Spartan Motors, Inc. [SPAR]
Q4 and Full-Year 2019 Earnings Conference Call
Thursday, March 12, 2020, 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 Fourth-Quarter 2019 Earnings Results Conference Call. All participants will be in listen-only mode. [Operator Instructions] Please note this event is being recorded.

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

Juris Pagrabs: Thank you, Elissa. Good morning, everyone, and welcome to the Spartan Motors 2019 fourth-quarter and full-year earnings call. 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 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 full year along with a brief business update, followed by a more detailed review of the fourth-quarter results and an update of our outlook for 2020 before proceeding to the question-and-answer portion of the call.

I would like to remind everyone that, with the divesture of the ER segment on February 1, 2020, the revenues and expenses associated with the ER group, as well as the assets and liabilities, have been reclassified as discontinued operations for all periods presented. With this reclassification of the ER segment to discontinued operations, the results discussed today will refer to continuing operations unless otherwise noted.

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 fourth-quarter and full-year conference call.

I'd like to start by acknowledging the team's incredible effort and hard work at transforming our business. Over the past year Spartan has integrated three acquisitions and completed divestiture of our ER segment. Those strategic changes allow us to significantly improve our focus within our core markets by expanding our national footprint and prior portfolio. This has positioned us in the growth markets that will allow us to accelerate top-line growth and profitability.

For the full year 2019 our sales increased 33% to $757 million, while our gross margins improved 270 basis points to 15.5%, which drove the 103% improvement in income from continuing operations of $37 million, or $1.03 per share, from $18 million, or $0.52 a share. [Included in that] discontinued ER operation, sales reached $1 billion compared to $816 million a year ago, which exceeded our previous guidance.

Turning to Slide 4, I want to provide some context surrounding the recently announced divesture. Last month we announced the strategic decision to sell our ER business. We appreciate the team's efforts over the past years turning around the ER business, enabling us to make the transformative move at a time that we feel is advantageous. This change will allow us to redeploy capital for higher returns in the delivery and specialty vehicle segments in order to maximize shareholder value.

The commercial, fleet, delivery and specialty vehicle markets have undergone a significant change. Exciting new opportunities exist, driven by the growth in the e-commerce and upcoming electric and alternative propulsion vehicles, the fundamental drivers of our business moving in the right direction.

Our acquisition pipeline is robust. With redeployed resources and capital we will have the flexibility to drive accelerated growth and profitability in our core businesses, both organically and through strategic acquisition. We believe this strategy will enable us to better serve our customers with innovative solutions and products over the long term.

Lastly, the sale provides us the opportunity to rebrand our corporate identity to more closely align with our current business and the markets we serve. We plan to provide updates on the rebranding effort in the months ahead.

Now, please turn to Slide 5 and I'll provide an overview of our growth strategy. We continue to see strong momentum in vehicle classes 1 through 7, as consumers focus even more on their spending online, creating higher demand for delivery vehicles across our entire portfolio of products. In 2019 consumers spent $602 billion online. That's up 31% from $461 billion in 2017, which is reflected partially in our increasing backlog. This momentum has created a strategic imperative for us to establish an infrastructure to meet our customer demand.

Over the past 14 months we've acquired 3 companies that included 8 US manufacturing facilities in 4 states. We also added or expanded 4 additional facilities, which included optimizing both our walk-in van and truck body facilities. These acquisitions provide us with expanded coast-to-coast flexible manufacturing capability, which covers approximately 80% of the total US population within a 300-mile radius of our facilities.

Now please turn to Slide 6 and I'll highlight a few initiatives that support this growth strategy. To support our customers' needs and as vehicle preferences continue to move down the GVWR class spectrum, last week at the NTEA work truck show, we unveiled the Velocity M3, a purpose-built walk-in cargo van. This new purpose-built Class 3 walk-in cargo van blends the fuel efficiency, driver ergonomics and safety provisions of a cargo van cab and chassis with the expansive cargo space of a traditional higher vehicle class walk-in van.

The Velocity M3 has a lighter body design, a 70% payload improvement over its predecessor, the Reach, and better fuel efficiency. But the real game changer is our proprietary patent-pending innovations that deliver unequaled stop-by-stop efficiency gains that our customers demand. This vehicle, which can be built on three OEM van chassis, is receiving significant interest from our major fleet customers and is a strong example of our commitment to bring customer-sought innovation that deliver efficiency gains, best positioning us to meet their needs in the first-to-last-mile delivery segment.

Earlier this year we also announced the opening of a new 105,000-square-foot facility to support the FVS production complex in Bristol, Indiana, due to increased capacity demand and growth in our delivery vehicles. In November we opened a new vehicle modification center at our Charlotte campus to support the growing demand for chassis modifications requested by Isuzu dealers in support of their contract-manufacturing operations.

In the luxury motor coach market we continue to gain market share in a down market, having gained 2 additional points of share during the fourth quarter, ending at 28% in the older 400 horsepower Class 4 diesel market. By adopting and integrating automotive safety technologies into our chassis over the past 4 years, we've increased our market share by 10%, solidifying our position in this niche market. Having said that, we are well positioned when the demand for the high-end luxury motor coach market returns.

To conclude, the acquisition of Royal Truck Body has proved to be a significant addition to our Specialty Vehicle product portfolio. Not only did it greatly expand our western manufacturing facilities across California and Arizona and Texas, it also brought in a talented Specialty Vehicle team that will play a significant role in our future.

With that, I will turn the call over to Rick to discuss Spartan's financial results for the fourth quarter.

Rick Sohm: Thank you, Daryl. Please turn to Page 18 [sic, Page 8].

Our 2019 results from continuing operations improved significantly over 2018 on every key financial metric and reflect well on our ability to integrate key acquisitions, transform the Company by completing the ER divestiture, while improving productivity.

For the year, adjusted EBITDA was up 83% to $64 million from $35 million a year ago and margin improved 37% to 8.5% from 6.2% in the prior year. Backing out the impact of the USPS truck body order, that margin would have been 9.6%. Including discontinued ops, adjusted EBITDA was $58 million compared to $34 million in 2018. Adjusted net income nearly doubled to $44 million from $23 million in the prior year, while adjusted EPS grew to $0.66 per share -- or went from $0.66 per share to $1.24 in 2019.

Demand for our products continued to grow and our backlog at year end was $337 million, up $194 million, or 136%, from the prior year when you exclude the one-time truck body order.

Turning to Page 9, I'll provide an overview of the quarter. Q4 revenue increased $6 million to $180 million. Excluding the truck body order, our revenue grew 30% compared to $139 million in 2018. Fourth-quarter income increased to $14 million from $4 million in 2018, reflecting increased volume and mix, improved pricing and our acquisition of Royal Truck Body. Q4 EPS grew to $0.40 per share compared to $0.12 per share in the prior year.

On Page 10 you'll note the Q4 adjusted EBITDA grew $14 million to $23 million from $9 million a year ago and margin increased 770 basis points to 13.1% from 5.4% a year ago, driven again primarily by volume and mix, Royal Truck Body and partially offset by lower luxury motor home volume. Adjusted net income rose 166% to $17 million from $6 million in Q4 of 2018 and adjusted EPS grew to $0.47 per share from 17% -- or $0.17 a year ago.

Now I'll review each operating segment, beginning with Fleet on Page 11. Fleet reported revenue of $133 million compared to $131 million last year. Excluding $34 million of pass-through revenue, growth was $36 million, or 37%. We reported adjusted EBITDA of $21 million, up $14 million from $7 million a year ago, largely due to mix, pricing and manufacturing productivity. And our adjusted EBITDA margin increased to 15.9% from 5% a year ago. Fleet backlog grew $201 million, or 191%, to $306 million compared to $105 million a year ago, excluding the one-time truck body order.

Moving on to Page 12 and the Specialty segment, revenue was $47 million, up from $46 million primarily due to revenue from the Royal Truck Body acquisition and partially offset by a $9 million decline in luxury motor coach volume. With slightly higher revenue and better mix, adjusted EBITDA increased to $7 million from $5 million a year ago and margin improved to 13.9%, up 20% from 11.6% a year ago. Although our backlog declined 19% to $31 million at year end, we are pleased, as Daryl mentioned, that we are gaining market share and we're outperforming the overall market, which saw a 24% decline in Class A diesel volume in 2019.

Please turn to the balance sheet on Page 13. The balance sheet presented here is from continuing operations, as the ER business has been classified as held for sale at year end. During the quarter we paid down another $20 million on our revolver on top of the $5 million paid at the end of Q3 immediately following the Royal acquisition. Our total liquidity at year end was $79 million.

Upon receipt of the proceeds from the ER sale, we paid down another $30 million on the revolver and we expect to make further payments over time as we continue to monitor our M&A pipeline for additional growth opportunities. As a result of the sale we also have a number of short- and longer-term plans to right-size our cost structure. We expect to complete our shorter-term initiatives in 2020, which will generate run rate savings of approximately $2 million annually. Longer term, we will be making several IT investments to drive down costs for our company.

And, finally, I'd like to make you aware that during our ongoing assessment of our internal control environment, we identified a material weakness in Fleet relating to revenue recognition controls. I would like to make clear that this issue had no impact on our financial statements at year end, but we have moved quickly to implement our remediation plan to ensure our internal controls are improved and designed to operate effectively.

Now I'll turn the call back over to Daryl for our 2020 outlook beginning on Page 14.

Daryl Adams: Thank you, Rick.

Overall, we are excited about 2020 and our position in the market. Spartan's near-term outlook is strong, despite the unknown impact that the coronavirus may have on our business. At this time our supply chain has not been disrupted. We continue to monitor and assess the potential impact daily and we are working closely with our suppliers to ensure continuity of supplies. Additionally, with the higher demand of our products we are closely monitoring the chassis supply as well.

Our current outlook for 2020 is as follows: Revenue to be in the range of $730 million to $780 million, with a midpoint of $755 million; net income of $37 million to $43 million, with a midpoint of $40 million; adjusted EBITDA $66 million to $74 million, with a midpoint of $70 million; earnings per share of $1.04 to $1.20, midpoint at $1.12, assuming a 22% tax rate and 35.4 million shares outstanding; adjusted earnings per share $1.20 to $1.36, with a midpoint of $1.28.

Now please turn to Slide 15 for my closing comments. In 2019 we have transformed the Company by expanding our geographic footprint, enhancing our product portfolio and accelerating our previously stated vision of revenue growth and improved EBITDA margin. Today we've aligned our business to ensure we accurately target opportunities within ongoing macro and micro trends to ensure we maximize top-line growth and profitability in the delivery and specialty vehicle markets. And, most importantly, the Spartan team has the resources to drive both organic and acquisitive growth as we continue to provide innovative solutions in the markets we serve, which will benefit our employees, customers and shareholders.

Operator, we're now ready to take questions.

Questions & Answers:

Operator: We will now begin the question-and- answer session. [Operator Instructions] The first question today comes from Steve Dyer of Craig-Hallum.

Steve Dyer: I guess before I get to the obligatory coronavirus questions, you raised your 2020 EBITDA guidance pretty considerably, about $10 million, $10-plus-million at the midpoint, despite the fact that I think generally speaking the macro's kind of just gotten worse. Is that a function of a large order, several large orders? What sort of changed in the last 3 months relative to your outlook there?

Rick Sohm: Good question, Steve. It's basically a function of the demand we're seeing, our backlog increases. We're here in March and you start to get visibility out further in the year, probably until September or so. So that gave us some confidence to come out with maybe a little better number than people had been expecting.

Steve Dyer: And was that a function -- I mean, was that driven by -- was there any customer concentration, I guess, in there or was it fairly broad-based?

Daryl Adams: No, Steve. It's broad-based. As I mentioned, we're seeing growth in all of our vehicle classes in 1 through 7, and all customers. I think it's the e-commerce trend, significant growth there in the macro space. And now with divesting ER we're much more focused on the two segments we have left and we see operational improvements as well as growth in the revenue side.

Steve Dyer: Got it. And then I guess maybe what have you seen, if anything, from your clients, your customers, in the last couple of weeks? Have there been any cancellations? Or, conversely, just given more people seem to be having more things delivered, has anybody told you to speed it up? Or any change in the last week or two? Or maybe what's sort of contemplated in that guidance for virus impacts, if anything.

Daryl Adams: Yes. And I think we mentioned, Steve -- I might answer your last question first -- we mentioned this is without that, because actually right now we don't see an impact in us at all. And we'll obviously update if we see something. But right now our supply is good. Obviously, we had some inventory right when this thing kicked in. We are tracking our products from China that we sourced over the last year. We also have backup suppliers. As I mentioned in previous calls, anything we offshore we have backup suppliers in North America. And we're in contact with them on a regular basis. And we're tracking the chassis. So we're seeing it -- we haven't seen it yet, any request to speed up. But I think we saw the demand coming with, as Rick said, our backlog and we're actually improving our throughput at plants. As I mentioned on the last call, we moved truck body from Bristol up into Charlotte to give Bristol a whole other line to fulfill the walk-in van demand. And we see, as we mentioned before also, moving down the vehicle class scale, we now have a Class 3 vehicle that's been tested for durability. Was at NTEA. Customers have seen it and they're excited about it. As a Class 3 [indiscernible] the features in the cab and the increased payload. So we're hearing good things from customers in that space.

Rick Sohm: Yes. And maybe I'll just add to Daryl's point, when we talk about monitoring the chassis flow, they could be a problem in 2020, but right now that would be unrelated to COVID 19.

Steve Dyer: Okay, got it. So it sounds like you're more -- if there's a concern it's around the supply more so than customers cancelling orders or anything like that.

Rick Sohm: Correct.

Steve Dyer: Okay. And then last for me and I'll jump back in the queue. Your Specialty chassis margins were really strong in the quarter, 13.9% I think. Is that a good number to use going forward or was there anything sort of one time to the plus or to the minus in that segment? Or is that a good way to think about that margin profile going forward?

Rick Sohm: Yes. I don't know that I would model it the entire way forward. We acquired Royal Truck Body kind of mid-September and they had a good amount of orders that needed to get shipped before year end. I think we've mentioned before that their margin is accretive to the overall margin of Specialty. And there is a somewhat seasonality impact and they tend to do I think a little stronger in the back half of the year. So I don't think I would carry that margin all the way through.

Steve Dyer: Got it. Okay. That's it for me. Congratulations on the execution.

Operator: The next question comes from Justin Clare of Roth Capital Partners.

Justin Clare: So I guess, first off, given your revenue growth outlook here and the strong growth that you are seeing in Fleet Vehicles, was wondering if you would comment on your market share there. How are you seeing market share trending, especially given that you have an expanded national footprint now?

Daryl Adams: Justin, I would love to know that answer as well. The problem is it's really hard to get data from our customers, especially the big fleets, on when they dispose of the vehicles. We're trying different ways and we've hired a new business development person to help us obviously with M&A, also a strategy, but just gathering some more data. We're talking to some new companies we haven't talked to before about registrations. And we're trying to get to that answer, because I also believe -- I've also mentioned I'm pretty much a data guy, so I like to make decisions based on data, not emotions or trends. And right now we can't give you that answer.

But we do know with one of the newer companies into the field what we've delivered, we have a strong opinion on what we've built versus what might be out there. But we also know that the customers are going to have dual sources. So we're trying to figure out of their entire fleet how many have we built over the years. So it's something we're working on, but we don't have it right now.

Justin Clare: Okay. All right. Thank you for the detail, though. I guess, shifting gears, so you indicated the Royal Truck Body acquisition is performing better than expected. Was wondering can you provide a bit more detail on the business performance there? How is that integration coming along? And when do you expect that business to be fully integrated?

Daryl Adams: Sure. I'll take the first half and I'll let Rick follow up with the financial section of your question.

So the integration is going well. As you know, we put that under Specialty Chassis, which is Steve Guillaume. Steve's traveling out there. Right now we have some travel restrictions, I think like every company. But integration is going well. I mentioned we have a great team. And that's what we're really excited about. Obviously, when we're talking to different companies about acquiring them, part of our request or part of the plan that we have is that the management team has to stay. The majority of it stayed here. The owner wanted to get out, but the functioning team is very strong operationally, financially, sales-wise, and you can see that through the expanded footprint that they have. Those are all independent locations, not through a dealer network. So we're excited on what we can do with Royal going forward on the sales side.

Rick Sohm: Yes. And in terms of performance, I would not say that they are outperforming. I would say they were performing in line with our expectations. And, like Daryl mentioned, there's a strong management team and we have good visibility of what's coming at us. I think longer term the opportunity will be to take their product portfolio and take it to other parts of the country where we'll have manufacturing operations that are flexible. And we think there's opportunity for their product throughout the country.

Justin Clare: All right. Great. And then one last one for me. Can you share how much in CapEx you expect to spend for the Bristol facility that you're opening up and then for the full year 2020 how much in CapEx you anticipate spending?

Rick Sohm: Yes. I don't know that I'll comment directly on CapEx at a particular facility. Daryl mentioned that we already moved in 2019 some of our truck body out of Bristol into Charlotte. But we do expect to see a higher amount of capital spending to, not only make our plants more flexible to multiple product lines, but there's also going to be some IT infrastructure spend. And I would say capital spending could be up 50-plus-percent or more year over year.

Daryl Adams: And just if I could add, last summer we announced we added Todd Heavin as our COO. And since then we've added a VP of Operations to support him in order to continue the operational improvements that we have with the plants. And we're actually running a number of Kaizen events that I think we talked about in the last call, one of the first ones. We'll continue with those. So when you're doing that kind of not only transforming the company but transforming your operations into lean facilities, the COO and the VP of Ops are starting to hit the ground and get some traction, it's going to take some capital to grab the efficiency, but the payback is usually short and that's what we're excited about.

Justin Clare: All right. Thanks.

Operator: [Operator Instructions] The next question comes from Steve O'Hara of Sidoti and Company.

Steve O'Hara: I guess first, going back to the CapEx question, can you just remind me what maintenance CapEx is here now that you no longer have the ER business? And then maybe around the fleet, or in terms of your business now going forward, I mean, how much would you say of your business is focused on last mile, kind of leans more towards e-commerce-type solutions versus maybe traditional trucking and things like that?

Rick Sohm: Yes. You're right, Steve. With the ER divestiture our maintenance CapEx number goes down significantly. But the returns that we can get in Fleet, our capital spending will be more heavily weighted there, like I said, to make these multiple manufacturing locations flexible enough that they can build multiple product lines.

Daryl Adams: Yes. Steve, if I could add, for example, we've bought -- acquired General Truck Body out of Montebello, California. They have a number of products that we don't have -- one of them in particular at the time we didn't have; now we do -- is refrigerated box trucks, Class 6, 7s. We want to move that technology to some of the other locations, based on the data I talked about earlier that Justin asked about. So we're going to use data to understand where the market is, and so now we have to buy some additional fixturing, some more [foaming] equipment. So that stuff does get a little expensive and we have a plan to do that in '20 and going forward as a plan that we have put in place.

Steve O'Hara: Okay. And then maybe just on the kind of old world/new world revenue mix now -- and I mean it would seem like delivery and things like that may be picking up here and, given the situation -- and I would think maybe the share of e-commerce jumps certainly over the year term. But how much would you say of your business is currently focused on maybe the high -- I guess maybe what should be considered the higher growth versus maybe closer to GDP-like growth at this point?

Rick Sohm: Yes. I think if you're looking for a breakout of our revenue going forward, I would say it's probably three-quarters Fleet and the remaining quarter would be with Specialty. But I think as we really get Royal Truck Body ramped up and able to move their product across the country over time, some of that gap can narrow. But we haven't disclosed in the past the revenue by product line.

Steve O'Hara: Okay. Okay. And then, maybe in terms of acquisitions and things like that, can you talk about maybe your expected returns or your hurdle rates and things like that for investments going forward now that the ER business is no longer with you?

Rick Sohm: Yes. I think that's a good question. We would certainly expect to invest with returns that are higher than our cost of capital. And Royal Truck Body is a perfect example. Like I've mentioned, it's accretive to the overall SCV segment. And we plenty of liquidity and we've had an M&A pipeline that remains active. And we've told people in the past that, absent a deal, we would delever the Company. But very quickly we expect the leverage ratio right now to be under 1.

So we'll continue to look for growth opportunity. We've added talent to manage a larger company and manage it better. So we'll be selective. While we'll focus on last-mile delivery, if there are opportunities that complement the specialty chassis business, be it RTB or contract manufacturing, we'll look at that as well.

Steve O'Hara: Okay. And maybe just a quick follow-up on that. Just is there a way to think about acquisition size? I mean, would you be open to doing something transformational in terms of -- maybe not comment on that, but maybe on where your comfort is taking the leverage ratio up to, and then if you're seeing anything interesting in the near term, given the disruption in the market.

Rick Sohm: Yes. I think good question again. We are comfortable doing bigger deals. In the past we had talked about kind of bolt-on acquisitions. But we've transformed the Company already by getting rid of ER. And you'll remember that we've told people we're very selective about our M&A activity and we don't feel that we need to chase a deal. We've also told people we didn't feel real comfortable above 2x on our leverage ratio. But I think there's a lot available to us and we'll continue to look.

Steve O'Hara: Okay. Thank you very much.

Operator: As there are no further questions, this concludes our question-and-answer session. I would like to turn the conference back over to Juris Pagrabs for any closing remarks.

Juris Pagrabs: Thanks, everyone, for joining the call today. Normally I'd give you an update on some of the conferences we will be attending here in the near future. But, given the environment, seems like that's not going to happen. I will reach out to you. If you want to talk with management, we can certainly set up virtual calls in the short term as we get through this process.

First-quarter earnings will be around the first week of May and look forward to keeping you updated. Thank you.

Daryl Adams: Thank you.

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