The Shyft Group

Third Quarter 2022 Earnings Results

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CORPORATE PARTICIPANTS

Randy Wilson - *Vice President, Investor Relations and Treasury*

Daryl Adams - *President and Chief Executive Officer*

Jon Douyard - *Chief Financial Officer*

PRESENTATION

Operator
Good morning and welcome to The Shyft Group's Third Quarter 2022 Conference Call and Webcast. All participants will be in listen-only mode until the question and answer session of the conference call. This call is being recorded and if anyone has any objections, you may disconnect at this time. I would now like to introduce Randy Wilson, Vice President Investor Relations and Treasury for The Shyft Group. You may proceed.

Randy Wilson
Good morning and welcome to The Shyft Group's Third Quarter 2022 Earnings Conference Call. Speaking today will be Daryl Adams, President and Chief Executive Officer; Jon Douyard, Chief Financial Officer. Earlier today we published our results which are available on our website. Today's call is being webcast and is accompanied by a slide presentation which includes a reconciliation of GAAP to non-GAAP financial measures that we will use during our call.

Please turn to slide two of the presentation for our Safe Harbor Statement. You should be aware that certain statements made during today's conference call may be considered forward-looking statements. These forward-looking statements are subject to risks that could cause actual results to be materially different from those expressed or implied. For a more complete discussion of these risks, please see the 8K filed with the SEC this morning and other filings we make with the SEC, which are all available on the company's website.

I remind everyone that the divestiture of the emergency response vehicle business on February 1st, 2020, is classified as discontinued operations. The results discussed today will refer to continuing operations unless otherwise noted. And now, I'd like to turn the call over to Daryl Adams, beginning on slide three.

Daryl Adams
Thank you, Randy. Good morning and thank you for joining us to discuss our third quarter 2022 results. I am pleased with our overall performance as the team continued to manage through the dynamic environment in the third quarter. Special vehicles once again delivered strong results across all product lines. Record revenue for service bodies, solid results in motorhome chassis and contract manufacturing reflect the continued effort by the team to execute on our growth strategy.

In addition, fleet vehicle and services saw a sequential improvement as chassis inflow continue to improve in the third quarter. Supply chain remains challenging due to component part shortages and delays impacting production, but the team remains focused on delivering for customers and improving profitability. Our excitement continues to build around our Blue Arc electric vehicle offering, as evidenced by a recent customer preorder.

Please turn to slide four. Demand within our end markets remain strong as backlog is robust and we achieved revenue of $286 million. However, reported EPS declined year-over-year as electric vehicle investment and production efficiencies caused by the supply chain adversely impacted our results. The team maintains a focused and nimble approach to our operation and remains committed to prudent cost management. Backlog was $1 billion, up 22% versus prior year but was down sequentially as production improved.

Please turn to slide five where I'll discuss our business segments. Fleet vehicle and services continue to work through supply chain challenges. Our team remained focused on performance during the quarter, and remain diligent to reduce production inefficiencies, increase production to deliver backlog as chassis flow improved and maintained pricing discipline while working with customers to meet their needs. We demonstrated a significant ramp of Velocity R2 production in the quarter as customers demand our innovative industry-leading products. The R2 van showcased at the FedEx Ground Contractors Expo in Las Vegas to3,000 contractors and received positive customer feedback.

Turning to specialty vehicles. The business continued its momentum as we are focused on executing our growth strategy. Our service body business saw continued strong growth in demand as these vehicles are productive tools, which are critical to the markets they serve. We are expanding our position as a leading national service body player, which is allowing us to expand Royal products into other geographies. We saw improvement in our Zuzu business as F-Series production ramped up, and our motorhome chassis business continues to perform well. Overall, both businesses are working hard to navigate dynamic market conditions and deliver.

Please turn to slide six. We're excited by the continued progress of our Blue Arc go-to-market brand as we have received strong interest from a range of traditional customers, including last-mile delivery and other fleet operators, as well as government agencies. At the North American International Auto Show, the Merchants Fleet Summit, the contractors event held in Vegas and a private ride and drive event in Memphis, our customers received firsthand experience with the Blue Arc last-mile delivery vehicle. Earlier this month, we also hosted a Blue Arc showcase here in Michigan, allowing customers, media and investors, the opportunity to drive our Blue Arc last-mile delivery vehicle, so they could get the true sense of its performance and drivability.

As customers continue to interact and get experience with the quality of the vehicle, their feedback is increasingly complementary of the design, engineering and capabilities of our Blue Arc last-mile delivery vehicle. The Shyft Group stands alone in the Class 3 to 5 space in the emerging EV market. As a testament to this, we secured a preorder of 2,000 of our Blue Arc last-mile delivery vehicles from Randy Marion Dealership Group, which is a strong indication of customer demand. We are on track with our vehicle validation testing, and we'll start building customer field test vehicles during Q4 and expect to ramp up production in the middle of 2023. We are truly excited by the potential of the Blue Arc and look forward to updating you on our progress.

Please turn to slide seven. Our industry has a responsibility to creating a more environmentally sustainable future. We recognize that our electric vehicle strategy is part of a broader discussion of our environmental, social and governance initiatives. We recently released our inaugural sustainability report to highlight how many efforts can make a difference in the world. We are making changes to reduce the environmental impact of our business activities. We are committed to providing the resources and opportunities that will allow all team members to thrive at the Shyft group. Finally, we are pursuing excellent governance and best policies and practices.

With that, I'll turn it over to Jon, starting on slide eight.

Jon Douyard
Thank you, Darryl, and good morning, everyone. Overall, we were pleased to see the business recover and to deliver solid results in Q3. Revenue for the third quarter was $286.1 million, up 4.9% from the year ago quarter and up 23.2% sequentially with improvements in chassis availability. Net income from continuing operations was $17.3 million compared to $21 million a year ago. Adjusted net income was $18.6 million compared with $22.9 million in the prior year. Diluted earnings per share from continuing operations was $0.49 per share compared to $0.58 per share in the third quarter of 2021.

Adjusted EPS from continuing operations decreased to $0.53 per share from $0.63 per share a year ago. Third quarter adjusted EBITDA was $27.1 million compared to $33.7 million in the previous year, while as a percent of sales, adjusted EBITDA declined 9.5% compared to 12.4% in the same period last year. These results include EV spending of $7.7 million.

Turn to slide 10, and I will review our fleet vehicles and services results. The FVS team did a nice job ramping production in response to improved chassis availability, improving sales output by 35% versus the second quarter. FVS revenue was $184.5 million compared to $191.4 million a year ago. FVS adjusted EBITDA was $24.4 million versus $36.4 million a year ago. The decrease was primarily driven by volume, productivity inefficiencies that resulted from ongoing supply chain challenges and cost inflation, partially offset by pricing actions. Adjusted EBITDA margin was 13.2% of sales and while down year-over-year, margin was up 260 basis points versus the second quarter. FVS backlog was $915 million, up 22% year-over-year, which positions us well for the fourth quarter and into 2023.

Turn to slide 11, and I will review our specialty vehicles results. The SV team delivered another solid quarter, achieving record revenue and profitability levels with growth across all businesses. Sales were $103.9 million, an increase of $22.7 million or 27.9% year-over-year with the benefit of both higher volume and strong pricing versus 2021. Adjusted EBITDA was $15.6 million or 15% of sales, up 730 basis points year-over-year compared to $6.2 million or 7.7% of sales in the same period last year. The improvement was driven by higher sales volume, pricing actions to offset inflation and favorable product mix. SV backlog was up 25% year-over-year to $129 million, with demand led by our service body business as we continue to benefit from our product and national expansion strategy.

Turn to slide 12, and I will discuss our balance sheet and updated 2022 outlook. Overall, our balance sheet and liquidity remain healthy. At the end of the third quarter, we had liquidity of $168 million, and our leverage ratio was approximately 1.4x adjusted EBITDA, positioning us well to fund operations and invest in the business. In the first 9 months, cash flow from operating activities was an outflow of $44.5 million, driven by an increase of substantially complete vehicles that are waiting final components as supply chain disruptions persist.

Turning to the full year. While our outlook remains consistent with our prior quarterly communications, given our third quarter performance, chassis visibility for the balance of the year and strong backlog, we are tightening our full year outlook as follows: revenue in the range of $1 billion to $1.1 billion; adjusted EBITDA of $62.5 (million) to $72.5 million, including approximately $30 million of expenses related to EV initiatives; adjusted earnings per share of $1.02 to $1.24; capital expenditures of approximately $25 million for the full year. And while cash flow performance has been challenged year-to-date, we expect to see a recovery in the fourth quarter as delivery of finished vehicles improves.

In closing, as expected, we saw a meaningful recovery in performance as our team has done a fantastic job responding to the improved chassis inflow to start the second half. Our third quarter results have shifted up for a strong close to the year, and we look forward to carrying this momentum into 2023. And with that, I'll turn it back to Daryl.

Daryl Adams
Thank you, Jon. Please turn to slide 13. We are pleased with the solid effort of our team during the third quarter to execute and drive long-term value for customers, employees and shareholders. We will continue to invest in technology, capacity and talent. We will act for long-

term sustainability in our business, including the development and launch of our Blue Arc EV products to meet the evolving needs of our customers. Our disciplined capital allocation strategy allows us to grow our business and efficiently return capital to shareholders. In conclusion, our operational improvement, investment in innovation and financial discipline clearly demonstrate that The Shyft Group is an industrial growth story.

Operator, we are now ready for Q&A portion of the call.

QUESTION AND ANSWER

Operator
We will now begin the question and answer session. To ask a question, you may press star, then one on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star, then two.

The first question is from Steve Dyer of Craig-Hallum. Please go ahead.

Steve Dyer
Thanks. Good morning, guys.

Daryl Adams
Good morning, Steve.

Steve Dyer
Given you still have a year's worth of backlog, given the stuff that you're quoting and RFPs and things like that with your final mile customers looking out a year, qualitatively, are you still--are the majority of the conversations sort of around ice chassis and ice vehicles? Are you starting to quote more EV stuff sort of how you have given--again, that we're talking about a year out now? Could you just maybe give us a little color on those conversations?

Daryl Adams
Yes. Sure, Steve. This is Daryl. No, all the discussion from all of our customers is still all about ICE and chassis availability. The discussion on EV is us going out to our dealer network and working with mainly the contractors and having discussions with our customers. I think you'll see, once we get our products, our EV products into the customers' hands in the first half of next year for their testing, we should probably see some more activity on the EV side from the Shyft Group.

Steve Dyer
Got it. And then could you remind us--I think it's $25 (million) or $30 million of EV specific costs this year. Can you remind us how we should model that going forward?

Daryl Adams
Yeah. So we communicated a step down next year. We haven't put out a specific number, but if you go back to our original investment thesis, it's a step down to somewhere in that $10 million to $15 million range.

Steve Dyer
And should we think about that as a maintenance CapEx level for that piece of the business going forward, or is next year still some growth pieces to that?

Daryl Adams

No, I think we've indicated higher R&D going forward. And so I think, certainly, as the EV volume really starts to ramp when you get into 2024, you've got support of volume for that, but we do expect that to maintain at a higher sustainable level going forward.

Steve Dyer
Got it. Last one for me, we've been talking about chassis availability forever. Obviously, a big step up in units this quarter. Can you quantify or in any way give color as to in the last quarter it was, one quarter doesn't make a trend, but it would appear to be, I don't know if you'd say "out of the woods," but certainly on the upswing there. Is that something you expect to continue into the first half of next year?

Daryl Adams
Yeah. All indications, Steve, and discussions that I've had with some of the suppliers personally are that, again, I don't want to say we're out of the woods, but they're more confident that the supply will continue.

Steve Dyer
All right. Got it. Thanks, guys. Good luck.

Daryl Adams
Thank you.

Jon Douyard
Thank you.

Operator
The next question is from Matt Koranda of Roth Capital. Please go ahead.

Matt Koranda
Hey, guys. Thanks for taking the questions. So just a near-term one real quickly. Just in the implied fourth quarter outlook, the midpoint of your revenue guide implies about $325 million in the fourth quarter, which does seem like a pretty big step-up sequentially. Maybe could you just talk about what you're seeing on the supply chain front that gives you confidence that you can step up that revenue run rate into the fourth quarter?

Jon Douyard
Yeah. I would say a couple of things, Matt. If you think about chassis flow, it progressed to the year. We saw improvement late in the second quarter, and that continued into the third quarter where we were really healthy, call it, mid-Q3. And so we would expect that to sustain based on the visibility that we have now. And so call it a full quarter, maybe a couple less days but still a full quarter of chassis visibility. We also do have some of the USPS volume in the fourth quarter as well. So there's about $15 million of just chassis pass-through as well.

Matt Koranda
Okay. That's helpful. And then one other near-term one for you, Jon, if you could just talk about the working capital reversal that you're expecting in the fourth quarter. Does that primarily come from the inventory flush? You mentioned a bunch of finished vehicles that were awaiting components. So assuming that those flush, but maybe any more color on just how we should expect cash flow and the puts and takes in the fourth quarter.

Jon Douyard

Yeah. Yeah, no, that is the biggest piece. I think at the end of the third quarter, we did have a decent amount of vehicles that were missing one or two components that we needed to flush through. We've seen progress on that as we've even started October--as we're nearing the end of October, but as we've gotten into Q4. And so we expect that to continue. So that will be the biggest piece as we convert those vehicles, able to invoice them and then convert to cash.

And then inventory, we've maintained higher inventory levels through the year. Part of that, strategic, other parts, trying to align it to the schedule and with improved chassis visibility now through certainly the end of the year and into January, February, we're able to manage that more efficiently. And so that will be the other piece that helps us drive cash conversion here in Q4 .

Matt Koranda
Great. And then one other one on just with the improvement in chassis visibility that you're saying there. Should we assume that the FVS segment doesn't have the typical seasonality that you guys have usually had where 1Q is a bit lower than the third and fourth quarter? Should we expect a sequential increase in FVS from the fourth quarter into the first? Just any help with seasonality and how to think about as you clear the relatively large backlog you have in FVS, how that plays out.

Daryl Adams
Yeah. I think we'll continue to have seasonality in the business for a couple of reasons. There are model year changes and shutdowns that the OEMs have at the end of the year, which naturally impacts flow really starting in December and into the first quarter. And so while we have visibility, we do expect that to not be linear as we move forward. And so I think you'll have the natural seasonality. I think, on some of our product lines as well, we'll start to see orders here later in the year, in early Q1, to fill some of those gaps as well, which would maybe be later in Q2 and Q3.

Matt Koranda
Okay. that threads into my next question and the last one, and I'll leave it to others. But just on FVS and order flow. Your order flow at the moment in the third quarter, it does this seem constrained to me. And maybe just given some of the checks we've done on sort of lead times and availability of chassis, it just seems like maybe that is the issue that's constraining order flow in FVS. But maybe just if you could level set us on what's the right level of sort of new orders to expect over the next couple of quarters? Should we expect it to be a little bit constrained until we clear out some of the backlog, just given the lead times have been extended in that segment? And what's the catalyst, I guess, to kind of pick up on order flow? And then maybe just also just clarify, I just want to make sure. I don't think there's any EV in backlog at the moment, but just clarify for us if there is anything in EV there.

Jon Douyard
I'll take the second part first, which is no. No EV orders in the backlog currently. I think in terms of timing, I think you kind of hit it. I think lead times are going to be a constraint here until we see that improve. Obviously, we've seen chassis improvement, but components continue to be a bit of a challenge just from a broader supply chain perspective. Go back historically, even in our orders are not linear. We've got lumpiness. And so we would expect that to continue and so you might see some pockets of orders here in Q4 and into Q1. But we're very comfortable with where we are from a demand perspective as we look out into '23.

Matt Koranda
Awesome. I'll leave it there. Thanks.

Jon Douyard
Thanks, Matt.

Daryl Adams
Thanks, Matt.

Operator
The next question is from Mike Shlisky of D.A. Davidson. Please go ahead.

Mike Shlisky
Hello. Good morning, and thanks for taking my question. Jon, I want to follow up on your last answer there. Maybe just get a little bit more granular. As you talk with larger fleets and even some of the smaller ones, what's been your most recent discussions and the tone of those discussions about buying additional vehicles from here? What's been the tone around new CapEx in potential for some parts of the economy turning downward next year?

Daryl Adams
Yeah, Mike, this is Daryl. Our discussions that we've had is they're all still positive. I think they may have extended some of their facilities, more than their vehicles in the past because you have to remember, they didn't receive the vehicles they needed in '20, '21 or even the first half of '22. So there's a bit of catch-up still for them, and I think that's shown in our backlog to get the vehicles out.

And as we've discussed in the past, we still see a lot of rental vehicles at the distribution centers that are close to offices that we operate. So they need the vehicles, and I think that's key for them. And as they continue to have replacement needs and normal growth, there's still a nice inflow or discussions about quotes.

Mike Shlisky
Got it. Thanks. And just turning over to Jon, real quick, I want to clarify one of your other answers to your questions from earlier about the Blue Arc spending next year. I know it's going to be stepping down, but in prior events, you had mentioned the overall business because of some revenues next year could be pretty much EBITDA neutral. Is that still the case? Are we going to be going from 30 to 0, or is it 30 to 15 costs in 2023?

Jon Douyard
Yeah. I don't necessarily want to start guiding on 2023 specifically. We did talk about it at the Ride and Drive event where we will see some revenue contribution next year. We do expect R&D to step down year-over-year, and so I think that's consistent with what we said previously.

Mike Shlisky
Okay. Maybe thirdly, can I ask about the motorhome business. We are seeing some of the smaller motor home categories seeing a bit of a downturn here. What's the outlook for your business in the larger or, in the case of Shyft Group, absolute largest category that you guys play in? Is that--does that differ widely from the smaller towable and much smaller products these days?

Jon Douyard
Yeah. I mean I think generally, we've certainly lagged some of the changes that have happened in the towables and smaller-sized vehicles earlier in the year. We've said that we're certainly comfortable with this year. We just actually had, I think, record, if not close to record revenue here in Q3 on our product lines. And so that's not to say those levels are going to sustain forever.

I think as we get into '23, we'll probably see some negative impact, but we remain confident in our ability to take share from that perspective as well as look for other avenues to increase our revenue, including the Red Diamond launch that we did to expand aftermarket parts. And so I think as you look at that business in total, we're not expecting to see significant declines as we move forward.

Mike Shlisky
Okay. Thank you. I appreciate the discussion. I'll pass it along.

Daryl Adams
Thanks, Mike.

Operator
The next question is from Felix Boeschen of Raymond James. Please go ahead.

Felix Boeschen
Hey. Good morning, everybody.

Jon Douyard
Good morning, Felix.

Daryl Adams
Hi, Felix.

Felix Boeschen
Hey. I was hoping just to start, maybe quickly a follow-up on, Jon, your comments around the USPS truck body contract and the $15 million of chassis pass-through revenue in 4Q. Can you remind us of the size of that contract and how much of that pass-through revenue we should be expecting for 2023 at this point?

Jon Douyard
Yeah. So I think we've said the contract's about--the pass-through portion of it is about $40 million. And so we haven't seen any of that yet, so you'll see some of that come through in Q4 and then into '23. Unfortunately, some of the chassis' delays from the OEMs has pushed the schedule on that project.

Felix Boeschen
Okay. That's super helpful. And then I wanted to talk a little bit about specialty vehicle margins. They look super strong, in fact, close to your long-term targets already. Curious if you could talk about directionally where you expect them to go from here or any puts and takes that we should think about coming out of the quarter?

Jon Douyard
Yeah. I think that the team continues to perform incredibly well. I wouldn't necessarily start modeling 15% on a long-term basis. But as you look at the strength of the underlying businesses that we have there, we do feel confident with the margin profiles of those products and businesses as well as our ability to expand over time. I think when you look at it on a year-to-date basis, you're probably in the 13% range, which is still a great increase year-over-year. Probably that low teens is maybe where it naturally is, and then we'll see it peak depending on mix of products and customers in any given quarter.

Felix Boeschen
Okay. And then just my last one. I think in the earnings release, you all pointed out mix as a positive to fleet vehicles. And I'm just curious if we could broadly talk about the mix within that segment today, if you could give us directional comments around velocity versus traditional walk-in van and other sort of products and how that maybe compares to the backlog as it stands today?

Jon Douyard
Yeah. I think when you look at what we disclosed, I think we saw favorable pricing within that business, which we've combined with mix. I think as we look forward, we do like the margin composition of the product lines that we have. I think we've said historically, truck body is maybe a little bit lower than the average. We have seen significant growth there, which is creating some negative mix for us. But I think when you put pricing mix together, we've got positive year-over-year performance with a little headwind from mix.

Felix Boeschen
Okay. I appreciate it.

Jon Douyard
Thanks, Felix.

Daryl Adams
Thanks, Felix.

CONCLUSION

Operator
This concludes our question and answer session. I would like to turn the conference back over to Randy Wilson for closing remarks.

Randy Wilson
Thanks, operator. We look forward to meeting with analysts and investors at the Baird, Barclays, Craig-Hallum and Deutsche Bank conferences here in November and December. We thank you for your participation today in today's call and your interest in The Shyft Group. With that, operator, you may disconnect the call.

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