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Q2 2017 Spartan Motors Earnings Conference Call

Officers
Juris Pagrabs;Spartan Motors;Group Treasurer and Director, Investor Relations
Daryl Adams;Spartan Motors;President and CEO
Rick Sohm;Spartan Motors;CFO

Analysts
Steve Dyer;Craig-Hallum;Analyst
Rhem Wood;Seaport Global Securities;Analyst
Brad Noss;Roth Capital;Analyst

Presentation
Operator^ Good morning and welcome to Spartan Motors Inc., second quarter 2017 earnings results 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 Juris Pagrabs, director of investor relations and group treasurer for Spartan Motors. Juris Pagrabs, you may proceed.

Juris Pagrabs: Thank you, Andrea. Good morning everyone and welcome to Spartan Motors 2017 second-quarter earnings call. I'm Juris Paygrabs and joining me on the call today is Daryl Adams, our President and chief executive officer, and Rick Solm, our chief financial officer.

For today's call, we have included a presentation deck which will be filed with the SEC and is also available on our website at SpartanMotors.com. You may download the deck from the investor relations section of our website to follow along with our presentation during the call.

Before we start today's call, please turn to page 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 projects regarding Spartan Motors on its operations may be considered forward-looking statements under the Private Security Litigation Reform Act of 1995.

I caution you that as with any prediction or projection, there are a number of factors that could cause Spartan's actual results to differ materially from projections. All known risks that management believes could materially affect the results are identified in our forms 10K and 10-Q filed with the SEC. However, there may be other risks that we cannot anticipate.

For today's call, Daryl will provide an overview of the second quarter and a brief business update. Rick will review the second-quarter results and our 2017 guidance. We plan to then return to Daryl for closing remarks before proceeding to the question-and-answer portion of the call.

At this time, I am pleased to turn the call over to our CEO, Daryl Adams, for his opening remarks, which begin on slide three.

Daryl Adams: Thank you, Juris. Good morning, everyone. Thank you for joining us on Spartan Motors 2017 second quarter conference call. I am pleased to report another solid quarter of sales growth and operational improvement.

This marks the sixth profitable quarter in a row despite being up against some difficult comparisons in year-over-year. As expected, results for the quarter were impacted by volume and mix, a defense order that did not recur, and the timing of our previously announced Reach vehicle order.

Revenues for the quarter rose 4.4% to $169.7 million from $162.5 million a year ago. Increase in sales was driven by the acquisition of Smeal, which closed earlier this year. Smeal contributed $30 million in net revenue in the second-quarter.

The second quarter reported adjusted net income of $2.4 million, or $0.07 per share. Compared to $6.3 million or $0.19 per share last year.

Even with the comparative headwinds, we made significant progress in operational improvements which I will talk about in a few minutes. Momentum is building as showed by the quarterly sequential growth and adjusted EBITDA margins across our business units. We see this positive trend continuing into the second half of the year, which gives us confidence to raise our midpoint adjusted EPS guidance by 28%.

Please turn to slide four. I will provide an update on a few business highlights and developments. For the full year, we expect Smeal to generate revenues of approximately $105 million, up from $70 million in 2016. This increase is a direct result of improved efficiencies and streamlined manufacturing processes.

Our integration continues to run ahead of schedule. The operational team is focused on inventory reduction and implementing the Spartan production system. We are well-positioned for the second half to return the ER business unit to profitability on an adjusted basis for the full year.

Please turn to slide five for a brief update on the S-180. Acceptance of the S-180 pumper continues to grow. Backlog as of June 30 totaled 28 units. For the second quarter, we delivered 19 S-180 pumpers, that is up 36% over the first quarter when we delivered 14, and 280% over the fourth quarter of 2016 when we delivered five units.

Please turn to slide five, six, for a brief update on the Isuzu F-series. Today production of the new Isuzu F-series (inaudible) medium-duty truck is now in full swing as we recently celebrated the grand opening of our new production facility. The F-series truck is designed to optimize fuel efficiency and maximize cargo space to serve the growing urban and last-mile delivery segments, and will produce meaningful second-half contributions, and beyond.

Please turn to slide seven for an update on our Reach walk-in van order. Earlier in the quarter, we announced two new orders totaling approximately 900 Reach vehicles. Two delivery service companies including an 800-unit reorder and a first-time order from a global logistics leader. Reorder was primarily due to early positive feedback from last year's order that the Reach design met the ever changing last-mile delivery landscape that has directly impacted our growing e-commerce retail trade.

I will now turn the call over to Rick to discuss Spartan's financial results for the second-quarter and outlook for the remainder of the year.

Rick Sohm: Thanks, Daryl. Please turn to slide nine. Revenue for the quarter increased 4.4% to $169.7 million from $162.5 million, with Smeal contributing $30 million to the top-line increase for the quarter.

This excludes approximately $5.8 million of intercompany chasses sold to Smeal. For the year, we expect Smeal to generate approximately $105 million in revenue, excluding $20 million of Spartan intercompany chassis sales.

Second-quarter adjusted EBITDA decreased to $4.9 million from $8.2 million and adjusted EBITDA margin declined to 2.9% of sales from 5% of sales a year ago. On a sequential basis, our EBITDA margin grew 40 basis points to 2.9% from 2.5%, which reflects the momentum from our continued operational improvements.

As Daryl mentioned, results from the quarter were impacted by volume and mix and FVS, the timing of our Reach vehicle order which we announced in June, as well as a defense order that did not recur in 2017.

Our adjusted EBITDA excludes the impact of $400,000 of restructuring and acquisition-related expenses, and the impact from the one-time lag in recognizing sales and gross margin of $900,000 in chassis sales that are now in our company. This compares to $200,000 restructuring expenses and a product recall of 1.7 million in the prior year. Our backlog at quarter end was up $21.5 million or 6.1%, to end at $372.8 million compared to $351.3 million at the end of the first quarter.

Now let's take a look at the results by operating segment, starting with FVS on slide 10. FVS reported revenues of $53.5 million compared to $73.8 million last year. The revenue decrease was due to volume mix and the timing of the previously announced Reach order.

Adjusted EBITDA declined $900,000 to $6.2 million from $7.5 million a year ago, largely due to the items I just described. As we explained last quarter, we expected difficult topline comparisons as we were up against the large upfit order in the previous year.

Despite the sales decline, our adjusted EBITDA margin improved 190 basis points to 11.5% of sales from 9.6% a year ago, reflecting the strong improvement in manufacturing productivity as well as improved labor productivity. Backlog increased 15.2% to $131.3 million, compared to $114 million in Q1, reflecting our strong orders for last-mile delivery.

Moving on to slide 11 and the SCV segment, second-quarter revenue totaled $35.8 million compared to $37.8 million last year, which included a $4.4 million defense order. This was largely offset by a $3.7 million increase in motorhome sales as we continue to gain market share in the class A diesel segment with all of our major customers.

Adjusted EBITDA in the second-quarter declined 130 basis points to $2.8 million, or 7.7% of sales from $3.4 million or 9% of sales in the prior year primarily due to the defense order. Adjusted EBITDA margin improved 300 basis points sequentially, due to increased motorhome sales and aftermarket parts.

Our backlog experienced strong growth, up 17.1% to $26.7 million compared to $22.8 million in the first quarter, reflecting market shares gains which will drive sales in the second half of the year. On a year-over-year basis, our motorhome backlog is up 131% to $25.8 million versus $11.2 million in the prior year.

Please turn to slide 12 and the ER segment. Revenue was up 54.2% to $80.8 million, from $52.4 million, due to the $30 million of sales from Smeal, as I mentioned earlier. This increase was offset by slightly lower shipments from our base business compared to last year as we continue to focus on profitable sales.

Adjusted EBITDA loss declined $400,000 to $700,000 from an adjusted EBITDA loss of $300,000 a year ago primarily due to increased healthcare costs of approximately $1 million or $0.03 per share. This loss was offset by improved vehicle mix, increased labor and manufacturing productivity, material efficiencies and lower warranty costs. Adjusted EBITDA a year ago included a $1.7 million charge for a legacy product recall.

Adjusted EBITDA margin declined 30 basis points to -0.8 which reflects the increased healthcare costs we experienced. On a sequential basis, margin improved 80 basis points driven by S-180 volume and more profitable sales mix. Backlog remained essentially unchanged at $215 million compared to the first quarter, and our Smeal backlog was $70 million.

Going to our balance sheet on slide 13, you will see cash on hand was $22.2 million which reflects a $10 million payment on revolver, which reduces our acquisition related debt to $22.8 million from $32.8 million in the first quarter. Inventory at the end of the second quarter was $88.4 million.

If you exclude the Smeal inventory, the business ended the quarter at $59 million, which represents the lowest second-quarter inventory balance since 2012. Smeal inventory at the quarter end was down nearly $33 million or 53% from $63 million at the acquisition closing date on January 1.

If you turn to slide 14, we will now discuss our outlook for the remainder of 2017. In the second half of the year, we expect to see year-over-year revenue growth driven by last-mile vehicle delivery orders including Reach and walk-in vans, class A motorhomes, and the production ramp up of the new Isuzu F-series. This revenue growth, together with continued operational improvements and additional synergies from the Smeal acquisition, gives us the confidence to raise the 2017 guidance as follows.

Revenue in the range of $680 million to $720 million, up from our previous guidance of $650 million to $700 million. Our adjusted EBITDA is in the range of $28.3 million to $31.3 million, up from the previous range of $26.5 million to $29 million. Restructuring acquisition costs and intercompany chassis impact of $3.7 million, up from $3.2 million.

Interest income tax expense of $700,000 to $2.2 million, down from our previous guidance of $1.5 million to $32.3 million. We expect interest expense of $600,000, down from $800,000. We now expect adjusted earnings per share in the range $0.48 to $0.52, up from the previous guidance of $0.36 to $0.41 per share, assuming 35 million shares outstanding.

At this point, I will turn the call back over to Daryl for his closing remarks.

Daryl Adams: Thanks, Rick. Please turn to slide 15. Before I close, though, I want to take a minute to thank the entire Spartan team for their support and dedication to our plant and our first-half results. Overall, we were very pleased with the progress we have made to date. This marks our sixth profitable quarter in a row on an adjusted basis. The management team is confident and focused on delivering profitable growth and increasing shareholder value.

This combined with our market share gains, realizing better than originally planned synergies from the Smeal acquisition, the ER segment returning to profitability on an adjusted basis in 2017, and acceleration of second-half earnings growth across all business segments gives us the confidence to raise our midpoint adjusted EPS guidance by 28% for the year.

Operator, we are ready to take questions.

Questions and Answers

Operator: Steve Dyer;Craig-Hallum

Steve Dyer: Good morning, guys. Congratulations on another good quarter. Starting off in the ER segment, Smeal appeared to have a very good second-quarter relative to what you expected in the back half of the year, etc. Is there anything, one-time deliveries there, anything that jumped out that drove that strength in the quarter?

Rick Sohm: No, I think, Steve, it is just some continuous improvement. I think we have seen the team do a great job right out of the gate, and that is what we expect to continue for the remainder of the year.

The one thing we did see in the second quarter were some healthcare costs that were largely attributable to the ER business. But we have made some changes in some of our insurance programs and coverages, and we hope to mitigate that going forward.

Steve Dyer: Am I reading -- kind of digging around in the queue -- are you anticipating second-half Smeal incremental revenue of like $40 million or am I reading that wrong?

Rick Sohm: I think for the full year we are at about $105 million, I think. If you remember back in the first quarter, we had some revenue due to changes in the revenue recognition policy from what Smeal had done in 2016 and how we were handling it going forward.

Steve Dyer: Okay, yes, got it. Then staying on that segment, the S-180, we are a number of quarters into that now. Do you have anything to share with us just in terms of, I don't know, orders or anything quantifiable about it, or are we still in the stage where we are gauging customer interest, etc.?

Daryl Adams: No, Steve, I will take that. What we figured out over the trust we have built to date is there's more popularity on a certain number of the 11 models that we offer. We are gaining good information back from our customers on what they do like and don't like. We will be continuing to refine that as we move forward. Probably drop a couple of the models, right, if we are not getting sales on them.

I think the key point is we are in the middle of engineering an aerial S-180, also a commercial tanker S-180 up at (inaudible). We have a number of new products now that we are seeing what they like and don't like, what the market will accept, we are adjusting and moving forward with it.

Steve Dyer: Okay, great. Then within FVS, there's been a lot of chatter, continues to be, whether it is Amazon talking about creating their own fleets, etc. What are you hearing in that segment?

Backlog appears to be strong, but is that still sort of the same big secular tailwind that it has been all along here?

Daryl Adams: Yes, I think, Steve, the Reach order, again, this year was high. Not quite as large as last year. So we think we are seeing a trend maybe from the larger vehicles into the walk-in van and into the Euro van upfit market.

But again, Amazon is a big player. They have not announced. I think we are not the only one that is making sure we stay close to Amazon and try to understand what they do. I think it is anybody's guess, but we continually talk about what is our strategy and what are we doing to make sure that we are in a good position to take advantage of some of those orders when they come out.

Steve Dyer: Got it. Okay. Then finally for me, just as it relates to acquisitions, we're a couple quarters into the integration of Smeal. Obviously have some flexibility on the balance sheet there. What is the thinking or mindset as a relates to acquisitions right now? Are you still, you still need a couple of quarters to integrate? Or if you saw something that fit well, are you guys actively on the hunt? Any help there would be great. Thanks.

Daryl Adams: I think to answer that, Steve, we are always ready to go, right, as you said, we are ahead of schedule. Synergies are good, the team is doing well. I'm not sure if we would really be looking in the ER space right now, but I think the other two business units are fair game if there's anything that comes along.

We want to be opportunistic and we still want to make sure that whatever we do is accretive to our earnings. The team has worked hard to get us where we are and we want to make sure we continue. Yes, we are looking, we are making sure that nothing passes by us, but if you have any ideas you want to share with us we would be willing to listen.

Steve Dyer: Okay, will do. All right, thank you.

Operator: Rhem Wood;Seaport Global Securities

Rhem Wood: Good morning. Congratulations on the quarter and the guide there. All right, so my first question. Based on your guidance, obviously you are going to have much better margins going into the back half of the year. Can you just give us an update from the turnaround? What inning are we in? How long will it take to complete? Really, where do you think margins can go now, seeing what you see and how long will that take? Specifically, I guess EBIT margins, if you will. Thank you.

Rick Sohm: Yes, no problem, Rhem. Like Daryl said, we continue to make continued progress. I think as we go here through 2017, we thought of it as moving from a turnaround story here to one where we are going to focus on growth. The previous question talked about M&A. We have discussed this on prior calls that we are open to it. We have the liquidity and the earnings power to do it now.

We are starting to transition out of turnaround. I think in the previous quarters we had talked about being at the top of the fourth or fifth inning. We are moving forward there. We have an analyst day scheduled for October 12 in New York where we will come out and show you guys a three-year plan. We have EBITDA margins that we expect moving north of 4% this year, and over the next three-year period we are not afraid to target overall EBITDA margins of 10%.

Rhem Wood: Yes, that is great. Yes, I look forward to the upcoming analyst day. You are talking -- so you think on an EBIT basis you could get 6% to 10% EBIT margins?

Rick Sohm: I would target EBITDA margins going from 4% to 10% over the next three years, that is right.

Rhem Wood: Yes. Okay. Okay. That helps. Can you talk about just the earnings cadence in the back half, third quarter versus fourth, and how this FVS revenue will layer on? I mean, physically there's some seasonality I think in the fourth quarter. I mean, just help there with the seasonality in the business and how things layer on.

Rick Sohm: Yes, as you know, we don't provide quarterly guidance, but we have talked about some of the big orders we are working on now with Reach. Our customers typically are looking for those vehicles to be delivered in the early part of the fourth quarter. I would say as it relates to some of the FVS volume, it is probably a more heavy weighting in the third quarter.

Rhem Wood: Okay, thanks. Then just two modeling questions. What tax rate should we use? Then the restructuring charges, did that go into SG&A or in COGS? Thanks for the time.

Rick Sohm: I think the small amount of restructuring charges we took in the second quarter were in SG&A. Your other question, Rhem, was the tax rate, right?

Rhem Wood: Yes, that is right.

Rick Sohm: Yes, right now the guidance we are giving on our tax rate is probably consistent with how we have looked at the year so far. As we continue to make forward earnings progress and the earnings continue to grow, at some point we will be looking at the valuation allowance that we put on the books back in the third quarter of 2015, which would then have the offsetting impact it had back in 2015. Over time as I look out into 2018, I would think of it more as something closer to a statutory tax rate.

Operator: Matt Koranda;Roth Capital;Analyst

Brad Noss: It is Brad Noss here on for Matt. I just wanted to go ahead and look at the guidance revision. Looks like the guidance revision implies a pretty substantial increase for the second half compared to what we were expecting.

Can you just highlight some of the biggest pieces that were changes to the guidance this quarter versus what we were looking at last quarter? I know you mentioned some of the Smeal acquisition synergies and productivity improvements there, some last mile delivery orders and F-series ramp-up, but which of those elements changed the most? Or were you not building in as much prior?

Rick Sohm: Yes, I think when we came out and announced the Reach order in June, Brad, that not all of the volume had been contemplated in our guidance on the May call. That certainly has been important.

As you see, the motorhome backlog has had some big growth, up 130% year-over-year, and up 17% sequentially, so we are going to get some more motorhome volume. I think we have made some significant inroads in market share. We have talked about that in previous quarters as well, but now you are seeing it across all of our major motorhome customers.

Brad Noss: Okay. Thanks for that color, that is helpful. Then looking at the motorhome sales, we looked at the class A data and it seems like it is mixed, maybe flattish for Q2's shipments just overall for the industry. But some customers are seeing expanding capacity and strong demand for gas-related platforms. Can you just help us understand how the gas-related platforms would impact you, or is it typically just class A shipments that we should be looking at?

Daryl Adams: Hey, Brad, this is Daryl. It is a good question, and we continually try to separate, if you will, our segment, which is the class A diesel rear pusher engines over 400 hp. I think the starting place of our units are much higher than the average motorhome, so we don't see the fluctuations that you see in regular motorhomes, even in the smaller diesel segment.

I think the key that we talked about was getting back some of the market share that we may have lost over the previous years due to some of our new content we are putting in. We are putting on new platforms at both of our two largest motorhome customers.

We believe that is significant. It is market share gain, we try to separate ourselves from the rest of the RV market, which is key, so we can help you with that data. Really, it is mainly market share and new platforms.

Brad Noss: Okay. Perfect. That has cleared it up a little bit. Just staying with the SUV segment, with the F-series Ram, as that progresses, how we should expect that to impact the SUV margins?

Rick Sohm: Yes, I think, Brad, you will see improvement sequentially, Q3 versus Q2. Then Q4 should ramp a little higher sequentially over Q3.

Brad Noss: Okay, perfect. Then, lastly, just looking at the S-180 backlog, I think you referenced 28 units there. Should we anticipate the Q3 and Q4 run rate continuing to grow ahead of the 19? Or how much should we be expecting the run rate to increase to the back half of the year?

Daryl Adams: Yes, Brad, I think we will see a little bit of an uptick. As I mentioned earlier, we are going to adjust some of the models we are offering. We are honing that in, we are seeing very, very good feedback, positive feedback, a lot of interest as we are getting some of the demos out on the road, getting them out to different customers, different municipalities. Like Rick said, we don't really try to forecast it out through quarter by quarter, but we believe we will get more orders at the end of the year to increase that 28.

Brad Noss: Okay, perfect, that is all the questions I have. Thanks, guys.

Operator: This concludes our question and answer session. I would like to turn the conference back over to Mr. Juris Paygrabs for any closing remarks.

Juris Pagrabs: Thank you, Andrea. Thank you everyone for joining us today. We look forward to updating you on Q3 later this year. Thank you, and have a great day.

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