Spartan Motors Q1 2016 Earnings Conference Call
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Officers
Greg Salchow; Spartan Motors; Group Treasurer, Director of IR
Daryl Adams; Spartan Motors; President and CEO
Rick Sohm; Spartan Motors; CFO

Analysts
Mike Shlisky; Seaport Global; Analyst

Presentation

Operator: Good morning and welcome to Spartan Motors first quarter 2016 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 any objections you may disconnect at this time.

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

Greg Salchow: Thank you. Good morning, everyone. Welcome to the Spartan Motors first quarter 2016 earnings call. I'm Greg Salchow and I'm joined this morning by Daryl Adams, our President and Chief Executive Officer, and Rick Sohm, our Chief Financial Officer.

For today's call we are incorporating a presentation deck which is filed with the SEC and available on our website at www.spartanmotors.com. You may download the deck from the shareholder section of our website to follow our presentation during the call.

Before we start today's call please turn to page 2 in 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 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 or management beliefs that 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 we cannot anticipate.

Daryl Adams will provide an operational review of the first quarter, followed by a financial review from Rick Sohm. Daryl will then make closing remarks before we proceed to the question-and-answer portion of the call. Now, I am pleased to turn the call over to our CEO, Daryl Adams, for his opening remarks, which begin on slide 3.

Daryl Adams: Thank you, great. Good morning and thank you for joining our call. Let me begin by saying I am proud of the team's performance this quarter as we begin to see the results of our efforts to strengthen the business.

We reported a net income of $500,000 and at $0.02 per share in the first quarter of 2016, a considerable improvement in year-over-year, as you see on the slide. This represents the first time since 2010 that the

Company has reported positive net income in the first quarter. In addition, we maintained our focus on our balance sheet ending the quarter with cash at $36.8 million.

All three of our segments reported stronger operating results compared to the first quarter of 2015. Delivery and Service Vehicles, especially chassis and vehicles, posted higher operating income and revenue growth year-over-year. Demand for our products remain strong with sales of our most popular products showing gains for the first quarter of 2015.

Returning our Emergency Response segment to profitability remains our top priority. While the segment was not profitable in the quarter, it did report a smaller operating loss compared to last year. Material utilization in the ER business improved, demonstrating the progress we have made in reducing waste and raising manufacturer efficiency. Operating expenses were also reduced as a percentage of sales and in dollar terms compared to the first quarter of 2015, primarily due to reductions in selling and restructuring expense.

Last quarter, I mentioned we were close to launching our Spartan Preferred Trucks. These trucks combine the most commonly ordered options into pre-engineered packages that can be easily manufactured. We actually started two new programs: The Spartan Select program for our custom cab and chassis customers and the 180 Truck program for our complete apparatus customers.

Both of these programs were publicly announced a couple of weeks ago at the FDIC show in Indianapolis, the largest fire industry conference in North America, and were well received by our dealers and OEM partners. The Spartan Select program is aimed at our OEM partners, those customers who build their own bodies on a Spartan custom cabin chassis.

The Spartan Select program offers the most commonly selected options combined into easily ordered packages. This program will allow us to manufacture a custom chassis with less lead time and reduces the complexity to order, engineer and build a custom chassis.

The 180 Truck program offers several pre-engineered aerial and pumper models that are based on the most commonly ordered option packages. Both reducing complexity, we are able to streamline the ordering, engineering and production processes, thereby cutting time-to-delivery to as little as 180 days.

As we look ahead, we will continue to focus on operational improvements while we expand efforts to increase output and become profitable. We made significant progress with our operational initiatives this quarter. Implementation of the Spartan Production System that we have talked about on our call last quarter has begun in Bristol and Charlotte.

Will you please turn to slide 4? We're also moving truck body production out of Wakarusa, Indiana into the Bristol facility in an effort to reduce operating expenses and improve manufacturing productivity. We expect this move to be completed by June 30, 2016.

With floor space at a premium in Bristol, we decided to move Reach production to the Charlotte campus. DSV received an order for 348 Reach vehicles, bringing the total for the year to more than 1,500 units. All these units will be built in Charlotte before the end of the first quarter in 2017.

We recently developed an active braking system for motorhome chasses. They have been shown to our customers and received positive reviews. We will unveil this collision mitigation system to the rest of the industry later in the second quarter. It is too soon to estimate market demand or when the system might be commercialized, but we believe this will be a meaningful contributor to growth in the motorhome chassis business in the future.

Finally, as we announced a couple of weeks ago, we broke ground on a new contract facility here in Charlotte. This facility will produce Isuzu's new F-series trucks. The F-series is a class-6 truck that brings Isuzu into a new market segment. We are proud to be their assembly partner and look forward to beginning production in early 2017.

Now, I will turn the call over to Rick to discuss Spartan's financial results for the first quarter.

Rick Sohm: Thanks, Daryl. Please turn to slide 5. As Daryl mentioned, we are pleased to report positive net income in the first quarter. Considering that the first quarter is typically one of our weaker periods, we believe that we are starting to see the favorable impact of initiatives we have taken to improve our financial results, including launching the Spartan production system, implementing lean manufacturing across our production facilities, and closely managing overhead and operating expenses.

Revenue for Q1 increased 4.1% to $133.7 million from $128.4 million with full DSV and SCV segments reporting strong revenue growth compared to last year. First quarter adjusted operating income improved to $1 million from an adjusted operating loss of $3.2 million in the prior year.

First quarter net income was $0.5 million or $0.02 per share, versus a loss of $2.9 million or $0.09 per share last year. As Daryl mentioned earlier, this is the first time Spartan has reported a profitable first quarter since 2010.

Now let's take a look at results by operating segment, starting with the DSV segment on slide 6. DSV reported revenue of $59.3 million, compared to $54.9 million last year. This was an increase of 8%. Revenue was driven by continued growth in our vehicle upfit business. This growth in upfit revenue more than offset lower vehicle sales compared to last year's first quarter, which included $6.6 million of pass-through chassis sales that are not typically treated as part of our vehicle revenue.

Operating income more than doubled to $5.6 million or 9.4% of sales, up from $2.6 million or 4.8% of sales a year ago. The increase is due to higher upfit volume, which typically carry more favorable margins and material productivity gains compared to the prior year.

We are currently fulfilling a large upfit order that we expect to extend through most of 2016. While we expect this business to be an important part of DSVs future growth, we do not currently have a follow-on order with this particular customer.

Now let's move to slide 7 and the ER segment. Revenue declined to $39.4 million from $43.2 million as a result of lower shipments of apparatus compared to last year, while revenue for our custom chasses were essentially unchanged. Apparatus production started slowly at the beginning of the quarter as we dealt with some residual production issues hanging over from the fourth quarter.

As we exited our first quarter, our production volumes are ramping as our productivity and throughput improve. Despite the lower revenue, we are pleased to report ER's operating loss decreased to $3.9 million from $5.4 million.

The operating loss narrowed due to better performance on the shop floor, improved cost control, and reductions in operating expenses. Excluding restructuring expenses, the ER segment had an adjusted operating loss of $3.6 million compared to an adjusted operating loss of $4.2 million, an improvement of 14.3% versus the first quarter of 2015.

Moving to the SCV segment on slide 8, you will see the first quarter revenue totaled $35.1 million. This is up 15.8% from $30.3 million in the prior year quarter. Motorhome chassis revenue grew 13.3% driven by higher volumes, increasing to $26.4 million from $23.3 million.

Demand for motorhome chasses continues to be robust. We expect further growth as we become the sole chassis supplier to a major customer and have been added to additional models at another major customer.

Increased levels of contract manufacturing accounted for approximately $1.2 million of revenue growth in the quarter, and our defense business contributed $0.6 million of incremental revenue as we built additional ILAV vehicles compared to a year ago. All of this contributed to significant operating income growth in the first quarter, as it increased 70% to $1.7 million from $1 million in the same period last year.

On slide 9, you will see some of our balance sheet metrics. We ended Q1 with $36.8 million in cash, up from $12 million at the end of the first quarter of 2015. Comparing our balance sheet to the prior year shows considerable improvement in working capital and reflects the progress we've made in running our business more efficiently.

Accounts receivable were reduced by $10.8 million to $59.5 million, and inventory showed even more improvements, declining to $71.2 million from $85.1 million, a reduction of $13.9 million. Improving working capital management and maximizing cash levels to support future growth will continue to be high priorities for our management team.

Please turn to slide 10 and we will discuss our outlook for the remainder of the year. As we detailed in this morning's press release, our outlook for the rest of the year has improved significantly. As we reported last quarter, our order intake is strong and continues to grow across the board as evidenced by our current backlog of $318.9 million, our highest backlog since the second quarter of 2008.

Based on the strong demand for our products, we are raising our revenue estimate for the year by $10 million to a range of $570 million to $590 million. Our expected range of operating income is now between $7 million and $10 million, based on higher revenue, favorable product mix, increased manufacturing efficiencies, and lower overhead and operating expenses.

Operating income includes estimated restructuring expense between a half million dollars and $1 million. We anticipate income taxes in the range of $1 million to $1.2 million. As a result, we now expect earnings-per-share to be in the range of $0.15 to $0.25 for the year. We also expect each quarter of 2016 to be profitable.

This concludes my remarks. Now I will turn the call back to Daryl for his closing comments on slide 11.

Daryl Adams: Thanks, Rick. We are pleased to start 2016 by reporting a profitable first quarter. Especially after a challenging 2015. As previously mentioned, this is typically one of our weaker quarters so we are particularly encouraged by the results.

All three of our segments reported better financial results compared to the first quarter of 2015, indicating our strategy and turnaround plans are working. The outlook of 2016 has improved since last quarter and our expectations for revenue and operating income have also increased.

We will continue to follow our 2016 focal points this year. Our top priority remains to return the ER segment to profitability. We made progress during the first quarter and have a roadmap to achieve our goal. There is still a lot of work to do, but we can see a clear path to reach a breakeven run rate by the end of 2017.

Our new management team is gaining momentum on our business objectives. These actions taken have already begun to show improved financial results. Although we are still in the early stages of our transformation plan, we expect better results for the year and remain focused on increasing value for our shareholders.

Operator, we are now ready to take questions.

Questions and Answers

Operator: Thank you. We will now begin the question and answer session. (Operator instructions.)
Mike Shlisky; Seaport Global

Mike Shlisky: Nice quarter. Let's start with a quick question just on your overall outlook here. You did tick up operating income. Could you give us a little more color, maybe breakdown for us maybe is there a certain business that you think in particular is the main reason for the uptick in your operating income, in your operating income outlook, or is it really across-the-board, or a corporate [expense] type of improvement there?

Rick Sohm: I would say, Mike, it is across-the-board. Each business is experiencing increased manufacturing productivity and efficiencies. We are keeping a close lid on the expenses and we see growth on top line from DSV and from our Specialty Vehicle segment.

We told you before in prior quarters that we don't expect a lot of top line growth out of ER, but we are focusing on getting that thing to profitability and I think we have seen some good progress in the first quarter. That should continue to ramp in the remaining three quarters of 2016.

Mike Shlisky: Great. That does lead to my next question about the business. Could you give us a sense of how you feel ER is doing from a market share perspective? There are some companies out there that have been claiming to have been gaining share recently. I guess the other part of the question is, is your goal of breaking even by the end of 2017, is that in any way volume dependent or is it all about what you can do to improve your own operations?

Rick Sohm: I believe, Mike, it is largely a matter of efficiencies and productivity and operational turnaround and not dependent on volume. One of the things I think we mentioned on the last call was we have been taking price increases along the way, going back to probably the second quarter of 2015, and our ER backlog is not reducing significantly. I think we also mentioned that we have turned down some business recently for trucks that we thought we couldn't build profitably.

Mike Shlisky: Okay, got you. The other thing I want to ask about, in your backlog comments in the press release you did say that your ERV backlog was, I think it said 13 months or less for your ERV vehicles in your backlog. I guess is the goal now, maybe next quarter or in the next couple of quarters, for it to be six months or less for the entire business? Or is your 180 program only for certain models of truck or certain kinds of orders?

Daryl Adams: Yes, Mike, very good question. The long delivery time of 13 months is the industry standard right now. Actually some of our competitors are higher than that. The 180 Truck is not meant to substitute for every other truck we're building. We are still a custom manufacturer. This is just another way to shorten up that lead time to give the industry the trucks they're looking for.

Mike Shlisky: Okay. If I could just squeeze in one last one here on your R&D expenses as well. I saw those were down over $2 million in the quarter. Could you update us on some of your R&D initiatives? Have you changed what is on your plate? Can we expect to see that kind of run rate for the rest of the year, about $1 million to 1.5 million dollars? Can you also update us separately on your CapEx budget for 2016?

Daryl Adams: Mike, if I can remember correctly, didn't we move the R&D from -- separate line item up into cost of goods sold? That is why you are probably seeing the quarter over quarter number there. We can get back to you on how that has changed if we want to normalize it.

Rick Sohm: I think to Daryl's point, there has been no significant change in our R&D planning or spending. I think there's a couple of million dollars up in COGS that we started to reclassify last year. No major changes there, Mike.

I think from a CapEx perspective we have a significant ramp up year-over-year. I would expect the CapEx for the year to be in the range of $12 million to $14 million, and probably half of that number being driven by the new production facility that we're building for the Isuzu F-series.

Mike Shlisky: Okay, got it. Thank you, guys. I will hop back into the queue.

Operator: (Operator instructions) Mike Shlisky; Seaport Global

Mike Shlisky: Can I ask one or two more while I have a few more moments here?

Rick Sohm: Sure, Mike.

Mike Shlisky: Thank you. Look, I wanted to also ask about the active braking system that you guys had just mentioned in your comments and in your slides. Now, I have heard of it elsewhere at some of the class VIII manufactures with their own active braking systems. Could you tell us, is this entirely developed in-house or did you appropriate one of the other larger brand's version of it? Or tell us what this is all about.

Daryl Adams: It is one of the class VIII suppliers that we work with and adapted their system to work with our motorhome chassis. With all the logarithmic issues you have on braking and weights and stuff, it is a class VIII system that was tailored to meet our motorhome customers and their demands.

Mike Shlisky: Okay.

Daryl Adams: Mike, I'm sorry, just one thing to add, which is the first in the industry, by the way.

Mike Shlisky: Got it. Got it. While I have my list of questions open, could I maybe also ask, could you give us more color on the Isuzu F-series expansion? Can you give any kind of color as to the volume potentials coming from that as soon as that expansion opens, or is that not something you can currently put out there publicly at this point?

Rick Sohm: Not able to comment right now, Mike, on volumes. We think the facility will be completed later this year and we expect production to start sometime late first quarter of 2017.

Daryl Adams: Mike, I will add that the facility we are building is very flexible. It is much different than our normal production facilities, if you have been through any of them. It can run both the F-series or the

N-Gas or if we want to we can put a motorhome chassis down that line as well. It is state-of-the-art, 2016, lean type systems put in place inside that facility. So it is flexible, and if we don't see the volume in the future with Isuzu, or something changes, that plant can be used for anything else.

Mike Shlisky: Perhaps I could ask this a different way. Is the volume that you expect from Isuzu, does that cover an appropriate -- just on its own, does that cover an appropriate return on your invested capital from the outset?

Daryl Adams: Yes, yes it does. Absolutely.

Mike Shlisky: When I say appropriate that means appropriate to your prior returns. Or what do you [expect] in the future as far as a higher shareholder value --?

Rick Sohm: Your second point is what we're looking at here, Mike. It is an acceptable return for our shareholders.

Daryl Adams: Not the historic number.

Mike Shlisky: Okay, perfect. Then while I've got you, one more thing on the RV side. It has been doing well thus far this year. You've seen some of the broader industry numbers. Can you give us a sense -- is it important for us to watch the housing market going forward to kind of see that how that market may or may not do better or worse as we go forward here? I guess I was wondering if you could give us what you think is your top metrics watch for the health of that broad end market?

Greg Salchow^ Hi, Mike, this is Greg. We have done some research on it and you are pretty close. We think it is largely related to home equity values. When the buyers typically have home equity, they can use that to help finance the vehicle. Yes, it is related to home values, but specifically home equity.

Mike Shlisky^ Okay. Let me do one last one here about your SG&A for the quarter as well. That was flattish. I was wondering if you could tell us if that is an appropriate run rate around $13 million or $14 million for the rest of the year, or do you have some cuts coming in the rest of the year here? Or increases perhaps?

Rick Sohm^ I think what we said on a prior call, Mike, is we are rebuilding the team and as we cascaded that down through the organization, we have addressed some needs to strengthen the organization in manufacturing and in our quality organizations. So I don't -- we shouldn't think of it as cuts going forward.

Mike Shlisky^ So it is a change in the structure of the organization? But it is going to be from a dollar perspective lower or higher or equal do you think to the rest --?

Rick Sohm^ We are targeting it to be relatively flat, and as we build the organization, at some point we will look at synergies and consolidating some of the back-office operations. But nothing pending currently.

Mike Shlisky^ Okay. Good. Guys, thank you for answering all my questions. Excellent quarter and good luck.

Daryl Adams^ Thanks, Mike

Rick Sohm^ Thanks, Mike.

Operator^ This concludes our question-and-answer session. I would now like to turn the conference back over to Greg Salchow for any closing remarks.

Greg Salchow^ Thank you, everybody. We appreciate your time and interest. As always, if you have any follow-up questions feel free to contact us later. Thanks again and have a good day.

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