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Q1 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
Matt Koranda;Roth Capital;Analyst
Rhem Wood;Seaport Global Securities;Analyst

Presentation
Operator^ Good morning, and welcome to Spartan Motors 2017 first quarter 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. (Operator Instructions)

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, Ryan, and good morning, everyone. Welcome to the Spartan Motors 2017 first quarter earnings call. I'm Juris Pagrabs, and joining me on the call today is 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 and 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 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 the 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.

For today's call, Daryl will provide an overview of the first quarter and a business update, and Rick will review the first 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'm pleased to turn the call over to our CEO, Daryl Adams, for his opening remarks, which begin on slide 3.

Daryl Adams^ Thank you, Juris. Good morning, everyone, and thank you for joining us on Spartan Motors' 2017 first quarter conference call. I'm very pleased to report another solid quarter of growth and profit improvement on an adjusted basis for Spartan Motors. We've met our internal expectations, and this marks our fifth profitable quarter in a row.

Revenues for the first quarter rose 24.9% to $167.1 million, from $133.7 million a year ago. The increase in sales was driven by the acquisition of Smeal Apparatus, which closed on January 1, 2017. Smeal contributed $35.2 million in revenues during the first quarter, including $5.5 million of Spartan inter-company chassis sales.

For the first quarter of 2017, we reported an adjusted net income of $1.3 million, or $0.04 per share, compared to $0.5 million, or $0.02 per share, last year. That's an adjusted net income increase of 142.1% year-over-year.

Our solid performance during the quarter was driven by the operational improvements we continue to make in labor and manufacturing productivity. As we've told you, our delivered investment in manufacturing and best practices are starting to pay off.

I'm extremely proud of all the Spartan team members, how quickly they've embraced our initiatives of improving and growing the business. We are starting to see the impact of implementing our Spartan production system, lean manufacturing, and continuous improvement initiatives, and the positive momentum is building quarterly as we execute our plans.

Now, turning to slide 4, I'll provide an update on a few business highlights and developments. As we previously announced, we completed the Smeal acquisition January 1, and for the full-year, we expect Smeal to increase sales by $35 million to approximately $105 million in revenues. That's up from $70 million in 2016, including our Spartan chasses sold to Smeal.

The increase is a direct byproduct of improved manufacturing processes and an increased level of interest from our dealer network and customers as a result of having a more robust, broadened product portfolio.

I am pleased to report that our integration efforts are running ahead of schedule due to the well-disciplined, focused and hard-working teams. Equally exciting is that not only have we met our synergy goals, we've identified significant additional opportunities, which we can credit to the application of our lean and continuous improvement initiatives, which will accelerate the turnaround timeline of our emergency response business.

The newly combined Spartan emergency response business unit ranks as one of the top four North American fire apparatus manufacturers in an increasingly consolidated industry. As we work through the integration process, we are applying lessons learned and documenting the processes required to optimize future acquisitions.

Now, please turn to slide 5 for a brief update on the S-180 pumper. As you are likely aware, in 2016, we brought to market the S-180 truck line currently in 11 pumper models. As a reminder for those new on the call, the S-180 is designed to provide the market with faster order-to-delivery cycle times.

The S-180 truck offers several pre-engineered 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.

The product line continues to gain momentum, as our dealers are showing increased excitement and support. During the first quarter, we shipped 14 S-180 pumpers. That's up 180% over the fourth quarter, when we shipped just five. In April, we shipped three units, and our backlog is currently at 18 units through June 2017.

Please turn to slide 6. Last week, in conjunction with the annual Fire Department Instructor's Conference, also known as FDIC, we launched Spartan Refurbishment Centers as a direct outcome of listening to our customers and providing them a cost-effective approach to repair out of service, damaged or worn trucks at a fraction of the time and cost of a new vehicle.

These Spartan Refurbishment Centers are designed to solve municipality backorder issues and keep production service by improving safety, increase performance, while ensuring they stay within their budgets. Fire departments across the country are battling aging fleets and trucks that are out of service. They require emergency response vehicles to not only last longer, but to perform more reliable over a longer period of time.

Located at Spartan campuses primarily in the Midwest, we offer a complete range of services and refurbishments, from lights to cab -- full cab and chassis replacements, to the recertification of critical systems for departments or municipalities looking for a cost-effective way to update their fire trucks without the capital expense associated with purchasing a new vehicle.

Now, please turn to slide 7. Lastly, at the National Association of Fleet Administrators Institute and Expo in Tampa Bay, we also announced a new partnership with Ranger Design, a commercial van outfit manufacturer for mobile professionals. The new partnership expands van outfit options for fleet customers that combine the customer -- sorry, the custom engineering and deep industry expertise of Spartan Upfit Services with Ranger's real-world-tested standardized products.

Ranger and Spartan will offer an industry-leading portfolio of work truck solutions with OEM ship-through availability. The partnership will also expand customer warranty support to over 300 locations in North America for Ranger components installed by Spartan Upfit Services.

Spartan Upfit Services is a cost-effective, modernized fleet outfit assembly operation dedicated to the customization of cargo vans and other mid-size fleet vehicles serving the utility, telecom, healthcare, construction, food and beverage, parcel delivery, and the last, non-delivery markets. Spartan offers a combination of kits and locational packages with corresponding customized services.

With that, I'll now turn the call over to Rick to discuss Spartan's financial results for the first quarter and outlook for the remainder of 2017.

Rick Sohm^ Thanks, Daryl. Please turn to slide 9. As Daryl mentioned, we are pleased to report a strong first quarter performance, which reflects a favorable impact of continued operational improvements we have made in labor and manufacturing productivity as a result of implementing the Spartan production system, lean manufacturing and continuous improvement initiatives across all our production facilities. Concurrent with the improvements to our base business, the Smeal integration is running ahead of schedule.

Revenue for the quarter increased 25% to $167.1 million, from $133.7 million, with the Smeal acquisition contributing $35.2 million to the top-line increase for the quarter, as Daryl mentioned earlier. For the full year, we expect Smeal to generate approximately $105 million of revenue, which excludes $20 million of Spartan inter-company chassis sales.

For the first quarter, our adjusted EBITDA increased almost 46% to $4.2 million, from $2.9 million. Our adjusted EBITDA margin improved 40 basis points to 2.5% of sales, from 2.1% of sales a year ago. Operational improvements, enabled by our Spartan production system and lean manufacturing initiatives, continue to drive year-over-year improvements.

Our adjusted EBITDA excludes the impact of $1.5 million of restructuring and acquisition-related expenses and the impact from the one-time lag in recognizing sales and gross margin on chassis sales of $1.1 million that are now inter-company. This compares to $330,000 of restructuring expenses in the prior year. Our backlog at quarter end remains strong at $351.3 million, up from approximately $250 million at year-end, and reflects $78.6 million in Smeal backlog as a result of our acquisition.

Now, let's take a look at results by operating segment, starting with the FVS segment, on slide 10. FVS reported revenues of $53.9 million, compared to $59.3 million last year, a decrease of approximately 9%. This revenue decrease was due to lower parts sales and upfit volumes, and was partially offset by favorable vehicle product mix.

Adjusted EBITDA declined $300,000 to $6.2 million, from $6.5 million a year ago, largely due to the lower upfit volumes. As we explained last quarter, we expected difficult top-line comparisons, as we had a large upfit order last year. Despite the sales decline, our EBITDA margin improved 70 basis points to 11.6% of sales, from 10.9% a year ago, which reflects our improved manufacturing and labor productivity. Our backlog remains strong at $114 million, compared to $89.5 million at year-end, an increase of 27%.

Moving to slide 11 and the SCV segment, first quarter 2017 revenue totaled $33 million, essentially flat year-over-year despite being up against some difficult comparisons, as the first quarter of last year included a defense order that did not reoccur in 2017. Adjusted EBITDA for the first quarter declined $100,000 versus the prior year, primarily due to that defense order not reoccurring. Our SCV backlog also remains strong and increased 13.4% to $22.8 million, compared to $20.1 million at year-end.

Now, let's move to slide 12 and our ER segment. Revenue was up just over 95% to $80.2 million, from $41 million, due to the $35.2 million in sales from the Smeal acquisition, as I mentioned earlier. This increase was offset by slightly lower shipments of complete fire apparatus and custom cab and chasses from our base business compared to last year as we continue to focus on profitable sales.

Our adjusted EBITDA loss for the quarter improved $1.8 million, from $1.3 million, from an adjusted EBITDA loss of $3.1 million a year ago, driven by improved vehicle mix, increased labor and manufacturing productivity, material efficiencies, and warranty costs. Backlog is up significantly, reflecting an additional $78.6 million from the Smeal acquisition. Backlog at quarter-end was $215 million, compared to $140 million at year-end.

Turning to slide 13, you'll see our balance sheet continues to improve. Cash on hand was up almost 11% to just over $35 million, compared to $32 million at year-end. Inventory at the end of the first quarter was $109 million, up just over $50 million compared to our year-end balance, as the first quarter includes $44 million of inventory due to the Smeal acquisition.

The Smeal inventory at quarter-end is down nearly $20 million, or 32%, from $63 million as of the acquisition closing date on January 1. Reducing Smeal inventory continues to be a high priority, as we believe the cash generated will fund a significant portion of the acquisition cost.

Given the strength of our balance sheet, we have initiated a $10 million payment on our revolver, which will reduce our debt level to approximately $23 million. We'll continue our disciplined approach to working capital management, and we'll continue to be opportunistic as market conditions dictate to support both future growth and maximize shareholder value.

Please turn to slide 14, and we'll discuss our outlook for 2017. As we look at the remainder of the year, we expect our strong first quarter performance to continue to reflect the favorable impact of successfully implementing our lean manufacturing and continuous improvement initiatives across all production facilities. We expect to see continued year-over-year operational improvements and additional synergies to be realized from the Smeal acquisition.

This, together with the Smeal acquisition and integration running ahead of schedule, gives us comfort in raising the 2017 guidance as follows. We now expect revenue in the range of $650 million to $700 million, up from our previous guidance of $615 million to $685 million. Our restructuring, acquisition costs and inter-company chassis impact of approximately $3.2 million, up from $2.8 million previously.

We expect adjusted EBITDA in a range of $26.5 million to $29 million, up from the previous range of just over $25 million to $28.3 million. Income tax expense to be in the range of $1.5 million to $2.3 million, down from our previous guidance of a range of $1.7 million to $2.8 million. Our interest expense to be approximately $800,000, down from our previous guidance of $1 million. And we now expect adjusted earnings per share of $0.36 to $0.41, up from our previous guidance of $0.30 to $0.36, and this assumes approximately 35 million shares outstanding.

And finally, as a reminder, our forecast for the remainder of the year includes the impact from the one-time lag in recognizing Smeal sales and gross margin on chassis sales that are now inter-company. Approximately $1.1 million of related margin deferral still remains, which will impact the second quarter of 2017.

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

Daryl Adams^ Thanks, Rick. Please turn to slide 15. First quarter 2017 results marked our fifth profitable quarter in a row and ensures us that we will be profitable in all four quarters again in 2017 on an adjusted basis. To say that we're pleased with the progress we've made to date is an understatement. Not only do we have the right people in the right seats across the organization, our bench strength is building.

Acquisitions and the workload that comes along with them are not easy to accommodate. The fact that the Spartan team has not only been able to assimilate and integrate Smeal and its brands while improving and simultaneously growing our core business is a testament to how dedicated and, frankly, powerful this team is. Our thanks go out to the team and to our shareholders for their continued confidence. We are incredibly proud of this, and we are incredibly proud of the power and capabilities of this team, and this is just the beginning.

I intended on closing this call by telling you the momentum is building and becoming tangible, but there's more than that going on here. There's literally a cultural shift. There's an appetite for more -- more challenge, higher standards, and taller goals. It's no coincidence, then, that the Spartan production system is improving significant -- improvements in labor, manufacturing and productivity across campuses.

The Smeal integration is well ahead of schedule, and we're well-positioned to take on other strategic acquisition opportunities as they present themselves. The ER segment will return to profitability on an adjusted basis in 2017. Earnings are accelerating. We've increased our midpoint EPS guidance by 18% for 2017.

While we've made notable progress to date, I want to be clear it's only the top of the fourth inning. Our Spartan team is energized, confident and determined on improving and growing the business. I can't wait for you to see what winning means at Spartan.

Operator, we're now ready to take some questions.

Questions and Answers

Operator^ And we will now begin the question-and-answer session. (Operator Instructions) Steve Dyer, Craig-Hallum.

Steve Dyer^ With respect to Smeal, it looks like you're calling for $105 million in revenue, which is up from previous expectations and the $70 million that was done last year. Is that just the inter-company, or has something else changed there?

Daryl Adams^ No, Steve, I think it reflects that we'll have higher volumes in 2017 versus the prior year. So there's a healthy backlog there, and as we've improved the manufacturing productivity, I think our expectation for the number of units we'll be able to deliver has increased since the date of the acquisition.

Steve Dyer^ Got it. Okay. Jumping over to FVS, you guys, obviously, have a tough comp on that big upfit order from last year. Any sort of visibility or sort of color on potential for large orders there over the next quarter or two?

Daryl Adams^ I don't know that we expect orders to that same magnitude, Steve, but we feel we have a nice order backlog now. And I think that we've talked previously about our new facility in Kansas City, where we do upfit business over the Ford transit platform, and we see that ramping nicely as we head into the second half of the year.

Steve Dyer^ Okay. Great. And then, Daryl, you touched on M&A at the end. Smeal looks to be going well. Is that -- do we see another deal this year, or are you still thinking maybe a little bit of a slower pace than that?

Daryl Adams^ No, Steve, you could be in the right range on that. I mean, we want to make sure we close that one out, integrate it, get it into our systems. As we also stated, right, we want to be opportunistic. That's the way we were on the Smeal acquisition. So I'm not comfortable with telling you that we have these things scheduled or locked in certain dates, but if something comes along, we'll definitely -- and it makes sense and it can be accretive, we'll take the opportunity.

Steve Dyer^ All right. Great. Thanks, guys.

Daryl Adams^ Thank you.

Operator^ Matt Koranda, Roth Capital.

Matt Koranda^ Just on the guidance, it looks like the primary driver of the top-line increase is really 100% related to Smeal, so could you just confirm that's the case? And then maybe could you provide a little more color on sort of what you've done on the production side that enables you to -- for this revenue by that amount at Smeal?

Rick Sohm^ I think, Matt, the improvements we've seen in the Smeal business and the confidence we have there has been the driver on a lot of the top-line increase in guidance, and also I think the continued momentum we're seeing in our S-180 program.

Daryl Adams^ And Matt, I'll take the second half of your question about the operation. So January 1, we hired a new VP of operations, an automotive style individual, understands our Spartan production system. He's jumped on it. We have hired another couple of individuals on the operational side. So along with implementing the lean principles, we're also doing a number of kaizen events that are very fruitful for us and will be sustainable as we move forward.

Matt Koranda^ Okay. That's helpful, guys. And just sticking with the emergency response segment, it looks like the way that the cadence is playing out for the S-180, you guys are implying that you could be shipping close to 20 units in the second quarter here, which would imply a nice ramp. Is that the case? And then, also, should we expect that sort of cadence through the remainder of the year, or are we kind of fulfilling demand early in the year and then we take a pause before you look at other orders?

Daryl Adams^ No, it's a really good question. So what we did -- I think we've mentioned it previously. We want to make sure we don't get out over our skis on the delivery of timing of 180 days. So we were -- at this time last year, after we announced the 180, we worked on the design, got our dealers in, made some changes. After those changes were implemented by engineering, we've built a number of demo units, and I think that's where you're seeing the increase. The demo units are out on the road. Our new Smeal dealers are excited, as we've mentioned, and we're picking up orders, but we are going to manage it so that we do stay within 180 days, which is our commitment to our customers.

Matt Koranda^ Okay. Got it. And then on the refurb side, could you just help us understand sort of how that refurb business fits in with your OEM business? I guess just at face value, it looks like it may be kind of complementary and drive some stickiness with customers, but I just wanted to hear kind of the rationale in your own words there.

Daryl Adams^ You nailed it. That's exactly what our approach is. We continue to hear from these guys that they're tired of waiting for their trucks. That's why we're excited about the S-180. And we've told you in the past that the S-180 isn't for everybody, so this is a complementary initiative that we have to pick up additional, as you said, customers that can't buy new trucks, maybe they don't have the money. Also, it's going to help us keep that customer going forward, since we're working with them on their current products.

Matt Koranda^ Okay. And then impact to margins on that business? I mean, I would assume it's more like aftermarket type margins, but could you help us understand that?

Rick Sohm^ Yes, Matt, I think you're spot on in your characterization of it. It is a good-margin business, like aftermarket, and would certainly be accretive to the business's margins.

Matt Koranda^ Got it. Okay. Maybe one last one on the ER side, just in terms of the competitive environment that you guys are seeing. Obviously, there's been some additional consolidation activity happening in the recent weeks, so could you maybe talk about if you're seeing any impact to kind of order flow, pricing or other elements of the business related to kind of industry consolidation?

Daryl Adams^ I'll take that. I think that last acquisition that you were talking about, it's a little early to see any outcome of it, but I think it's part of the strategy or the industry consolidating we've talked about in a number of quarters. We're seeing it, and we actually were involved in it. So I think it's actually helping the industry move its -- shorten up its delivery cycles -- not well below a year, but as we get the capacity -- and the other three companies ahead of us have very good processes -- that we're putting in place, I think it's going to be a dynamic industry going forward.

Matt Koranda^ Okay, got it. And then, lastly, on SCV, just any update or change in cadence to the ramp-up in the F-Series and how that's factoring into your overall guidance for the year?

Daryl Adams^ No, the -- we're on schedule. We're actually starting to do some slow ramp-up right now on production units, but we'll see the impact start to move up in the second quarter.

Matt Koranda^ Okay, got it. I'll jump back in queue, guys. Thank you. Nice quarter.

Daryl Adams^ Thank you.

Rick Sohm^ Thanks, Matt.

Operator^ Rhem Wood, Seaport Global.

Rhem Wood^ I wanted to -- you mentioned that you're in the fourth inning. Was that referring to the lean implementation? Maybe just some more color on that, like where you're seeing the most improvement, and where do you still have work there to do?

Daryl Adams^ Let me clarify that for you, Rhem. We've talked before about where the Company stands, right, since 2015, when we started building our new team, so the reference to the fourth inning was in association with the new team, the Company, and where the Company is at in its transformation.

And then to your second question, initially, when you start to put in SBS by process or lean kaizens, continuous improvement activities, you're picking up some low-hanging fruit. We see that also in maybe the fourth inning, maybe even earlier than that. There's a lot of runway left on both of those initiatives, and that's why we're pretty -- not pretty, we are confident we'll be profitable again in all four quarters this year.

Rhem Wood^ Okay. Great. And then can you talk about -- I want to get back to the M&A. Can you talk about your pipeline there, what kinds of multiples you're seeing? And then as you think out, do you see more opportunities in M&A or in additional partnerships?

Rick Sohm^ Rhem, I think we, ultimately, see additional M&A opportunity. I think as I look at the balance sheet and our liquidity and our ability to generate cash, we certainly have that dry powder, if you will. I think Daryl summed it up pretty well earlier, that I don't know that we have a cadence or a timeline, but I would say based on the success of what we've seen with Smeal so far, it certainly has us looking more actively going forward.

Rhem Wood^ Okay, great. And then can you just talk -- just a couple modeling questions. You've given the tax range, but can you talk about what rate to use and see how much share count, maybe, just to help with the cadence there? And the last one is just the EPS. Can you help us with first half versus second half cadence? How do you expect the EPS to play out? Thank you.

Rick Sohm^ If I look at first half versus second half, I think it is definitely more weighted to the second half, Rhem. We have some continued headwinds heading into the second quarter. There's the additional headwinds in the second quarter from some defense orders that didn't reoccur. So the weighting is certainly back half weighted.

Rhem Wood^ Okay. And then one last one, just on the ER business. It sounds like your improvement is going well. I mean, could you be profitable in the second quarter, or is it still kind of the end of the year thing? Thanks for the time.

Daryl Adams^ Thank you, Rhem. I think what gives us confidence in taking our guidance up is, like we've said before, the Smeal acquisition will accelerate the turnaround of the ER business. And I'm not ready, I think, to say what specific quarter it will return to profitability, but we have a lot more confidence sitting here today than we did back in early February.

Operator^ And this concludes our question-and-answer session. I would like to turn the conference back over to Spartan Motors for any closing remarks.

Juris Pagrabs^ Thank you, everyone, for joining today's call. We look forward to continuing to provide you updates on our progress, as well as our next earnings call, which will be in the first week of August. Thanks, and have a great day.

Operator^ Ladies and gentlemen, this concludes our conference. Thank you for attending today's presentation. You may now disconnect.