Spartan Motors Q4 2015 Earnings Conference Call
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Officers
Greg Salchow; Spartan Motors; Group Treasurer, Director of IR
Daryl Adams; Spartan Motors; President and CEO
Rick Sohm; Spartan Motors; CFO

Analysts
Rhem Wood; BB&T Capital Markets; Analyst
Mike Shlisky; Seaport Global; Analyst
Art Winston; Pilot Advisors; Analyst

Presentation

Greg Salchow: Thank you, John. Good morning, everyone, and welcome to Spartan Motors' fourth quarter and full year 2015 conference call. I'm joined on the call today by Daryl Adams, President and Chief Executive Officer; and Rick Sohm, Chief Financial Officer. For today's call, we are incorporating a presentation deck, which is filed with the SEC and available on our website at www.spartanmotors.com. You may download the deck from the Shareholders section of our website to follow the 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 our 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.

Daryl Adams will provide an operational review of the fourth quarter followed by a financial review and fourth quarter outlook provided by Rick Sohm. Daryl Adams will then conclude the call with his comments on our future operational focus before we proceed to the Q&A portion of the call.

Now, I am pleased to turn the call over to our CEO, Daryl Adams, for his opening remarks, which begin on Slide 3.

Daryl Adams: Thank you, Greg. Good morning and thank you for joining us on Spartan Motors' fourth quarter 2015 conference call. When I became CEO a year ago, I shared with you the five focal points the company would follow as part of a multiyear turnaround plan. The focal points have been revised slightly and strengthened over the past year as they continue to be our roadmap for the turnaround effort.

The first focal point continues to be the turnaround in Emergency Response business. The remaining focal points are improve operational discipline performance, increase level of accountability, improve quality and reduce warranty expense and strengthen the team. We have made a number of changes to the ER segment that are not yet reflected in our operating results.

As we mentioned during last quarter's call, John Slawson was named President of Emergency Response. John is an industry veteran and has spent a large part of his career in the ER business. His expertise has been invaluable as we take steps to fix the business. Some of the actions he has taken to move Spartan toward a market competitiveness include, one, consolidating the sales force into one team, thereby eliminating duplicated effort and costs; two, reducing layers of management to increase accountability and improve communication; three, developing the Spartan preferred trucks that features the most common options and configurations ordered by our customers. This is the truck design that fits the 80/18/2 philosophy we've discussed in the past. By reducing complexity, we can shorten production and delivery time, improve quality, profitability while providing all of the functionality our customers want. In the event a customer wants something truly custom, the 2% if you will, we still build it but we will charge accordingly for the additional design, engineering, material and labor required. Fourth, implementing a more rigorous order review process to ensure we accept only orders that we can build profitably. We have turned down several orders in recent weeks and months that do not meet our standards for profitability.

Rick Sohm: Other initiatives underway in ER include a new and simplified ordering process that consolidates our product line to focus on our most popular products and reduce complexity, along with a revised pricing and marketing strategy. All these initiatives are important to our turnaround plan. But keep in mind that our total order book value extends 12 months into the future with backlog for area units approaching 18 months. So we will not see the full effect of these recent changes until early 2017. However, we do expect to see improved performance in 2016 with each quarter showing better operating performance than the same quarter in the prior year.

Turning to the operational discipline and performance focal point on Slide 4. We have made a good deal of progress over the past year. The Spartan Production System or SPS was developed in 2015 and is being implemented in 2016. SPS is based on automotive industry standards for production, engineering, quality and manufacturing. This will result in common systems and processes that will allow us to spread best practices across the company and become a more efficient, integrated organization.

We were starting implementation of SPS at the Charlotte and Bristol campuses during the first quarter of 2016. We are taking steps to consolidate DSV's manufacturing footprint by moving truck body production into our existing plant in Bristol, Indiana. We expect the move to be completed by June 30th, which will allow us to reduce certain expenses by closing our Wakarusa, Indiana facility.

To achieve our 2016 plan, we must increase the level of accountability, which is a new focal point for this year, shown on Slide 5. Increasing accountability means changing the culture to one of accepting responsibility for driving change and generate a result. This means encouraging and rewarding leadership and fostering a sense of ownership at all levels of the organization. This involves measuring results using data, KPIs and adding rigor to the measurement process.

The fourth focal point on Slide 6, improve quality and reduce warranty expense, an area that received a great deal of attention during the second half of 2015. We reported earlier in 2015 that we have identified some older product designs that will require service campaigns or recalls. We are proactively conducting a comprehensive review of our product designs and components. Our review will examine components and vendors to verify that all validation procedures were followed and to take corrective action as needed. Driving this effort, our quality and launch engineers brought in to ensure we follow automotive industry standard validation and design processes that include Finite Element Analysis. Similar to the automotive industry, critical components will be engineered to significantly exceed projected service requirements, a move we expect to reduce warranty costs.

Finally, as shown on Slide 7, we are continuing to strengthen and develop the team. Our initiatives will only be successful if we have the right people in key leadership positions. For reference, 80% of the senior executive team has joined Spartan over the past 12 months. During 2015, we appointed a new president of Emergency Response, president of Specialty Vehicle, a chief financial officer, all of these changes were made to bring the proper skill sets needed to meet particular challenges. We also brought in corporate level resources to the engineering, quality, human resources and manufacturing. These leaders will drive and accelerate change throughout Spartan Motors.

As I will discuss later in the call, these initiatives are driving positive change and allowing us to shift some of our focus to offense. That is actively driving Spartan's long-term profitable growth. During the latter part of 2015 and into early 2016, we saw some leading indicators of positive developments to come. I can see that real progress has been made that we are following the right plan and that our outlook is improving.

Before we get into that part of the call, I will turn it over to Rick to discuss fourth quarter and full year results.

Rick Sohm: Thank you, Daryl. Please turn to Slide 8. During the fourth quarter and full year, Spartan reported several non-recurring items that significantly impacted reported results. Starting with the fourth quarter, Spartan reported an operating loss of $10 million, including warranty accruals of $6.3 million and $1 million of expenses to wind down our joint venture with Gimaex. We believe we have largely addressed our warranty issues and increased reserves to appropriate levels based on the information we have today.

If we back out those non-recurring items and $0.4 million of restructuring charges, our adjusted operating loss was $2.3 million, which is in line with the guidance we have provided during our third quarter 2015 conference call. Those numbers compared to our reported operating loss of $1.9 million in the fourth quarter of 2014 and an adjusted operating profit of $0.2 million excluding restructuring and joint venture expenses. Spartan's net loss for the fourth quarter was $9.5 million or $0.28 per share versus a net loss of $121,000, which was less than $0.01 a share.

Looking at the full year on Slide 9, Spartan reported an operating loss of $12.5 million versus an operating loss of $1.2 million in 2014. The 2015 results included several restructuring and non-recurring items that totaled $17 million. If we exclude those items, Spartan had adjusted operating income of $4.5 million. That compares to our reported operating loss of $1.2 million in 2014 and excluding restructuring and joint venture expenses and adjusted operating income of $1.3 million.

In the fourth quarter of 2015, we made an additional non-cash adjustment to our valuation allowance for deferred tax assets in the amount of $1.9 million. This is in addition to the $3.2 million non-cash adjusted made in the third quarter of 2015. These adjustments, plus the impact of certain non-tax deductible expenses during the year resulted in a full year 2015 income tax provision of $4.9 million. For the full year, Spartan's 2015 net loss was $17 million, equal to $0.50 per share compared to net income of $1.2 million or $0.03 per share in the prior year.

All of the non-recurring charges and expenses for the fourth quarter and full year are shown on Slide 10.

Now we will turn to our business segments and talk about DSV and SCV, which recorded revenue growth from the fourth quarter and full year. Both segments were profitable for each period.

Starting on Slide 11, DSV reported its fourth quarter revenue grew more than 50% while revenue for the full year increased 8.2%. Vehicle revenue increased due to a favorable product mix in both periods, while vehicle up-fit center revenue accelerated in the fourth quarter as volume increased at both our Saltillo, Mexico and Kansas City facilities. Fourth quarter operating income more than doubled to $4.5 million due to higher revenue growth, especially in our vehicle up-fit centers.

For the year, which is shown on Slide 12, operating income grew nearly 75% to $14.5 million from $8.3 million in 2014.

Now we'll turn to the ER segment on Slide 13. ER posted a fourth quarter revenue decline to $40.6 million from $45.8 million, although revenue for the year rose to $187.1 million compared to $184.5 million in 2014. Fourth quarter revenues declined primarily due to the absence of fleet orders in 2015 compared to the prior year during which we shipped the final 14 units of a 70-unit order.

For the year, higher chassis sales to external customers more than offset lower apparatus sales compared to 2014. In the fourth quarter, the ER segment booked additional warranty accruals of approximately $5.9 million. The increase in reserves was made after conducting a comprehensive review of claims history that included significantly more data than was previously available.

During the quarter, ER also recorded a $1 million charge for the termination of our joint venture with Gimaex and $0.4 million in restructuring expenses. All of these factors resulted in a fourth quarter operating loss of $12.2 million versus an operating loss of $3.6 million in the fourth quarter of 2014.

If we turn to Slide 14, you'll see that the ER business reported a full year 2015 operating loss of $24.8 million compared to an operating loss of $7.1 million in 2014. Non-recurring charges included an incremental $7.2 million of warranty accruals, a $2.2 million non-cash asset impairment charge, and $0.7 million of regulatory settlement costs. Restructuring costs amounted to $2.9 million, an increase of $0.7 million from the prior year. Production inefficiencies resulting from the relocation of our operations in Ocala, Florida to our Brandon and Charlotte facilities and unfavorable product mix reduced operating income by a combined $6.9 million. Total non-recurring expenses accounted for $13 million of the $24.8 million operating loss for 2015.

Now turning to the SCV segment on Slide 15. Fourth quarter revenue increased to $34.3 million from $29.6 million, an increase of 16%. Operating profit, however, declined to $0.2 million from $2.4 million in 2014 due to the impact of motorhome chassis pricing actions taken earlier in the year and $0.5 million of warranty accruals taken in the fourth quarter.

Turning to Slide 16. For the full year, SCV's revenue rose to $135.6 million from $111.7 million, an increase of 21% versus the prior year. Operating income for 2015 was $6 million, down from $7.4 million in 2014. Operating income declined despite higher revenue due to the adverse impact of competitive pricing actions on motorhome chassis, NHTSA settlement cost, and an increase in the warranty and campaign accruals.

Turning our attention to the balance sheet on Slide 17, you'll see we ended 2015 with $32.7 million in cash, compared to $28.6 million at the end of 2014 and $20.9 million at the end of the third quarter. Our focus on improving working capital in the fourth quarter resulted in a reduction of accounts receivable by nearly $12 million to $56.6 million at year-end. And we successfully reduced inventory by $18 million in the fourth quarter to end 2015 at $60.6 million, our lowest yearend inventory level in five years.

Managing working capital in a more efficient manner will continue to be a priority for us throughout 2016. Our guidance for 2016 was included in this morning's press release and is shown on Slide 18. We currently have a considerable amount of new business booked for the year and our order intake continues to be strong. We anticipate revenue for the year to be between $560 million and $580 million and operating income to be in the range of $3 million to $5 million. Included in this range of estimated operating income are restructuring expenses of between $1 million and $1.5 million. And earnings per share for the year are estimated to be in the range of $0.05 to $0.10 per share.

That concludes my remarks and now I'll turn the call back over to Daryl for his closing comments.

Daryl Adams: Thanks, Rick. Please turn to Slide 19. The first year of our turnaround is now behind us and we are well into the first quarter of 2016. Order intake has been strong, especially for DSV, with new orders for Reach at 700 units, more than 800 conventional walk-in vans and our up-fit business continues to grow. Early indications are that our customers generally have robust capital budgets approved for this year and are looking to expand or replace part of their vehicle fleets. eCommerce and the number of shipments continue to grow, with the number of shipments up more than 10% in 2015. According to our sources, eCommerce accounts for about half of the total refill growth in the US with no sign of significant slowing.

In the SCV segment, we were recently informed that one of our major motorhome chassis customers has named Spartan as its sole chassis supplier. We expect an increase in motorhome chassis orders from another customer due to the performance a custom Spartan chassis offers. We are in discussions with a customer to expand our contract assembly manufacturing business for a multiyear period that will significantly expand that part of our business.

The ER business is showing operational improvement as we made up lost ground from the third quarter of last year. By the end of the year, we met production targets and continue to work on the operating side of the business. We are solely focused on generating profitable orders and review every potential order to ensure we can build it profitably. With that said, keep in mind that our backlog extends 12 months, so most of these benefits will not be realized until 2017.

There are further steps to take in terms of ordering, pricing and engineering new orders as well as focusing on more standard features in option packages. Still to come are more changes to our go-to-market strategy that we will discuss in upcoming quarters.

Recent business in ER includes a 14-unit order for Toronto, Canada as well as a multiyear agreement with the City of Philadelphia for up to 20 new fire trucks.

Please turn to Slide 20. I mentioned earlier that we are launching lean manufacturing initiatives at Bristol and Charlotte during the first quarter. Rolling out lean initiatives at Bristol is timely because we are transferring truck body production into our Bristol facility. I want to be clear. We are making solid progress toward our objectives and the outlook for 2016 is improving as our turnaround plan continues to yield results.

Operator, we are now ready to take questions.

Questions and Answers

Operator: Thank you, sir. We will now begin the question-and-answer session. (Operator Instructions) The first question today comes from Rhem Wood with BB&T Capital Markets. Please go ahead.

Rhem Wood: So first, can you talk a little bit more about the backlog? I know you're focusing on profitability in the ER segment and it'll take a year to sort of work itself out but what is the profitability like in the other segments? And then in ER, I assume the new orders of Toronto and Philadelphia are at better margins, like will those flow into 2016?

Rick Sohm: Yes. I think like Daryl said earlier, Rhem, recently, we've turned down some apparatus orders because we didn't feel that they would be profitable enough. So I think as we work through the backlogs and start to exit 2016, these orders will be profitable and allow us on a run rate basis in the ER business to look at profitability in 2017.

If you look at the other businesses, I think we've also said in the past that while DSV and SCV are profitable, we believe they could be more profitable. And I think, especially on the DSV side, you've seen the revenue increase and some significant profit improvement in the fourth quarter of this year on a year-over-year basis and we think there's still more opportunity.

Rhem Wood: Okay, good. And then in DSV, I think you said 700 Reach were shipped, is that right?

Daryl Adams: No, we have new orders for 700 Reach units.

Rhem Wood: Oh, sorry, new -- how many were shipped in the quarter?

Rick Sohm: I think we'll have to get back to you, Rhem. I don't know that I have that number right here but we can get back to with the fourth quarter shipments.

Rhem Wood: Okay. And then can you give us an update on Velocity? I think you said last time that it had been pushed out to mid-2016 because of chassis issues. Where does that stand at this point?

Daryl Adams: Yes, Rhem, you're exactly right. We're working with our chassis supplier. They moved some airbag locations around that we need to take a little bit more time and engineer our units to accept those changes they made. And we expect to get that in late second quarter. As long as their timing remains what they promised to us, we should be ready to go then.

Rhem Wood: Okay. And then I think as I look at this, it seems like you have good visibility on the backlogs and so the guidance for 2016, it seems to be pretty set. But can you talk about the components of what could drive earnings higher than your guidance? Is it further cost reductions and operational improvements or if you get more orders, do you have the capacity to push through additional volume this year?

Daryl Adams: Yes, Rhem, I think if we go back to our previous call, it's my belief that this is what happened in the ER business a few years ago was we were looking more at backlog and driving backlogs than correcting operations. So that's the reason we're moving lean into Bristol and in the Charlotte campus is to drive operational efficiency that will allow us to take on additional orders. What we don't want to do is take on additional orders without being ready in the manufacturing environment. Efficiency goes down, over time goes up and then it just turns into a non-profitable event. So we're making sure we're getting ready with lean, continuous improvement on the shelf floor and then we can push the orders probably in the second half of 2016 and on.

Rhem Wood: Okay. And then last one, I'll turn it over. When specifically do you expect the ER business to return to profitability? Thanks for the time.

Rick Sohm: Yes, Rhem, I think what we've said previously is that we expect on a run rate basis for ER to become profitable in 2017 and more specifically, in the second half.

Rhem Wood: Okay, thank you.

Daryl Adams: Thank you, Rhem.

Operator: The next question is from Mike Shlisky with Seaport Global. Please go ahead.

Mike Shlisky: I just want to start off with questions on ERV. I just wanted to clarify, so you guys walked away from some orders in the last few months here because they weren't profitable enough. I guess the question is, do you think somebody else won those orders and is going to take a loss or could these folks come back to you in the future if they can't find someone else to build it and say, hey, we'll pay up here? What's the kind of background, what's going to happen going forward on what your backlog is?

Daryl Adams: Sure, Mike. Thank you for the question. Unfortunately, the bid has not been (inaudible), if you will, of any source. We just knew that we didn't want to go in with the prices that others or where we thought we needed to be to win the business. So once the bid tabs are out, we can go back in and check that but we don't have that information right now.

Mike Shlisky: Okay. And you mentioned also in the same segment that what's being signed today is going to be done in a profitable way. Is that to say if you were to build those newest orders today, they'd be profitable or do you have to wait until other overhead and lean initiatives get done prior to really being able to actually execute on that?

Daryl Adams: Yes, it's actually a little bit of both. Along the way, every time we come out with a new order book, we would put in economics and price increases. We do that four times a year. So they've been trickling in. In addition to that, we're also making operational improvements on the floor but some of the previous orders that didn't have the price increases and did not have the built-in operational improvements are what we're building through today. And like we said, you're going to see improvement quarter-over-quarter but the real profitability is going to come in late 2017 once all this flushes through and the orders move through.

Mike Shlisky: I got it. And also, Daryl, you had mentioned a few times in your remarks about moving to auto industry standards --

Daryl Adams: Yes.

Mike Shlisky: Warranties and kind of elsewhere. Are those standards tougher than normal truck body standards and are there any additional costs there for compliance engineering that we should be aware of that might differentiate some of your cost structure with other folks going forward?

Daryl Adams: No. We're using that term -- we're putting in the disciplines. I'm not sure what other companies do. I know the disciplines that we had and we're moving them up, ratcheting them up to the automotive level. It's actually not going to, in my understanding and belief, I've done it before, it's not going to cost extra money. What it's going to do is actually help us be more profitable by validating and testing the products to the different level that will save our warranty and cost portfolio going forward.

Mike Shlisky: Okay, okay. And then finally, I wanted to ask about the competitive environment especially on delivery. I mean you are seeing some pretty large companies in the industry that haven't been in the segment before, trying to get in in 2016, 2017. You're seeing some pretty interesting looking new products coming out this week and next, some of the trade shows out there. So I want to just ask kind of what's your thought on the current environment. Is there the possibility you have some pricing pressure or some competitive company offerings that haven't been there in the past but you might have to deal with going forward? Just any thoughts as to how you think that might play out as you go through 2016.

Daryl Adams: Yes, very good question. Our orders for 2016 are strong. As I mentioned, eCommerce fees continues to grow, where the van up-fit and most of that or all of that is in the Eurovan style vehicle which is also where our Velocity fits into the market. So overall, we feel we're in a good position in 2016 and actually to move into out-years 2017 as well. And there's some other new players coming to that last mile piece of the business that we're also communicating with and working with and in discussions with to see if our product can fit their needs.

Mike Shlisky: Great, excellent. I will pass it along. Thank you.

Daryl Adams: Thanks, Mike.

Operator: (Operator Instructions) the next question is from Art Winston with Pilot. Please go ahead.

Art Winston: Thank you and good morning, everybody.

Daryl Adams: Good morning, Art.

Daryl Adams: We're having a real hard time understanding Art. Actually, we don't even hear him now. Operator, I don't know if you can hear him but we can't.

Operator: Art, your line is open.

Daryl Adams: We can follow-up with Art after this call and get his questions. We'll take note of that.

Operator: Thank you. At this time, we have no further questions. I would like to turn the call over to Mr. Adams for closing comments.

Daryl Adams: Thanks, Joe. As always, thank you for your time and interest in Spartan Motors. And we hope you have a great day.

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