Spartan Motors
Q2 2016 Earnings Conference Call
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Officers
Juris Pagrabs; Spartan Motors; Group Treasurer, Director of IR
Daryl Adams; Spartan Motors; President, CEO
Rick Sohm; Spartan Motors; CFO

Analysts
Steve Dyer; Craig-Hallum; Analyst
Mike Shlisky; Seaport Global; Analyst

Presentation

Operator: Good morning, and welcome to the Spartan Motors second 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 Juris Pagrabs, Group Treasurer and Director of Investor Relations for Spartan Motors. Mr. Pagrabs, you may proceed.

Juris Pagrabs: Thank you, Danielle, and good morning, everyone, and welcome to the Spartan Motors second quarter 2016 conference 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, 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/investor presentation section of our website to follow along with our presentation during the call.

Before we start, 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 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 of what management believes could materially affect the results that are identified in our Forms 10-K and 10-Q filed with the SEC. However, there are many other risks that we cannot anticipate.

Our agenda today includes Daryl providing an overview of our operations for the second quarter, followed by a financial review from Rick. And then we plan to return to Daryl for closing remarks before proceeding to the Q&A portion of the call.

Before we begin, I would like to point out on slide 3 that during the quarter, our delivery and service vehicles business segment changed its name to fleet vehicles and services to more accurately reflect our end-use target customer, including our large fleet [set] or walk-in van customer, and our growing cargo management systems customers. Both the press release and our Form10-Q filed with the SEC today reflect the segment name change.

At this time, I'm pleased to turn the call over to our CEO, Daryl Adams, for his opening remarks which begin on slide 4.

Daryl Adams: Thank you, Juris. Good morning, everyone, and thank you for joining us on Spartan Motors second quarter 2016 conference call. I'm pleased to report another solid quarter of our growth for Spartan Motors.

Revenues in the second quarter rose 12% to $162.5 million, and for the first half of the year, we reported a profit, something Spartan has not accomplished since the first half of 2009.

For the second quarter of 2016, we reported income of $4.4 million or $0.13 per share. That's up $3.2 million or $0.10 per share year-over-year and made Spartan's most profitable quarter since the second quarter of 2009.

I'm extremely proud of our employees. They have embraced our transformation, and as a result of their efforts, all three of our business segments showed sequential quarterly top line and operating income improvement during the first half of 2016.

Our fleet vehicle and service and specialty chassis vehicle segments posted significantly higher revenue and operating income growth year-over-year, driven by higher unit volumes, favorable mix and the continued strength in our Saltillo, Mexico and Kansas City up-fit business.

Our emergency response segment continues to makes good progress for returning to profitability. As we previously indicated, this is a top priority in our turnaround plan.

Sequential operating loss improved by $1.3 million in the second quarter compared to the first quarter while our year-over-year showed a decline in revenue and operating income. This was due primarily to last year's quarter including non-reoccurring international multi-unit orders; and in the current quarter, a legacy one-time product recall reserve, which Rick will cover in more detail during his remarks.

Moving to slide 5 -- in April at the FDIC show in Indianapolis, the largest fire industry conference in North America, we announced two new ER programs -- the Spartan Select and 180

Truck Programs, both designed to streamline the ordering process, reduce production times and improve operational efficiencies.

The Spartan Select was created for our OEM partners, those customers who build their own bodies on the Spartan custom cab and chassis. The Spartan select chassis offers the most commonly selected options, combined into easily ordered packages. This will allow us to manufacture a custom chassis with less lead time and reduces the complexity to order, engineer and build the custom chassis.

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

Moving to slide 6 -- in early June, we completed the consolidation of our truck body production from Wakarusa, Indiana into our Bristol, Indiana facility. We expect to see the benefits of reducing operating expenses and improved manufacturing productivity beginning in the second half of this year.

Also, in early June in 2016, at the Electric Utility Fleet Managers Conference in Williamsburg, Virginia, we showcased an innovative walk-in van, specifically designed for underground utility maintenance, featuring hybrid electric auxiliary that incorporates two key pieces of technology designed to make utility worksites greener and quieter and more comfortable for workers. The walk-in van features an Odyne plug-in hybrid battery that feeds auxiliary power to utility maintenance equipment and an onboard air exchange system that provides workers in underground vaults with cool or heated fresh air from above.

Drive innovation is a priority across all of our business units, and our team has delivered a product that is purpose-built to address the unique needs for our customers in the utility industry.

Moving to slide 7 -- in partnership with General Motors and Isuzu Commercial Truck of America, last week we announced the production of our first new Chevrolet medium-duty, gasoline-powered truck in Charlotte, Michigan. Spartan will be manufacturing seven Chevrolet cab older models, including regular cab and crew cab body styles with varying chassis lengths. These are based on Isuzu's N-series design.

We were awarded this incremental business as a result of our longstanding relationship with Isuzu, and our demonstrated contract manufacturing expertise. We realized significant growth and success in this energy segment due in part to the great trust Isuzu has shown in our team's execution of their vision for this broad product line.

In fact, earlier this year, we celebrated the 30,000th Isuzu N-series production milestone. And we expect Chevrolet, particularly with its strong dealer network, will realize similar success with their vehicle line.

Earlier this week, SCV announced the launch of its new advanced protection system, APS, a package of market-leading collision mitigation and coach stability features designed to make owning and operating a class A recreational vehicle safer for drivers, passengers and other vehicles that share the road. The new advanced protection system integrates [forward] stability and defensive driving technologies, collision mitigation, electronic stability control, adaptive cruise control and an integrated tow-vehicle airbrake system.

Our R&D efforts brought safety innovations that have been exclusive to the passenger vehicle segment into the motor coach market for the first time. In doing so, we offered OEM partners the industry's first comprehensive set of RV-specific safety provisions, so they may extend additional protection, security and value to their premium coach customers. The new package will be available beginning with select 2017 model year class A coaches.

Moving to slide 8 -- finally, we announced last quarter in April, we broke ground on a new 85,000-square foot contract assembly facility on our Charlotte campus. This facility reproduces Isuzu's new F-series trucks. The F-series expands Isuzu's product offering into class 6 on-highway commercial trucks.

The facility will incorporate a flexible production line that can be easily reconfigured to accommodate the assembly of multiple product lines, and will also allow us to scale production to meet customers' varying capacity needs and to accommodate changing business cycles. Construction continues on schedule, and we look forward to beginning production during the first quarter of 2017.

Now I'll turn the call over to Rick to discuss Spartan's financial results for the second quarter.

Rick Sohm: Thanks, Daryl. Please turn to slide 10. As Daryl mentioned, we're pleased to report continued quarterly progress and a significant increase in net income for the second quarter of 2016.

Our improvement reflects a favorable impact from the initiatives we've taken to strengthen our financial results, including implementing lean manufacturing and continuous improvement across our production facilities and closely managing overhead expenses.

Revenue for the quarter increased 12.2% to $162.5 million from $144.8 million, with the FSV and SCV segments reporting strong revenue growth over the second quarter of 2015.

Our gross margin improved 80 basis points to 12.8% of sales, up from 12% a year ago, primarily due to a favorable product mix, which included a higher proportion of sales from higher margin parts revenue.

Second quarter operating income rose 86.7% to $4.4 million from $2.3 million. As Daryl mentioned earlier, this is Spartan's highest quarterly profit since the second quarter of 2009.

The quarter did include a legacy power steering product recall reserve of $1.7 million and restructuring charges of $0.2 million for our ER division.

Our operating margin for the quarter improved to 110 basis points to 2.7% from 1.6% a year ago.

Now I'll turn to slide 11. Our adjusted operating income improved to 111.2% to $6.3 million from $3 million in the prior year. The prior year second quarter included adjustments of $1.2 million, relating to the impact of some non-recurring international ER orders, a $1.2 million NHTSA settlement and 0.8 million in restructuring charges.

Adjusted net income was $6.3 million or $0.19 per share compared to $2.1 million or $0.06 per share last year.

Let's take a look at the results of our operating segment, starting with the FVS segment on slide 12. FVS reported revenue of $73.8 million compared to $52.8 million last year, an increase of 39.8%. Revenue was driven by a 27% increase in vehicle sales, primarily in reach and truck body units and continued growth in our vehicle up-fit business.

Operating income nearly doubled to $6.5 million or 8.8% of sales from $3.3 million or 6.2% of sales a year ago. This increase is due to higher up-fit and reach volumes.

We're currently fulfilling a large up-fit order that we expect to extend through the remainder of 2016, and while we expect this business to be an important part of FVS's future growth, we do not currently have a follow-on order.

Backlog for the quarter remained strong at $139.7 million compared to a $137.7 million at the end of the first quarter.

Now turning to slide 13 and the SCV segment -- second quarter revenue totaled $36.3 million, up 24.3% from $29.2 million.

Our motorhome chassis revenue grew 24.2% to $24.5 million from $19.7 million, driven by higher volumes, a favorable mix, and to a lesser extent, price changes enacted during the quarter. As others in the industry have experienced, demand for our motorhome chassis in the past year has been strong. Class A motorhome sales in the industry are up 5% year-over-year.

Within the class A segment, gas is up 7% and diesel, where we are positioned, is up 1%.

Our growth is outpacing the industry, as we gain market share from -- as we previously announced -- becoming the sole chassis supplier for a major customer and being added to additional models at another major customer.

Although our backlog as of June 30 was down from March 31, it has since rebounded to pre-March levels, reflecting seasonal shift and increased order strength. We'll continue to monitor this closely during the second half of the year to see if this trend will continue into 2017.

Increased levels of contract manufacturing and our defense business accounted for the remainder on the revenue growth during the quarter.

Operating income for the second quarter increased 83% to $3.1 million from $1.7 million in the prior year, driven by favorable mix, which contributed to our operating margin increasing 280 basis points to 8.5% for the quarter.

Now going to slide 14 and the ER segment -- revenue declined $10.4 million to $52.4 million in the second quarter from $62.8 million in the prior year quarter, due to fewer shipments of complete fire apparatus and custom cab and chassis compared to last year.

Please note that last year's quarter included a non-recurring multi-unit order totaling approximately $8.9 million in revenue, which accounts for the majority of the sales decline.

Our operating loss for the quarter increased $1.5 million to $2.4 million from $0.9 million last year. Included in our second quarter operating loss is a legacy one-time product recall reserve of $1.7 million and restructuring charges of $0.2 million.

Our adjusted operating loss improved to $0.5 million from an adjusted operating loss of $0.9 million a year ago. The operating loss for the prior year second quarter included the impact of the non-recurring multi-unit order for $1.2 million, $0.8 million in restructuring charges, and a $0.4 million NHTSA settlement cost.

Our backlog remains strong at a $152.2 million compared to $160.4 million at March 31. And as we said previously, we are not necessarily looking to grow the ER business, but rather, return the ER business to profitability.

Now please turn to our balance sheet on slide 15. You'll see that we're continuing to improve and strengthen our balance sheet. We ended the second quarter with $39.8 million in cash, up from $32.7 million at year-end and $20.6 million at the end of the second quarter of 2015.

Cash on hand at the end of the quarter also reflects approximately $2.3 million in CapEx for our new production facility currently under construction.

Comparing our balance sheet at quarter-end to a year ago shows considerable improvement in working capital and reflects the progress we've made in running our business more efficiently.

Our total liquidity improved 78.6% or nearly $40 million to $89.7 million from $50.2 million a year ago.

High priorities for our management team continue to be growing earnings, improving working capital and maximizing cash levels to support future growth and maximize shareholder value. To that end, during the quarter, we paid out $1.7 million in dividends and repurchased, in open-market transactions, approximately 422,000 shares for $2 million for an average price of $4.74 a share.

Now please turn to slide 16 and I'll 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 remains strong.

For the second half of 2016, we expect modest year-over-year sales growth and continued operational improvements. As a result, we are revising our guidance as follows -- revenue in the range of $570 million to $590 million, which is unchanged from our previous guidance; operating income in the range of $8 million to $10 million, including restructuring expenses of $0.5 million to $1 million -- this is up from our previous guidance of $7 million to $10 million.

Income tax expense remains unchanged in a range of $1 million to $1.2 million, and earnings per share in the range of $0.20 to $0.25 for a midpoint $0.23, up from our previous guidance range of $0.15 to $0.25 or a midpoint of $0.20, with the assumption of 34.5 million shares outstanding.

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

Daryl Adams: Thanks, Rick. Moving to slide 17, in summary, I'd like to emphasize that we're pleased with the progress we've made to date. And it's especially gratifying to see that the financial markets are beginning to have confidence in Spartan, shown by our inclusion in the Russell 2000 index on June 27 of this year, which is a strong testament to our strategy and continued positive turnaround momentum. We have made notable progress in our turnaround plan.

As we continue this journey, our path to profitability is becoming clear. We plan to continue following a disciplined data-driven approach to manage the business and to follow our 2016 focal points.

Our top priority remains to return the ER segment to profitability, and we believe we are on track to reach a breakeven run rate in ER before the end of 2017.

As we told you last quarter, we expect to be profitable each quarter in 2016. We're confident in our ability to achieve this goal to meet or exceed our new revised guidance for the second half of the year.

Our new management team is in place and our employees are truly excited about the direction Spartan is headed. We remain fully focused on improving the business and increasing shareholder value.

Operator, we're now ready to take questions.

Question-and-Answer Session

Operator: We will now begin the question-and-answer session. (Operator Instructions). Steve Dyer, Craig-Hallum.

Steve Dyer: Nice quarter.

Daryl Adams: Thank you.

Frederick Sohm: Thank you, Steve.

Steve Dyer: The ER segment had a pretty nice improvement in operating margin. Does that change your view as to getting profitable in that segment before the end of 2017?

Rick Sohm: No, Steve, I think we're comfortable with what we said before about being profitable on a run rate basis. Unfortunately, this isn't linear. I think some of the actions we've taken in rolling out the 180 Truck program maybe make us more confident based on its initial reception that we can hit those numbers, but we'll keep pushing hard. But I think we're comfortable with what we said in prior quarters.

Steve Dyer: Okay. And then as it relates to the 180 Truck program, what's the initial feedback then? And when would you expect that's going to be a contributor to revenue?

Daryl Adams: Yes, Steve, this is Daryl; I'll take this one. We launched it at the FDIC show, like I mentioned, and the reception was great. We've continued to have interest actually with additional dealers calling, wanting to be part of that program. So we think it's a going to be positive for us going forward.

I think we've also mentioned in the past, it's only going to touch maybe 30% to 40% of the market, so it's not going to take over the whole market, but it'll be a positive for Spartan. And we're going to start with a slow ramp-up starting in Q3 and continue to move it. And we'll give you more color on that at the next call we have.

Steve Dyer: Okay. What's generally I guess been driving the strength in the fleet vehicle services business? Any more granularity as to why that's been so strong?

Frederick Sohm: I think part of it is our van up-fit business that we run out of Saltillo, Mexico with the Dodge ProMaster and in Kansas City with the Ford Transit. And I think as we've talked before, this is part of what we're seeing with the omni-channel and the last mile delivery. We think we're well positioned across our entire product offering to serve this van market and we've seen some real strength there.

I think as we look forward, we hope to see more improvements driven by the implementation of our Spartan production system and our lean manufacturing efforts, not only in Bristol, but across the Company.

Steve Dyer: As it relates to that maybe overall, maybe using a baseball analogy, what inning do you guys feel like you're in, in terms of some of these profitability improvements you've put in place?

Daryl Adams: I'll take that. So I'm assuming [any] game, not extra innings.

Steve Dyer: (Inaudible).

Daryl Adams: I'll say we're probably maybe in the bottom of the second, top of the third, so there's a lot of room for improvement. And it's not a program that ends; it's continuous. So that's the reason I asked about extra innings, just a little bit of color there, but it does not end. The opportunities will become tougher to get, but as the employees and the team get stronger, they're going to be able to find more.

So we're going to find some low-hanging fruit now and we'll continue to harvest that and we'll see progress year-over-year. It's how we survive; it's something I grew up with in the auto industry, and it's something we're going to instill in the culture here at Spartan.

Steve Dyer: Great. I'll hop back in queue. Thanks, guys.

Operator: (Operator Instructions). Mike Shlisky, Seaport Global.

Mike Shlisky: Wanted to start out with a question or two on each of the major businesses. First on the fire side, there is one major apparatus maker out there that it [is] expecting see some growth next year in the fire apparatus business. I think it's still -- the market overall is still well below prior peaks and normalized levels. So I'm a little bit surprised to hear that you might not be looking to grow that business in your world.

Is it just really more of a focus on just trying to walk away from business that's not profitable or just not good for your production process; or do you feel that the market is not going to grow next year?

Daryl Adams: No, we agree with you on the market, Mike, so you're right. Okay. It's a manufacturing process and a couple of years ago, maybe even 3 now because I think I've almost been here 2 -- the Company was pushing backlog, backlog, backlog. The problem was that we couldn't swallow all that business at the manufacturing facility.

So we're making sure that we get the manufacturing process robust, get it solid. We're seeing improvements, and it does take some time because the order backlog and getting (inaudible) the year. So we agree the market increasing, but we don't want to do is take too much on and stumble like we did a few years ago.

And second is that we're not going to take orders just to take orders. We're reviewing the profitability and we're only taking profitable orders. We're not going to fight for the number of trucks we sold each year or backlog. We're going to make this profitable. That's how we see driving shareholder value in the Company.

Mike Shlisky: That's great color, thanks. I also wanted to touch on the truck market, especially class 5 trucks. Looking at what's out there from the industry data, you have inventories as high as we've not seen since the great recession.

You've got production levels that are now kind of turning downward for the industry last couple of months, and orders are now down double-digits also. And this is exactly what happened back in 2008, though of course, perhaps a little less pronounced this time versus last time; also what we kind of saw the last 12 to 18 months in the class 8 heavy truck market.

I guess probably, do you have any indications from Isuzu or other partners that next year could be a down year for class 5 production? And could you give us your thoughts on whether [year-over-year] next year will be up in your assembly business; of course, excluding the new F-series vehicle, which is more of a class 6.

Daryl Adams: Yes, Mike, I think as we look at the market, most of our trucks are in 3 and 4. That's where our higher capacities with the Isuzu vehicle and then the new vehicle is going to be a class 6. So we're looking at the same data, but in fact with Isuzu, they see strength in the last mile delivery.

They're specially designed [cab] (inaudible), right, which gets you through cities with a larger body on the back of the truck. And their forecast good and GM, they -- we just rolled this out last Wednesday with GM, and they were really excited. They're optimistic about what it means to them and their dealers. So we're not seeing it.

Maybe it's the product that we have versus others, but our customers are excited about it and looking forward to even the class 6, which is the F-Series when it gets on line. GM is already talking about wanting some of that too, so it's exciting and we'll see what happens with the market. But we're watching it closely as you guys are, especially when it comes to planning for next year.

Mike Shlisky: Okay. And then briefly also on RV business as well, are we just looking again, at the housing market going to hang in there for -- the major driver of that business -- for the next, let's call it, for the back half of the year at least?

Daryl Adams: We continually talk about this and it's difficult to pull out our diesel section of that, and the type of buyers that we have in that market, they're really high end. So some of our debates internally are, is it really the RV market in the class A or is it class A diesel? So we had a debate and we're seeing strong demand from our customers, or continued demand at the 1% rate that we mentioned earlier.

We don't see it deteriorate at all and talking with them, they're seeing good sales. I think Rick mentioned they had a down week in the backlog, so that's popped back up, and we're all diesel; we do no gas at all. So again, our market share is increasing, and that's how we're seeing the growth.

Mike Shlisky: Okay. I also wanted to turn to the balance sheet real quick. Could you update us on your use of cash priorities? Is buying back more shares (inaudible) per share at this price still a good idea? And given that there aren't that many shares outstanding at the current time anyway. And are you thinking about doing any kind of M&A transaction here or perhaps any kind of big CapEx project that could be in the pipeline for the next -- for the back half of the year?

Frederick Sohm: Mike, let me start with your first question on the share repurchase. Yes, these shares were purchased in April and you saw at an average price of $4.74. I think at that time, we saw it as an opportunity and that's how we kind of think about it. We want to be optimistic and use share a repurchase tool to help offset dilution over time. So I'd say we'd think of it differently now, given the run we've had, but that was our thinking at the time.

In terms of our CapEx, the Company is not very capital-intensive. We're going to probably double CapEx, or close to it, year-over-year with most of that being the new F-Series plant. We don't see that level of CapEx as we look out to 2017. So I guess I'll leave it there. I don't know that I'll comment on any potential actions we'll take other than how we see CapEx right now.

Mike Shlisky: Okay. But can you comment on would you deploy cash for M&A at all? Is that on the current radar screen at all (inaudible) get there?

Daryl Adams: Yes, Mike this is Daryl. I think in the past, we've commented that we want to make sure we get the foundation right; we get the lean system, our Spartan production system in place before we stress the Company, if you will. It's easy to say you want to do it and do an M&A, but when it comes down to executing on it, it takes a really good team.

The team is starting to gel, the management team is starting to -- I think they average maybe 7, 8 months now under the feet. So I'd give them a little time. I think in the past, we talked, when it happens -- maybe it's in late 2017, early 2018. I think that's still our position, but you never know what's coming and how the market changes. So we've gone on record I believe in late 2017 and 2018, and we'll stick with that.

Mike Shlisky: Okay, great. I'll give some else a chance. I'll hop back in queue. Thanks so much.

Operator: This concludes our question-and-answer session. I would now like to turn the conference back over to Mr. Pagrabs for closing remarks.

Juris Pagrabs: Thanks for joining us today, everyone.

Operator: I'm sorry. Actually, Mike Shlisky just phoned back in. He has a follow-up question, I think.

Juris Pagrabs: Okay.

Daryl Adams: Okay.

Operator: Please go ahead, Mike.

Mike Shlisky: Guys, guys, thanks so much. I figured I would just give someone else a chance, but I guess there was nobody else. I've got two more questions if you wouldn't mind.

Some companies are mentioning in the quarter that there were some material cost benefits on their margins elsewhere within the industrial world. Can you give us your thoughts on how material costs were for you in the second quarter, and what your outlook for the back half of the year is there?

Rick Sohm: I think if I look at material costs, we're a big user of aluminum. I would say if I looked at the second quarter, it was relatively flat quarter-over-quarter. There's been some pickup versus the prior year, but our outlook is probably one where we're not expecting a whole bunch of change for the remainder of the year, Mike.

Mike Shlisky: Okay, great. And then finally, I just wanted to get your thoughts. You had mentioned that a good mix of parts was helpful in the quarter. How sustainable is that mix for the rest of the year, or is it pretty low visibility right now?

Daryl Adams: We don't have the same visibility we have in our ER business, but I think our outlook -- we're pretty confident that the parts business will remain kind of at a current run rate.

Mike Shlisky: Excellent. Thanks, guys. I really appreciate that.

Operator: There are no further questions at this time. Mr. Pagrabs for closing remarks --

Juris Pagrabs: Yes, thanks, everyone for joining us today on our second quarter conference call. We appreciate the time you've taken to hear our story, and I look forward to talking to you again in Q3. Have a great day.

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