-material-tariff-related costs as being the primary driver. Anything you can comment on just around the margins of that business? The customer in mind is obviously a historically very tough negotiator, but the flip side of that is the up-fit business is about the most profitable business I think you have. So any comments there just around your comfort level with the margin profile as that business ramps?

Rick Sohm: Yes. Thanks for the question, Steve. I think if you look at the margin on our up-fit overall it's definitely accretive to the overall margin of the unit fleet. But I would also say that this large online retailer has an EBITDA margin that is accretive to the overall fleet margin. So the segment itself, up-fit, is accretive and this margin on the large online retailer is also accretive to the margin.

Steve Dyer: Got it. Thanks, Rick, go ahead Daryl.

Daryl Adams: Yes. Can I add a little bit to that? We've talked at some of our IR conferences with investors, right? We've seen what this customer has done with some other companies on the East Coast and some large trucking companies. If we're not happy with the margins or we're having some price increases like the aluminum shelving, we have taken in price increasing to them and explained it. If we can't get the margins we need we're not chasing it just because of the name. It'd have to be profitable for us in order to keep that business. Just like we stated in ER, we're not going to take any unprofitable orders. So we're watching it closely. We're managing it. And we're going to make sure that it's accretive to the bottom line of Fleet Vehicle and Service.

Steve Dyer: Perfect. Thank you. In terms of the cost pressures, tariff-related, raw material, et cetera, obviously the length of your backlog makes it tough to turn this quickly. But when would you anticipate seeing some of those abate? Or I guess a better way of saying it is the instances where you took price, when will those start to help margin later this year?

Rick Sohm: Yes, Steve. Rick here. I think on our last call we talked about it by segment, which is the way we look at it.

I think in motor home we're there now. And part of that is because of the timing of the model year changeover. We were able to get that in place last year. For Fleet, I think we talked about being out of the headwinds in the second half of the year, because we weren't able to price for some of the late '18 price movement that we saw. And in ER, we went out with a price increase of 3% in January of '18. And, like I said, we were happy with that at the time. But in light of everything that happened tariff-related it turns out 3% was probably not enough. We think that the second half of the year it may get better but it will not be completely eliminated from ER.

Daryl Adams: And I think, Steve, to add to that, Rick talked about the 2018 price increase. We've also put one in, as we talked about last call, January of '19 we put another one in, which was a 4% increase. And we're still receiving orders, right? So that's my thoughts about taking pricing. We're continuing to monitor that on all three of the segments and being opportunistic where we can on the pricing.

Steve Dyer: Got it. And then lastly, just around the M&A environment you've done a good job of sort of balancing your capital allocation. Any sort of change to the flavor of how you look at balancing M&A this year with buybacks, et cetera?

Daryl Adams: It’s going to continue to stay, Steve, I think we talked about the disciplined approach that we have, where we ran a couple of the deals that have been closed and we just didn't go for the high multiple that others have. So we're going to continue to stay focused on growing the business and stay focused on our capital allocation, and also with our M&A diligence, making sure that it's going to be accretive and that we get synergies out of anything that we do because we want to make sure that it adds to shareholder value.

Steve Dyer: Got it. Okay. Thanks.

Operator: The next question comes from the line of Steve O'Hara with Sidoti and Co.

Steve O'Hara: Just on the let's say online retailer growth or continued negotiations, and maybe you alluded to this already, but have you seen any change in behavior from your other customers relative to their more aggressive posture in the market?

Daryl Adams: No, Steve, we haven't. I think some of what Rick mentioned was they usually receive a lot of orders in Q2, which need to be built in Q3. We talked before that each of our continuing customers in that space would want to have all their units by Halloween. Now they're asking them through the end of the year. So I think there's enough volume out there with the increase in e-commerce and online delivery where everyone is trying to get as many trucks as they can.

And that's part of what I talked about with us building truck bodies now here on the Charlotte campus, is because of the increase walk-in van requirements and demand down in our Bristol, Indiana facility. We've built truck bodies up here before with Reach and some Frito-Lay, so it's not new. But it just continues to show the expansion in that market. And that's why Ephrata Pennsylvania, we're pretty positive on that, with North Charleston, South Carolina, that facility that we have there is big enough to take on truck bodies, and that would free up Bristol just to do walk-in vans. So I think if you go back and fact check some of the previous calls we've had, our strategy has fallen right into place where we expected it to be and it's paying dividends for us.

Steve O'Hara: Okay. And then maybe on the SCV side, within the backlog there, it looks like motor home chassis is kind of flat year over year, but maybe down relative to the previous three quarters. I mean, obviously there's been an inventory correction in the RV space. Is that related to that or is this kind of something else that's happening there?

Rick Sohm: Yes, Steve. Good question. I think as we've talked about for a while now, we are gaining market share. So if you look at even the class A diesel segment of the market, the growth is now tapering off and our ability to continue to grow revenue is a result of the increasing market share.

Daryl Adams: And I think, Steve, to add to that, we talked about going into the less-than-400-horsepower, less-than-40-foot space to gain additional $200 million of addressable market. That's helping. Innovations that we continue to bring to the market in those chassis are all adding to us being able to offset what might be the small decline in the market. We're gaining market share, like Rick mentioned. And it's just due to the team and some of the foresight we have in seeing where the market's going and what's happening. Not that our crystal ball is perfect, but we feel some of these trends coming and we do things to try to offset what might be coming at us.

Steve O'Hara: Okay. And then maybe finally, just on ER, and maybe a previous questioner asked this, but I mean in terms of the EBITDA for the full year, do you expect to be EBITDA positive in ER this year? Or is it going to take longer due to the kind of the longer-term pricing in that market?

Rick Sohm: Yes, Steve. Rick here. We expect for the full year to have a positive EBITDA margin in ER. I think when we get through and start looking at future quarters year over year we'll start to see the improvement. And for the full year, yes, we expect a positive EBITDA margin.

Steve O'Hara: Okay. Thank you.

Operator: This concludes your question-and-answer session and I would like to turn the conference back to Juris Pagrabs for any closing remarks.

Juris Pagrabs: Thank you. Thanks for joining, everyone. Just a quick update on some conferences that Daryl, Rick and I will be at, several in May and June, starting with Oppenheimer next week in New York, Craig-Hallum at the end of the month in Minneapolis, then Deutsche Bank and Stifel in June. Thanks. Have a great summer and we look forward to updating you first week of August on Q2. Thanks.

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