Spartan Motors, Inc. [SPAR]
Q3 2019 Earnings Conference Call
Thursday, October 31, 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:
Steve Dyer, Craig-Hallum Capital Group
Justin Clare, Roth Capital Partners
Steve O'Hara, Sidoti & Company

Presentation:

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

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

Juris Pagrabs: Thank you, Francisca. Good morning, everyone, and welcome to the Spartan Motors 2019 third quarter earnings call. I'm Juris Pagrabs, and joining me on the call today are Daryl Adams, our President and Chief Executive Officer; and Rick Sohm, our Chief Financial Officer. For today's call, we've included a presentation deck that has been filed with the SEC and is also available on our website at spartanmotors.com. You may download the deck from the Investor Relations section of our website to follow along with our presentation during the call.

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

On the call today, we will provide an overview of the third quarter along with a brief business update followed by a more detailed review of the third quarter results and an update on 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 on our third quarter conference call.

I'd like to start by thanking the entire Spartan team for their hard work this quarter, resulting in an exceptionally strong performance, which includes record sales and an 80% increase in adjusted EBITDA. The actions you've taken over the past several years support our strategic growth plan while building a solid foundation for improved performance in 2019 and beyond.

Our record revenues for the third quarter rose 28% to $289 million, underscoring the acceleration of both organic and acquisition growth, which includes significant geographic expansion as well as increased demand for delivery vehicles in all of our vehicle classes. The strong growth at FVS continued in the third quarter as sales were up 52%, driven by higher sales from delivery vehicles in all of our vehicle classes. ER also posted another quarter of sales growth up 7% to $64 million as the segment saw increased volume and improved pricing, while SCV as expected saw sales decline 13% due to lower sales for the luxury motor coach chassis and the completion of the Reach vehicle order. You may recall from last quarter's call we had higher Reach sales during the second quarter as those orders were pulled forward to meet customer demand.

Now please turn to Slide 4 and I'll provide an update on a few business highlights and exciting new developments. Investing in our future. As we continue to invest in our future, I'd like to highlight three key areas where we've made progress towards our long-term growth strategy in the quarter. First, one of the pillars of our strategic growth plan is to deliver on coast to coast expansion. And through M&A, we've delivered on our commitment. In fact, within the last 10 months, we've expanded our footprint through three acquisitions which added eight manufacturing facilities in four states.

Next, in addition to acquiring new facilities, we've remained focused on maximizing performance of our current operations. By repurposing and optimizing our current operations, we've been able to make progress towards achieving a leaner, more efficient and flexible manufacturing process. During the quarter, we completed the relocation of Bristol truck body build to the Charlotte campus. And by doing so, our Bristol facility is now a focused walk-in van factory. Truck bodies will now be built in Michigan, Pennsylvania and California. Additionally, I'm pleased to report that we currently have a six-month backlog at the Pennsylvania truck body facility, which nicely backfills the USPS order we completed this quarter. We also invested in all three of our upfit facilities to increase capacity, and we've ramped up Kansas City and north Charleston facilities to three shifts operations to meet strong demand for delivery vehicles.

Our third focus has been investing in new products and technologies to drive future growth. We have developed a new purpose built Class 3 vehicle that we plan to release next year; a new delivery vehicle and shelving concept that improves ergonomics and customer efficiencies; and a new cab manufacturing facility that we launched last quarter called Detroit Truck Manufacturing, which serves as a vertically integrated supplier of fabricated aluminum cabs for the ER business. The facility continues to increase its production ramp curve and provide material costs and quality benefits for ER beginning in 2020 as well as to fill other fabrication needs across the organization.

Please turn to Slide 5 and we'll discuss our most recent acquisition. Continuing with our strategic growth plan, last month we announced the acquisition of Royal Truck Body. As the largest specialty service body manufacturer in the West, with six operating facilities across California, Arizona and Texas, this acquisition provides us coast to coast geographic coverage. The acquisition of Royal Truck Body is complementary to the acquisition of General Truck Body, which we completed earlier this year. Together, both will provide significant West Coast and Southwest operations, which will position us to better serve our existing customers in the region while simultaneously allowing us to grow our overall customer base. We also perceive many opportunities for our expanded West Coast operations to support fleet customers by building and distributing commercial trucks more efficiently and cost-effectively.

Please turn to Slide 6 and I'll continue with our growth strategy. Our growth strategy is supported by the continued demand for delivery vehicles in all vehicle classes. In 2018, consumers spent $517 billion online, up 15%. This accelerated e-commerce growth is reflected in the FVS backlog, which is up 93% year-over-year. We believe the results in the quarter and throughout the fiscal year reflected broad industry demand for vehicles across our GVWR product offering, and we expect this trend to continue.

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

Rick Sohm: Thank you, Daryl.

Turning to Page 8. Our strong third quarter highlight growing demand for delivery vehicles across our entire product portfolio. As we noted last quarter, we expect to see stronger year-over-year revenue and profit growth in the second half of 2019. And our third quarter revenue grew $62.8 million, or up 28%, to $289 million. Q3 adjusted EBITDA grew 81% to $19.2 million from $10.6 million a year ago, and our margin grew to $6.6 million from $4.7 million a year ago, due primarily to a shift in product mix to last mile delivery demand across the portfolio. Adjusted net income more than doubled to $12.3 million from $6 million in Q3 of 2018, while adjusted EPS also more than doubled to $0.35 a share. And included in the quarter is approximately $1 million in startup and reconfiguration costs incurred in our upfit and car body plants. Our backlog at quarter end continues to grow and ended at $459 million, up 41% from a year ago, excluding the postal car body work.

Now we'll look at HBU, beginning with Fleet on Page 9. Fleet reported record revenue of nearly $180 million, compared to just over $118 million in the prior year for a growth rate of 52%. The revenue growth is driven by higher volume and pricing. Adjusted EBITDA grew $17.4 million to $24.7 million from $7.2 million a year ago largely due to volume, lower material cost from new load cross-country procurement and improved pricing offset by the million dollars of startup cost I mentioned earlier. Our margin grew to 13.7% from 6.1% a year ago. When you exclude the one-time truck body order, our margin would have been 15.8% compared to 7.6% a year ago.

Fleet backlog grew 93% to $224 million, compared to $116 million a year ago, excluding the truck body order.

Moving to Page 10 and ER. Q3 2019 revenue grew 7% to $64 million from $60 million in the prior year. The growth in ER revenue was driven by higher volume and pricing. Adjusted EBITDA in Q3 declined to a loss of $1.1 million from a profit of $0.6 million in the prior year. The decline was primarily the result of unfavorable mix, higher material cost and was partially offset by pricing and volume. Our backlog grew 11% to $195 million compared to $176 million in the prior year.

Turn to Page 11, and we'll cover our specialty. We reported revenue of $45 million down from nearly $52 million in 2018 due primarily to a $6 million decline in motor home volume and the completion of the Reach build in Q2 of 2019. As a result of the decline in revenue, adjusted EBITDA declined to $4 million from $6 million a year ago, driven by volume, mix and a manufacturing disruption due to an OEM strike. The resulting margin decreased to 9% from 11.4% a year ago. Our backlog at the end of the quarter did grow 18% to $40 million from $34 million in the prior year.

We'll look at our balance sheet on Page 12. Our overall leverage and liquidity position remain a key resource to support our long-term strategy. During the quarter, we paid $5 million down on our revolver, and our total liquidity at quarter end was $55 million. We've since paid down another $10 million on the revolver earlier in the month of October. Our improved liquidity matches the debt paid down on the $10 million, and we expect liquidity to continue to improve for the remainder of the year.

On Page 13, I'll review our outlook for the remainder of 2019. Based on our year-to-date performance combined with our footprint growth, improving backlog, growing productivity and new low-cost country procurement, we are improving our current outlook for 2019 midpoint by the following: revenue of 2% to a range of $990 million to $1 billion, net income up 11% to a range of $27.3 million to $28.8 million, adjusted EBITDA up 18% to a range of $51.9 million to $53.7 million, earnings per share up 10% to a range of $0.77 to $0.81 and adjusted earnings up 23% to a range of $0.89 to $0.93.

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

Daryl Adams: Thanks, Rick.

Please turn to Slide 14. Spartan's strong performance through the first 9 months of 2019 provides a solid platform, continued growth for the remainder of 2019 and into 2020. As the Spartan team continues executing our overall strategic growth plan, we'll continue to invest in new products, technology and manufacturing facilities to expand our leadership position in the markets we serve that will benefit our employees, customers and shareholders.

Operator, we're now ready to take questions.

Questions and Answers:

Operator: We will now begin the Question & Answer session. [Operator Instructions] The first question is from Steve Dyer with Craig-Hallum. Please go ahead.

Steve Dyer: Question on margins. So guidance for Q4 implies really exceptional margins. And I guess a couple things. One, am I right in assuming that a lot of that is due to the USPS pass-through business being done for the time being? And if so, are those the kind of margins we should be thinking about going forward?

Rick Sohm: I think you're right on. The fourth quarter won't include any of the pass-through revenue, and we expect to have a good, strong fourth quarter. The margin, I think I wouldn't model that as our go forward margin with the fourth quarter because in the fourth quarter of the year we typically get something of a downturn in deliveries of ER products and motor home products. But yes, in the fourth quarter it's going to be real good, Steve.

Steve Dyer: But from a segment perspective, absent mix, and absent, I guess, another big pass-through order at some point, these are the kind of FVS margins that you'd be comfortable with looking out into the future?

Rick Sohm: Yes. If you look at Q3, we feel comfortable for fleet on a go forward basis at that kind of level.

Steve Dyer: Q4 you mean, or do you mean Q3?

Rick Sohm: No. Q3 would be a good proxy going forward for Q4 in terms of a margin.

Steve Dyer: Got it. Okay. And then on Slide 4, you guys talked about a new purpose built truck in parentheses. Is that done for a specific customer? And if so, is that something you can branch out to other customers? A little color on that would be great.

Daryl Adams: Steve, I'll take that one. I think you've heard us talk about how we see the vehicle delivery class moving down into the lower classes. You have a lot of Eurovans out there that are running around, and people are asking for smaller vehicles. And so we've put together a vehicle that we think is going to be exceptional in the market and be exciting. So it's on a Class 3 platform, and it's available to any customer. It's not purpose built by customer, it's purpose built by the industry, which is going to be delivery vehicles.

Steve Dyer: Got it. Okay. And then last one for me and I'll jump back in the queue. The backlog that you guys have put together in Ephrata. Assuming that is little to no USPS and is all upfit and not purpose built? Is that right? Or, I'm sorry, pass-through.

Daryl Adams: Correct, Steve. We ended in this quarter with the USPS build. We have not heard any news about the add on order that we talked about previously, so the backlog is 100% regional and commercial in that region of the country.

Operator: Your next question is from Justin Clare with Roth Capital Partners. Please go ahead.

Justin Clare: So I guess first, with the acquisitions that you've made both on the East Coast and the West Coast, you now have a national footprint. So I was wondering if you could talk about the response that you're seeing from your customers and whether you're actually getting increased order flow from national accounts that may want to take delivery of trucks in different regions of the country.

Daryl Adams: Justin, this is Daryl. I'll take this one. I think if you go back to our strategy discussions in the past, we talked about establishing a national footprint like you described. The reason we did that was because we heard from customers that we would only receive a third of the order, and the other two-thirds would go to our competitors on either coast. So this fulfills our commitment to be on coast to coast.

And to answer your second part of your question, we are seeing increased order flow. We're seeing customers come to us and ask us if they can have a certain number of trucks at each location across the country. So we'll get a certain quantity in California, some here in Bristol or in Charlotte and then the balance in Pennsylvania. So that is fulfilling our commitment. Again, and our customer asks us to be there, and we put in place a strategy to get there and it's working.

Justin Clare: Okay. Great. And could you comment on the ability to improve margins as a result of that? Because I assume you only need so many people to manage a particular customer relationship, but now you can serve that customer across the entire customer. So you could assume that you could get a margin uplift. Can you comment on that?

Daryl Adams: Yes. We typically don't talk about margins by individual product line, but your concept is correct. And that's in the past, we've not been able to be competitive in either one of those two locations, the East Coast or the West Coast. Now with having those two covered, we can compete and it's going to be dependent on the market. But I think as they continue to get integrated, and our goal is to have them integrated within 12 months or less, you'll see some of that fall through the bottom line.

Justin Clare: Okay. And then shifting to the balance sheet, with the purchase of Royal Truck Body, you increased the level of debt. But it sounds like you've already repaid $15 million or so on the debt that you used to fund the acquisition. I was wondering if you could just talk about the level of debt you're comfortable with, what your repayment plans are. And then looking toward the future, if another acquisition were to -- if there was an attractive acquisition that were to present itself, could you use that to fund that purchase?

Rick Sohm: Yes. Good question. And I think what we've said all along is in absence of another deal, we'll use cash flow to pay down the revolver. And I would expect by year-end another payment on that revolver. I think we've talked not feeling real comfortable when you've started approaching 3x leverage. But I guess to your point, if there was an attractive acquisition that would be a positive to our footprint, a positive on the management front, we would pursue that. And we're confident we can get the financing for it.

Operator: The next question is from Steve O'Hara with Sidoti & Company. Please go ahead.

Steve O'Hara: Just curious, I think you noted that material costs were a headwind for ER, and then I guess a tailwind within fleet vehicle. I'm just wondering how that works. Is it longer lead time? It is just quicker turnover, maybe different sourcing areas? Can you explain that?

Daryl Adams: Yes. Steve, this is Daryl. You nailed it in your question. Right, so if you remember, ER is about a year backlog. And we talked about we still have some of those headwinds through the second half of this year in previous calls and meetings. So you got a year backlog, we have contracts with municipalities. They have certain clauses, and they're going back. And getting material increases through the contract is not easy, and we haven't had much success.

If you go to fleet, to your second part of the question, that's a much shorter lead time and quote period. And it's PO to PO. It's not a long-term volume, so we can price the material fluctuations into that. And if you remember, last year in Q3, as we told everyone, as the material was going up we committed to volume through the end of the year and the material came back down. So that volume, we had to swallow at a higher price. So we did put in some policies and procedures to eliminate that going forward. And I think if you remember, I also said that that will not happen to us again. And once we worked through the ER piece, we were finding our plan is working on the FVS side.

Steve O'Hara: Okay. And maybe just to follow up on that. I mean, is there a way to think about ER margins maybe into next year, as I assume you worked through that inventory and I think you guys went for a price increase, et cetera? How do you think about ER margins, maybe, next year?

Daryl Adams: Yes. We still stick to our commitment that we've made, 3% to 6%. But due to the tariffs and other items that have been pushed out, so we haven't put a year on it, but we see it somewhere between where it is today. It'll be a trajectory that is consistent over time. And it will get to that 3% to 6%.

Steve O'Hara: Okay. And then, was there any impact in the quarter or maybe going forward from GM's strike or anything like that? Has that not been an issue?

Rick Sohm: No. Good question, Steve. We had an issue starting kind of mid-September, so in the quarter it wasn't a big impact. The quarter that will be affected is October, and that will be a relatively small number because we could make up the production later in the quarter.

Daryl Adams: And Steve, our customers are asking us to put plans together to make up that volume that was missed during that strike. So we see a, like Rick said, a minimal impact if any to the quarter and full year.

Steve O'Hara: Okay. And then maybe just lastly on the USPS contract. Was there any USPS revenue in the quarter? And then, was that a big impact on FVS margins in the quarter? Or maybe the reduction of that revenue, was that a big impact on the quarter?

Rick Sohm: It probably wasn't as big as Q1 and Q2, but I think we had $23 million in the quarter of pass-through revenue. And that's what drove the adjusted number from 13.7% to 15.8%.

Operator: This concludes our Question & Answer session. I would like to turn the conference back over to Juris Pagrabs for any closing remarks.

Juris Pagrabs: Thank you, Francisca. Thanks, everyone, for participating today. Just a heads up, we'll be over in Chicago next week participating in the Baird Industrial Conference. Hope to see many of you there. And that'll be it. I think the next scheduled update will be the fourth quarter, sometime in February. Thank you, and have a great day.

Operator: Conference is now concluded. Thank you for attending today's presentation. You may now disconnect.