The Shyft Group

First Quarter 2023 Earnings Conference Call

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CORPORATE PARTICIPANTS

Randy Wilson -- *Vice President, Investor Relations*

Daryl Adams – *Chief Executive Officer*

Jonathan Douyard – *Chief Financial Officer*

PRESENTATION

Operator
Good morning, and welcome to the Shyft Group's First Quarter 2023 Conference Call and Webcast. All participants will be in a listen-only mode until the question-and-answer session of the conference call. As a reminder, this call is being recorded at the request of the Shyft Group. 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 of the Shyft Group. Mr. Wilson, you may proceed.

Randy Wilson
Thank you for joining this morning's call. I'm joined by Daryl Adams, President and Chief Executive Officer and Jon Douyard, Chief Financial Officer. Their prepared remarks will be followed by a question-and-answer session.

For today's call, we've included a presentation deck that's been filed with the SEC, and it's also available on our website.

Before we begin, please turn to slide 2 of the presentation for our Safe Harbor statement. Today's conference call contains forward-looking statements, which are subject to risks that could cause actual results to be materially different from those expressed or implied. Primary risks that management believes could materially affect our results are identified in our Forms 10-k and 10-Q filed with the SEC.

We'll be discussing non-GAAP information and performance measures we believe are useful in evaluating the company's operating performance.

During today's call, we'll provide a business update before moving on to a more detailed review of the results in our 2023 outlook. We'll then open the line for Q&A. Please turn to slide 3 and I'll turn it over to Daryl Adams.

Daryl Adams
Thank you, Randy. Good morning, everyone.

Overall, the Shyft Group had a solid start to the year, delivering improved financial performance while continuing to deliver on our strategy and long-term growth initiatives. Our team achieved 18% sales growth led by another record quarter in our service body business and improved performance in fleet vehicles and services.

Our ability to increase output enabled us to improve profitability by over $11 million versus the first quarter of last year. In addition, we delivered positive operating cash flow in the quarter and brought in nearly $34 million more than prior year, which allowed us to efficiently deploy capital.

We continue to make great progress on our Blue Arc Electric Vehicle program in the quarter. We were very pleased to announce that not only did we achieve CARB and EPA certification for our Class 3, 4 and 5 EV delivery vehicles, but we did so with performance that more than exceeds our fleet customers' needs. The car test results for our Class 3 vehicle included a 225-mile city range and over a 200-mile combined city/highway range, which can more than comfortably handle a daily delivery route.

I'd also like to take a moment to highlight a fantastic addition to The Shyft Group as John Dunn joined the company in January as our Fleet Vehicle and Service President. He is a proven leader in

manufacturing, customer relations and product development and has made an immediate impact with our employees, customers, and suppliers.

Turning to slide 4. Over the past five years, we have strategically moved the company toward last mile delivery and infrastructure focus specialty vehicles. We remain confident in these end markets and how the company is positioned to win over the long term.

Consistent with our commentary in February, the market and macroeconomic environment remains dynamic. I will take you through how that looks by segment starting with Fleet Vehicle and Services. We continue to analyze the parcel market, including performing independent market surveys, monitoring customer announcements, and reviewing published industry reports. The consensus is clear, after an acceleration driven by the COVID pandemic and subsequent pause in ecommerce penetration, the industry growth rate is expected to be in the mid to high single digit range for the foreseeable future, driven by the secular shift to ecommerce. As a leader in this space, we are well positioned to benefit from this growth.

As the operating environment unfolds in the near term, we continue to hear mixed feedback from our fleet operators, dealers, and suppliers. While certain fleet operators are looking to accelerate fleet replacement, others are still working to deploy vehicles from purchases made during COVID or working through efficiency actions given economic uncertainty. We remain close to our customers to support their fleet needs during this time but remain cautious given these market signals. We remain flexible in our operations and will take the appropriate cost actions required to balance efficiency and growth.

As we have previously communicated, the backlog in FVS continues to normalize from the higher levels that we saw during COVID driven by the improvement in production rates and supply chain. FVS ended the quarter with a backlog of $585 million, which is still elevated compared to pre COVID levels.

Moving to Specialty Vehicles. Continued investment in infrastructure, supported by federal government spending, is bolstering demand for work trucks, with funding across end markets including transportation, power and grid enhancements, and other critical infrastructure needs. As projects begin, contractors and fleet operators are investing in their fleet to meet demand. Sales of our work truck products were up 22% year over year, delivering above market growth and demonstrating strong customer demand.

To ensure our motorhome chassis business we, like many others, have previously communicated overall softness in the RV market. While the Class A diesel segment is less cyclical, we have experienced declines as well. Our market share continues to remain strong and has been trending favorably demonstrating the value of our product innovations and quality. Overall, The Shyft Group continues to have industry-leading brands that are well positioned to win in the markets we serve.

We remain confident in our team's ability to execute in these dynamic times, deliver for our customers and achieve our long-term financial targets. I will now share some exciting developments underway in our FVS and SV businesses. Please turn to slide 5.

Starting with FVS highlights, as discussed earlier, we have seen certain delivery customers accelerate investment in fleet replenishment. We're excited to have been awarded a commercial off-the-shelf contract for over 18,000 cargo van outfits, split between Ford ETransit and RAM Promaster. We expect deliveries to begin in mid-2023 and into 2024. This win demonstrates our position as a trusted industry partner and reflects our ability to deliver a highly quality product at high volumes.

Moving to our SV highlights. We have been successful in our service body geographic expansion and continue to execute our strategy of being a leading national provider. Consistent with this strategy, we

recently announced the opening of our new Tennessee location, which will serve as a hub for opening Royal, Durameg, Magnum and Strobes products. This location provides direct access to the one of the fastest growing regions in the country and enabled us to secure additional OEM chassis pools, which will help accelerate our growth in an already strong performing business.

Turning to slide 6. I'll put an update on our Blue Arc EV development program. We made great progress in the first quarter, and we are on track with our original development timeline, which has us starting vehicle production in the second half of the year. At the NTEA Work Truck Show in March, we saw significant interest from customers, dealers, and other industry partners.

We also successfully hosted numerous future customers as part of our Ride & Drive. This positive response emphasizes that our Blue Arc EVs are differentiated within the commercial electric vehicle industry, both for their design and their performance.

In the first quarter, the fact that we achieved CARB approval positions that previously discussed pre order with Randy Marion to a firm commitment. Their team remains excited about our progress, and we continue to work with them on finalizing specifications for their first deliveries. We also made solid progress with our production facility and remain on track for manufacturing readiness.

We continue to have positive momentum, both operationally and commercially. In the coming months, we expect to deliver on key milestones including delivery of our first test units to key customers, expansion of our national dealer and service network, and commencement of pilot and production vehicle builds. We are proud of the progress we have made, and we have efficiently executed this program and look forward to providing updates on future calls.

With that, I'll now turn the call over to Jon to discuss our first quarter financial results.

Jon Douyard
Thank you, Daryl. And good morning, everyone. Please turn to slide 8 and I'll provide an overview of our financial results for the first quarter.

As we anticipated, our team performed well in this dynamic environment, delivering solid sales growth and significant improvement in profitability after a challenging start last year. Sales for the first quarter were $243.4 million, up 17.7% from the year-ago quarter. The year over year improvement reflects strong service body and truck body performance, and improved chassis supply in our walk-in van and upfit product lines.

Net income was $1.7 million or $0.05 per share compared to a net loss of $3.9 million or $0.11 per share in the previous year. We improved the adjusted EBITDA to $10.8 million, or 4.4% of sales, up from a loss of $0.6 million, or negative 0.3% of sales in the first quarter of 2022. These results include EV spend of $8.5 million, up $4.1 million from the prior year. Excluding EV spend, adjusted EBITDA was 7.9% of sales, up 610 basis points year over year. Adjusted net income improved to $4.3 million, compared to a loss of $2.1 million in the year ago quarter, while adjusted EPS rose to $0.12 per share from a loss of $0.06 per share last year.

I'll now walk through our first quarter results by operating segment beginning with Fleet Vehicles and Services on slide 9. The team delivered improved performance year over year as we saw the benefits from prior year truck body expansion efforts as well as higher production output driven by healthier chassis supply. While margins did significantly improve year over year, we do continue to experience inefficiencies as we work through the impact of supply chain challenges.

FVS achieved sales of $159.4 million, up 41.5% compared to $112.7 million a year ago. FVS adjusted EBITDA was $12.5 million versus a loss of $0.9 million a year ago. Adjusted EBITDA margin was 7.8% of sales, compared to a loss of 0.8% of sales in the first quarter last year.

Please turn to slide 10 for the Specialty Vehicles first quarter results. Our Specialty Vehicles business continues to perform well despite the softness in the motorhome chassis business. The team delivered our third consecutive quarter of adjusted EBITDA margin of more than 15% driven by strong operating and commercial performance in our work truck businesses.

First quarter sales were $87.2 million, a 7.4% decrease from $94.2 million in the prior year. Adjusted EBITDA was $13.9 million, or 15.9% of sales compared to $10.1 million or 10.7% of sales in the same period last year reflecting strong operational performance and the impact of improved price and mix.

Please turn to slide 11 for our 2023 outlook. We are pleased with our overall start to the year and the underlying performance in our business despite an uncertain operating environment. We delivered first quarter performance that was in line with our expectations. And as we look to the balance of the year, we are reaffirming our full year guidance. We remain cautious on demand in the broader economy and are taking appropriate actions to remain focused on both cost efficiency and growth.

Our 2023 outlook is as follows: sales to be in the range of $1 billion to $1.2 billion; adjusted EBITDA of $70 million to $100 million, representing 20% growth at the midpoint; adjusted EPS of $0.98 per share to $1.60 per share with shares outstanding of approximately 35.8 million, which includes the reduction in shares given recent stock repurchases. And finally, free cash flow conversion as a percentage of net income expected to be greater than 100% as we drive down working capital.

Please turn to the capital allocation slide on slide 12. Overall, our balance sheet remains strong, and we were able to maintain an overall net leverage ratio of 0.9 times while investing in the business and returning capital to shareholders in the quarter. After delivering strong cash flow generation to end 2022, we generated $5.9 million of operating cash in the first quarter, demonstrating significant year-over-year improvement. Further progress on reducing working capital remains a key focus area for the company.

Shyft’s organic investment priority is the development and launch of the Blue Arc EV. As we ramp up production levels in the coming years, Blue Arc is expected to be a significant earnings contributor and deliver favorable returns. We remain flexible in other capital deployment. And while we continue to evaluate M&A, we are also focused on returning capital to our shareholders when appropriate, as evidenced by the $10.7 million deployed in the first quarter through repurchases and dividends.

In closing, we are committed to generating cash flow and maintaining a robust balance sheet to support strategic investments, future growth, and efficient returns to shareholders.

Now I'll turn the call back to Daryl for closing remarks.

Daryl Adams
Thank you, Jon. Please turn to slide 13. At The Shyft Group, we have created a compelling industrial growth company. Our priority starts with a culture of customer focused innovation, we are driving operational excellence across the company, and our financial strength allows us to invest in long-term growth and deliver returns ahead of our peers. We have the right people and processes in place to execute our strategy. I am proud of the dedication and agility of our team members, as they remain focused on delivering value for our customers and shareholders.

I want to conclude today's call by announcing that Todd Heavin, our COO, who joined The Shyft Group

four years ago, has recently communicated his intent to retire midyear, and we're working on an orderly transition. Since joining Shyft in 2019, Todd has been instrumental in laying the foundation and progressing Lean and operational excellence across the company. Over the last several years, we have built out the depth of our operational experience across our businesses, and we will look to these leaders to drive our continuous improvement journey going forward. I value Todd's insight and we'd like to wish him well in retirement.

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

QUESTIONS AND ANSWERS

Operator
And at this time, we'll begin the question-and-answer session. To ask a question, you may press star and then one on a touchtone telephone. If you are using a speakerphone, we do ask that you please pick up the handset before pressing the keys. To withdraw your question, you may press star and two. Once again, that is star and then one to ask a question. At this time, we will pause momentarily to assemble the roster.

Our first question today comes from Felix Boeschen from Raymond James. Please go ahead with your question.

Felix Boeschen
Hey, good morning, everybody. First of all, congrats on the upfit contract. I'm curious if we could talk about that. I'm just curious if you could maybe comment on the aggregate revenue impact of the 18,500 units? And also, if you could comment on the timing. I know mid 2023 start. I'm just curious if it's going to be all wrapped up by the end of 2024.

Jon Douyard
Felix, this is Jon. I think when we look at that contract, think about an upfit for us is mid-single digit thousands of revenue. So, you're talking north of $70 million from that perspective, which is an exciting win for the team as we continue to support the customer and carry on the long relationship that we've had there.

I think as we look at timing, we mentioned that it's across two different platforms, both the E Transit, as well as the Ram Promaster. There's a bit of a sort of timing sequence from that perspective, but we expect to begin production midyear. There will be a portion of that that does extend into 2024, though, but we're extremely excited about the win and the opportunity. Our team did a fantastic job being able to secure that.

Felix Boeschen
Okay, got it. That's helpful. And then just on the backlog, I know it stepped down a bit, but I just wanted to clarify, it does not yet include any of the EV preorders. And then just bigger picture, just curious if you could talk about how you were thinking about opening those Blue Arc order books just given the anticipated production star here.

Jon Douyard
I think from a Blue Arc perspective, we continue to see demand, as Daryl talked about in his comments, a high level of demand and interest from the customer base. We continue to work through building out the dealer network, as well as working with key customers and getting vehicles in their hands here, which we expect to do in the second quarter.

When you look at the backlog, to your point, it did not include the committed order from Randy Marion that we previously discussed. Our intent here at this time is to really continue to report backlog from a legacy business perspective. But as we look at Blue Arc, really talk about vehicle commitments and a piece of that is really because it's tied to our overall production levels. And so, we've talked previously about ramping the 3000 units here by 2025, and so putting an order in there that's multi years from $1 perspective, we don't necessarily need or want to artificially inflate the backlog and we think production is actually a better representation of what future sales will look like versus a multiyear order. So again, we'll talk vehicle commitments, and then continue to talk backlog in our legacy business.

Felix Boeschen
Understood. I appreciate the time. I'll pass it on.

Jon Douyard
Thank you.

Operator
Thank you. Our next question comes from Mike Schlisky from DA Davidson. Please go ahead with your question.

Mike Schlisky
Good morning, and thanks for taking my question. I want to start off with a quick follow up on the off the shelf 18,000 unit order that we've been talking about so far on the call. Is that the kind of order where you take ownership of the chassis like you have in previous large orders of this type or is it your typical update order where you are able to just build on top of an existing unit that you never actually hit your balance sheet or P&L?

Daryl Adams
Great question, Mike. Good morning. This is a traditional upfit contract where we're not taking possession of the chassis. It’s just our content and labor that's going into these vehicles.

Mike Schlisky
Great. Outstanding. Your comments, Daryl, on FVS or the five-mile business being a mid to high single digit kind of industry growth rate for the foreseeable future, is that roughly in line where you expect the actual FVS business to go over a long period of time here? Or do you have, other than Blue Arc, any kind of market share initiatives or other ways you can outgrow or perhaps underperform that growth rate here?

Daryl Adams
Good question, Mike. So, the parcel delivery space, we're comfortable with the mid to high single digit number. I think what can accelerate the growth of FVS would be the truck body business as we continue to see nice orders come in on that, and that's something that we jumped back into a couple of years ago and are seeing good order intake and customers excited about our product. So, longer term, I think that might add a little bit more to it to bump it up a percentage to or so, but the main driver, as you know, in FVS, the mature business is the parcel delivery.

Mike Schlisky
Got it. Thanks for that. And then looking at specialty vehicles real quick, do you expect the good margins there to continue for the foreseeable future, given the strong environment for demand? Can you give us some of the drivers there? Is it just volumes or do you have some supply chain improvements you can point to as well on that segment?

Daryl Adams
As we talked about in the prepared remarks, we've seen three fantastic quarters in a row delivering north of 15%. I think as we look at that business forward, the team has done a really nice job, particularly on the work truck side of the business, service bodies and the like, driving price as well as efficiencies in the factories, and so continue to see strong demand. I think, certainly we expect to continue to see momentum from that perspective. And like we said, the team has done a great job both commercially and operationally, to position that business and continue to move it forward.

Mike Schlisky
Got it. One last one in here, if I could. The guidance has been pretty much unchanged. It's still a pretty wide window now that we're a third of the way through the year already. Can you maybe just review the big questions your way to answer before you narrow that guidance, either the low high or middle of the range here?

Daryl Adams
I think when you look at how we've guided the year on our last call, we talked about doing mid-single digits in the first quarter, which we just delivered. We talked about roughly 30% of the year in the first half, which is still in line with our expectations. I think as we look to the second half of the year, we want to make sure that we understand what the demand side of things will look like before we solidify it. I think filling in our sales with the off the shelf order that we talked about earlier, the upfit order, things like that, I think there's a couple different dynamics there from a lever perspective that would put us in a position to narrow that guidance.

Mike Schlisky
Great. Appreciate the answers. I'll leave it there. Thank you.

Daryl Adams
Excellent. Thanks, Mike.

Operator
Our next question comes from Greg Lewis from BTIG. Please go ahead with your question.

Greg Lewis
Hey, thank you. And good morning, everybody. Thanks for taking my question. Daryl, I was hoping maybe for a little bit more color on those comments around the mix demand. I mean, you touched on it with some of the existing fleet squeezing out efficiency. Could you maybe talk about the opportunity for Shyft as some of these companies, or some of your customers are in the process of basically trying to extract some more value out of some of their legacy vehicles?

Daryl Adams
Good question, Greg. I think it's maybe a little early to put a pin in anything certain, but I think when you think about efficiencies, I'm sure you're reading the same article as we are, but maybe if you look at it a different way. Efficiency could also be getting rid of some of their older vehicles and moving to more fuel-efficient vehicles, which we would have. If they choose to do that, we would have our velocity vehicle, which gets double the fuel efficiency of a typical walk-in van and the cargo space is slightly smaller. So that's one option that our sales guys are talking to them about.

But I think it's too early, they're still trying to figure it out, especially if you look at FedEx, express to the FedEx Ground articles that have been out in the press, they're just on the start of a new project called Drive. So, rest assured, we are sitting in meetings with them, staying close and offering the products that we have to help them become more efficient, and we've been great partners in the past and expect it to

continue.

Greg Lewis
Okay, great. And then just real quick, we're going to keep it out of the backlog. But as we think about that normalization of the backlog, how should we be thinking about that run rate of kind of normalized?

Daryl Adams
I think when you look at where this business historically operated, it's in the four-to-six-month range. And so as you look at a next 12-month revenue, historically, we would have had, call it, 45%, 50% of that in backlog, but we're still north of 60 if you look at our 2023 guidance and extend that. And so, we would expect, as we've said consistently, to see that normalize here over the next couple of quarters. It's probably Q3, maybe later in Q3, Q4, but our view on where we are and our comfort with that hasn't necessarily changed, and so we expect to see that play itself out within the year.

Greg Lewis
Okay, perfect. Thank you very much for the time.

Daryl Adams
Thanks, Greg.

Operator
Our next question comes from Steve Dyer from Craig Hallum. Please go ahead with your question.

Steve Dyer
Thanks. Good morning, guys. I may have missed the SV segment, really fantastic margins, better than they've been in a long time. Was there anything specific that drove that? Is that just mix within the segment or was there anything particular to call out?

Jon Douyard
I think certainly a little bit of mix. We talked about some motorhome softness in there. But I think, really just strong performance within our service body and work truck businesses, both from a pricing and growth perspective, as well as just driving efficiencies in the factories.

Steve Dyer
The 18,500 upfits, you've talked quite a bit about it, is that a new customer? Is that just one customer? Any other color you can sort of give around that to frame that up.

Jon Douyard
Single customer that we've been a partner with for decades. And so really a good opportunity for us as they look to replenish a legacy fleet for us to step in and provide upfitting content, which we've been doing over the last number of years and so really just a continuation of that. Again, I think Daryl talked about, both from a quality perspective as well as our ability to just deliver at high volumes, we think is a differentiator for us, and we're happy with that business.

Steve Dyer
Okay. The rest of mine have been answered. Thanks, guys.

Operator
Once again, if you would like to ask a question, please press star and one. Our next question comes from Matt Koranda from Roth MKM. Please go ahead with your question.

Matt Koranda
Good morning. Just wanted to ask a more pointed question on the philosophy around guidance, I guess. No change to the range that you've provided despite a pretty big upfit win. Just curious if there's something specific that you can point to that offsets that incremental revenue within '23? Or is it just a more general tone of caution that you have toward sort of the overall environment?

Daryl Adams
This is Daryl. I think it's the latter that you brought up, is there's still a lot of moving parts. We're excited about the order. It's definitely going to help move the needle, but there's still some uncertainty that we continue to hear about. And like I mentioned in an earlier call, it's still early in the process of our traditional customers trying to figure out how they're going to become more efficient, or what actions they're going to take to be more efficient. So still cautious, still seeing some different comments coming in from even different ones, different customers recently in the news, so we're just being cautious on that.

Matt Koranda
Okay, fair enough. And then just on the margin profile of the upfit business specifically, I guess, historically, upfit has been accretive to the margin profile of FVS. Should we expect anything different on that front with this particular piece of business?

Daryl Adams
No, not necessarily. I mean, I would say, as you look at the upfit business in general, it's a bit shorter cycle of the business. And so, if the FVS backlog is four to six months, it's typically on the shorter end of that. And so, when we gave guidance back in February, we had assumed some level of upfit business for the year. This obviously filled that in and so I wouldn't view it as completely incremental. I think it sort of solidifies that upfit assumption. But again, it's a great opportunity for us and I think positions us well.

Matt Koranda
Okay, got it. And then curious on FVS, where should backlog normalize? If you want to characterize it in the form of like quarters, months, however you want to characterize it, would be curious to get your take on where FVS backlog should normalize over the next quarter or so. And then what does that mean for near term order flow?

Daryl Adams
I mean, it'd be tough to pinpoint a number there just because there's a number of variables. But like we said, we expect it to normalize here over the next couple of months. I think if you look, really over the last four quarters or so, we've had modest orders in that business coming off that record high backlog, I think we expect that to continue here in the near term until it normalizes and then see some activity from that perspective.

Matt Koranda
Okay, fair enough. And then just last one for me on Blue Arc, I just wanted to get a specific, some color, I guess, on an update with customer testing, how that's going. Do you have vehicles now in the field? And maybe you could just speak specifically to how that's progressing.

Daryl Adams
Customers do not have the vehicles in their hands yet. We're still working through development testing. And the big milestone that we have to achieve is the brake testing, which will give us ABS so that when customers have the vehicles, they're certified to be safe, and we expect that to happen later in this quarter.

Matt Koranda

Okay, great. Thank you.

CONCLUSION

Operator
Thank you. And ladies and gentlemen, with that we'll conclude today's question and answer session. I'd like to turn the floor back over to Randy Wilson for any closing remarks.

Randy Wilson
Thank you. I'd like to thank everyone for participating in today's conference call and your interest in The Shyft Group. Over the coming weeks, we'll be hosting one on one investor meetings at the Advanced Clean Transportation Expo in Anaheim and as well the 20th Annual Craig Hallum Institutional Investor Conference in Minneapolis. With that, operator, please disconnect the call.

Operator
Ladies and gentlemen, the call has now concluded. We thank you for joining. You may now disconnect.