Lakeland Industries, Inc.

Q2 2021 Results Earnings Call Transcript

September 9, 2020 (Unedited)

Company Participants

Charles Roberson - President & CEO

Allen Dillard - CFO

Operator

Good day, ladies and gentlemen, and welcome to the Lakeland Industries Incorporated Second Quarter Fiscal Year 2021 Financials and Conduct Conference Call. All lines have been placed in a listen-only mode and the floor will be open for questions and comments following the presentation. [Operator Instructions]

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As a result, there can be no assurance that Lakeland's future results will not be materially different from those described herein as "believed," "projected," "planned," "intended," "anticipated," "estimated" or "expected," or in other words which reflect the current view of the Company with respect to future events. We caution readers that these forward-looking statements speak only as of the date hereof. The Company hereby expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any such statements to reflect any change in the Company's expectations or any change in events conditions or circumstances on which such statement is based.

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Okay. This is Charlie Roberson. I'm CEO of Lakeland industries. Good afternoon to you all and thank you for joining our fiscal 2021 second quarter financial results conference call. I'm joined here today by Lakeland's Chief Financial Officer, Allen Dillard.

Over the past two quarters of hosting Lakeland industries earnings conference calls, I've talked about our company's efforts to advance our leadership position within the global personal protective equipment or PPE market. The outlook -- or the outbreak of the COVID-19 pandemic presents an unprecedented challenge to all companies within the PPE marketplace. Many struggle to deliver products to service both pandemic and regular customer demand. Lakeland has not.

We believe that our results for the first quarter of fiscal 2021 validated our commitment to attaining this leader -- leadership position within the industry as we leveraged our diverse manufacturing facilities and resilient supply chain with our new centralized data driven planning systems to deliver unprecedented financial performance, while increasing capacity to meet both pandemic and industrial demand for our products.

As we report our second quarter fiscal year '21 financial results, which again benefit from our COVID response efforts. I'm pleased to announce that we just exceeded the performance from our record setting first quarter. In turn, I believe that we have set the new standard of excellence for PPE manufacturers anywhere in the world. Measured by key indicators, the second quarter of fiscal year '21 brought us to new heights and most importantly, we now have greater visibility and insight into our business that we believe will yield sustainable operational improvement in a post-COVID-19 environment.

However, for the time being, COVID-19 remains a very significant global concern, and we believe that it will continue to have an impact on our business and our financial results into the second half of next year -- sorry, into the first half of next year. We anticipate an economic recovery beginning in the fourth quarter of fiscal year '21, and continuing through the first half of fiscal year '22, that will drive increased industrial sales as COVID-19 direct sales begin to wane.

Having successfully increased our penetration into our base industrial markets, we believe increased industrial sales will largely replace COVID sales. While this demand environment exists, we have and will continue to leverage our manufacturing resiliency to drive our profits and cash flow generation. In fact, we already have built a really nice cash war chest.

Our second quarter cash balance ended at $34.9 million, which is up 49% from the end of our first quarter. This cash level, which we expect to continue to grow is equivalent to 20% of our recent market value. And this is after funding our capital investments for continued global expansion and paying down all outstanding borrowings. We have strengthened the Lakeland enterprise to bring value to our shareholders.

While our stock has doubled in the past year, which in large part is attributable to being a COVID-19 beneficiary, we believe our financial performance supported by our favorable industry position and sustainable improvements should be more clearly evident in the post-COVID-19 economy, which may contribute to valuation expansion. Against a backdrop of these challenging times, I'm very proud of the efforts and achievements of our global team.

We're delivering for our existing and new customers alike, our shareholders, and perhaps most importantly, for the health and safety of people around the world. On behalf of the entire management team, I praise our global workforce for their continued hard work and adherence to safety protocols. Our corporate tagline is protect your people and our team is truly living up to it.

For the third consecutive quarter, we experienced increased demand for our products relating to COVID-19, specifically this refers to our disposable and chemical product lines. Through the benefit of owning our manufacturing capacity around the world and having a resilient supply chain virtually all of these orders were booked, manufactured and shipped within the quarter. By contrast, in the first quarter of fiscal year '21, sales of approximately $11 million were filled from products already in inventory, resulting in total sales for the quarter that was significantly above our quarterly manufacturing capacity.

Backing out inventory sales of approximately $11 million from our first quarter fiscal year '21 revenue of $45.6 million yields a manufacturing capacity of about $34 million in terms of sales revenue. When comparing second quarter fiscal year '21 revenue of $35 million to the first quarter revenue of $34.6 million, adjusted for sales filled from inventory on hand and adding the fact that we were able to increase our finished goods inventories from the end of the first quarter, it becomes apparent that we actually increased our manufacturing capacity quarter-over-quarter.

Here are some other key performance measures. In addition to revenues, second quarter records were set for operating income, net income and free cash flow. We have added more than 70 new customers who contributed approximately $3.9 million in sales during the second quarter of fiscal year '21. We were able to convert these customers to Lakeland products because of our competitors inability to supply reliably. So we gained market share.

Focus on new market verticals, highlighting our efforts to tap into niche markets for higher margin opportunities, produced substantial revenue growth. So we are showing select organic growth and execution of our initiatives to sustainably improve gross margins. This in part led to our gross margin increase to the highest percentage in company history at 49.5%, an enviable level for a global diversified manufacturer. And our operating expenses declined as compared to our first quarter and the year earlier period. So we continue to demonstrate strong management of expenses, which leverages our investment in information systems that we have talked about for the past couple of quarters.

Our record performance reflects improvements in profitability measures, factory floor and distribution efficiencies, and operating leverage that delivered a 269% increase in operating profit. Clearly, this growth rate and certain other performance measures are not repeatable absent COVID-19 or some other black swan event. However, that is not to say that improvements made during COVID-19 will pass with the virus. The difference this time around is compared to other crisis situations that temporarily increased our top line is the breadth and duration of this event.

Resources and capacities were strained to a point where response necessitated challenging long-held beliefs about product mix, purchasing, planning, manufacturing, expansion, customer relationships, and communications. Through this lens, we gained invaluable information about ourselves, our company, and the real impact of long held beliefs and new ideas. COVID-19 provided us with a proving ground for change that will benefit Lakeland well into the future.

We are centralizing, rationalizing our product offering, implementing new programs and developing new data models, which we view as providing sustainable advantages long after COVID is past. Thus, we believe we will emerge stronger and more globally competitive from both a balance sheet and operational perspectives. This confidence is supported by the improvements in our second quarter results as compared to our first quarter, since both were COVID impacted.

While first quarter had far greater revenue due to inventory sell-through, which was not repeated in the second quarter, we still improved our gross margin and our operating margin. Similar to the first quarter, we've been running our factories that make disposable and chemical products at near maximum capacity, a schedule of 12 hours per day, 6 days per week. As a result during the second quarter, we were able to deliver products when our competitors, many of whom use third-party contractors could not.

Our ability to provide timely delivery of product enabled us to convert new customers to Lakeland products. Many of these new customers placed container sized orders for significant business that we believe may be captured in whole or in part going forward. Particularly because of this increase in market share, we believe that our factories will continue to run at near maximum capacity for the remainder of the third quarter.

We have not yet resumed production of a number of disposable and chemical SKUs or product variations that had been curtailed or eliminated in the first quarter, but anticipate that we will begin to slowly add additional SKUs in the coming quarters. The reintroduction of these products to our manufacturing schedule will be metered and managed so that we emerge from COVID-19 with a rationalized product offering that preserves the majority of the manufacturing efficiencies we have realized and the resultant impact on margins. This rationalization means that we expect to offer far fewer products than we have previously. This streamlining has led to reduce customer lead times, more efficient and higher volume manufacturer, stronger gross margins and improve inventory turns.

Aiding our initiatives to permanently strengthen our gross margins is our enhanced focus on new high growth rate, high margin market verticals, specifically the critical environment and utilities markets. Both of these markets have significant barriers to entry in terms of product testing and/or validation and technical knowledge required to service the customers.

Not all of the impact of COVID-19 on Lakeland is positive. Automotive manufacturing plants were closed for a significant portion of the second quarter and this negatively impacted our sales for a few of our product lines. The oil and gas industry has been materially weakened given the price of oil and reduced travel. So spending within that vertical market has been reduced.

Based on our channel checks, municipalities lack requisite funding for additional protective garments, such as turnout gear. So the California wildfires do not appear to be contributing to our sales in the second quarter. And the utility sector is working smaller crews, resulting in a reduction or postponement of purchasing new protective clothing.

With elevated demand overall expected into the first half of next year, we remain attentive to future organic growth and market share attainment initiatives, all of which will be self-funded. This includes the emergence of institutional cleaning as a new market segment, secondary government driven demand as governments around the world seek to replenish and perhaps increase their PPE stockpiles and private sector stockpiling of PPE as supply channels catch up to demand.

In large part we are planning for this growth scenario through investments in our manufacturing capacity. We plan to spend $2 million this year on investments in our technology platform and capacity production increases. Investment in technology solutions, which commenced a few years ago, were delivering results with improvements in operating and factory floor efficiencies and greater visibility into customer requirements.

Capacity increases for the balance of this year will focus on near shore -- near shoring certain manufacturing assets to bring capacity closer to where it's needed and increasing production for our faster growing higher margin products. We also will be accelerating our build out in India where sales and production output were increased in part due to COVID-19 outbreak.

To put our capital expenditures into context, our investments for 2019 and 2020 combined were $4.1 million. And during that period, we had average quarterly revenue of nearly $26 million per quarter. With our improved operating capabilities and modifications in our planning amid heightened COVID related demand, we were able to deliver an increase in average quarterly revenue through the first half of this year of $40.5 million for a nearly 56% improvement in quarterly sales.

On the basis of operating profits, the average quarterly operating profit was approximately $1.2 million during the 2-year period as compared with the average quarterly operating profit through the first half of this year of approximately $11.1 million, for an increase of nearly 852%. This demonstrates the impressive scalability and operating leverage for a manufacturing company, while delivering enviable returns on invested capital.

Based on the initiatives implemented and discussed today, which addressed many facets of our business, we have been delivering on sustainable improvements that bolster our profitability and balance sheet. Similar to what we conveyed last quarter, Lakeland has been developing a resilient and flexible global manufacturing platform, a diversified and expanding customer base and a growing brand for high quality competitively priced PPE. We look forward to continuing upon the progress that has been made.

That concludes my remarks. I will now pass the call to Allen to provide a more thorough review of the company's financial results. Allen?

Allen Dillard

Thank you, Charlie. The following addresses my review of the financial results of our fiscal 2021 second quarter ended July 31, 2020. Net sales for the second quarter of fiscal 2021 were $35 million, up 28% as compared to $27.5 million for the same period of the prior year. For the fifth consecutive quarter, our revenues exceeded $27 million. And as Charlie indicated, we see sustainable increased levels in our business from prior periods.

On a consolidated basis for the second quarter of fiscal 2021, U.S sales were $14.5 million or 41% of total revenues and international sales were $20.6 million or 59% of total revenues. This compares with U.S sales of $14.4 million or 53% of the total and international sales of $13 million or 47% of the total in Q2 fiscal 2020. Sales were up significantly over the prior year period, but down as compared to the first quarter of fiscal '21, which reflects the immediate surge of orders from inventory that were in our distribution centers in the previous quarter.

Our business remains very well balanced from a geographic diversification standpoint. Drilling down in the second quarter of this year versus the second quarter of last year, sales in the U.S were increased by a $100,000, while international sales increased $7.5 million. Among our major international operations, sales in the U.K were $4.1 million versus $2.5 million last year; sales in Mexico were up marginally at just over $600,000; sales in Asia were up over 100% at $8.4 million from $4 million in the prior year. Sales in Canada were up marginally at $2.4 million; Latin America increased to $3 million from $2.6 million and sales in other foreign markets were $2 million compared to $900,000 a year ago.

As compared to the first quarter of this year, U.S and other key markets were lower, particularly absent COVID demand due to the pandemic shutting down factories and basic industrial usage, which are typically our mainstream customers. The COVID induced industrial decline was somewhat offset by growth in our new product categories and our winning business for new customers for disposable and chemical product lines, when they could not get supply from other manufacturers anywhere in the world. As Charlie discussed, owning our manufacturing is a significant competitive advantage. When our competitors freeze, we adapt and this incremental top line growth provides additional benefits throughout our income statement and cash flow as I review shortly.

Now let's look at our product mix diversification. Disposables, which continue to be our largest product group increased by 69% or nearly $10 million to $23.8 million from $14.3 million last year. Chemical suits were $6.2 million, up from $5.6 million. Both product groups benefited from organic growth, but the primary driver was COVID-19 demand.

Fire products declined to $1.7 million from $2.4 million, gloves were $500,000 versus $800,000, High-VIS products were lower at $1 million versus $2.6 million and wovens were $1.4 million versus $1.3 million. All of these markets reflect the COVID-19 impact with temporary closure of many industrial businesses, particularly in the automotive and transportation sectors and the oil and gas sector, which has remained under pressure due to the price of oil.

High-performance wear, one of our newer product lines contributed $500,000 in sales in this year's second quarter, and was very early in its launch last year. As was the case in the first quarter, we believe that PPE purchasing continued to be focused, if not refocused in the second quarter to pandemic efforts at the expense of certain traditional industrial usage. As of this time, certain of these trends, including workplace closures and purchasing of disposable and chemical garments over other product groups in the wake of the pandemic has eased somewhat, but still persist. Most automotive manufacturers have resumed business, so we expect some pickup there going forward.

Moving on to gross profit. Gross profit of $17.3 million for fiscal 2021 second quarter increased by $6.9 million or 66% from $10.4 million for the same period last year. Gross profit as a percentage of net sales was 49.5% for the fiscal 2021 second quarter, a company record for any quarter and an increase of nearly 12 percentage points from 37.9% in the second quarter last year, as compared with the first quarter of this year, when revenues were higher and gross profit was $22.1 million, our second quarter gross margin increased by nearly 1 percentage point.

The key drivers for our gross margin improvement over prior year period were fewer SKUs and longer operating hours leading to greater factory floor efficiencies, higher average selling prices, an increase in direct container sales and the inclusion and growth of our higher margin specialized product lines. As compared to the first quarter of this year, our second quarter gross margin benefited from improved product mix and incremental manufacturing efficiencies.

With our substantially higher sales volume and gross margin contributions, the leverage in our operating model drove substantial increases in profits and cash flow. At the same time, we are committed to improvements throughout the organization, which includes ongoing expense management. While investors might expect operating expenses to increase in the quarter due to higher sales over last year, such that we have more shipping and sales commission and compensation expenses, which indeed was the case, our total operating expenses were down year-over-year.

Operating expenses decreased to $7.6 million for the 3 months ended July 31, 2020 from $7.8 million for the 3 months ended July 31, 2019 and $9.8 million in the first quarter of this year. Operating expenses as a percentage of net sales was 21.7% for the second quarter this year, compared to 28.3% for the same period of the prior year and 21.4% in the first quarter of fiscal

2021. In addition to the aforementioned factors influencing our operating expenses, there was reduced travel and marketing costs year-over-year due to COVID-19 limitations.

Lakeland reported record second quarter operating profit of $9.7 million in second quarter fiscal '21, up from $2.6 million in last year second quarter. Operating margins were 27.8% for our second quarter fiscal 2021, up from 9.6% in the second quarter of prior year and up from 27.1% in quarter one of fiscal 2021.

Despite the higher pre-tax income, overall income taxes decreased. Income tax expense consists of federal, state and foreign income taxes. Income tax expense was $423,000 for the second quarter of fiscal 2021 as compared with $1.2 million in the second quarter of fiscal 2020. The company's foreign earnings are subject to taxation under the Global Intangible Low-Taxed Income or GILTI regime.

During the second quarter, the GILTI regulations were modified with respect to the treatment of income subject to a high foreign tax rate and provided guidance on the treatment of these available exclusions. As a result of these modifications, the company will be able to amend past tax returns and capture certain NOLs that had been previously utilized. As a result of the recapture of these NOLs, the company recorded an estimated tax benefit of $1.6 million for the 3 and the 6 months ended July 31, 2020. Lakeland's NOL for federal tax purposes is estimated at $8.6 million as of July 31, 2020, down from $15 million at the beginning of the fiscal year after considering the GILTI modifications and estimated utilization in the first 6 months of fiscal year '21.

The second quarter fiscal 2021 net income was a record $9.3 million or a $1.17 per basic and a $1.16 per diluted share compared to net income of $1.4 million or $0.17 per basic and diluted share in the prior year. The improved results reflect higher sales, gross margins, expense management, enhanced operating efficiencies and factory utilizations and lower GAAP taxes. The company had 7,976,275 basic shares outstanding at July 31, 2020. Those shares were repurchased in the second quarter as part of the company's $2.5 million stock buyback program approved in July 2016. To date, $1.7 million has been spent to repurchase shares with over 800,000 remaining available under the buyback program.

As of July 31, 2020 Lakeland had cash and cash equivalents of $34.9 million, up from $23.5 million at April 30, 2020 and $14.6 million at the beginning of fiscal 2020. Inventories were reduced by $1.1 million from the beginning of the fiscal year due largely to a sale through of sealed seam finished goods into COVID demand. This product line remained slightly below normal stocking levels in all of our warehouses around the world, and we are now quoting deliveries into the fourth quarter for new orders in many cases.

As we have stated, we are servicing coronavirus orders only to the extent we have capacity beyond what is required to service our traditional customers and organic growth targets. We believe this process upholds our long-term growth strategies, supports our commitment to our customers and contributes to the COVID-19 response. As compared to the beginning of the fiscal year, accounts receivable at the end of the second quarter of fiscal 2021 increased by $2.5 million due to higher sales as DSOs remained steady at approximately 53 days.

Accounts payable and accounts accrued expenses increased by $5.3 million from the beginning of the year and shareholders' equity increased by $18.3 million. Total assets increased over $20 million from $99.4 million to $121.6 million. The company had no debt outstanding at July 31, 2020, no borrowings outstanding on its new $12.5 million revolving credit facility with Bank of America.

The new revolving credit facility agreement provides greater financial flexibility with reduced administration and can be expanded to $17.5 million if needed. In addition, the facility provides us with access to Bank of America's global platform for cash management. This facility and its enhanced features reflect our efforts to optimize all aspects of our business and financial operations aimed at better supporting our continued worldwide growth.

Working capital of $86.6 million at July 31, 2020 was increased from $66.9 million at the beginning of the fiscal year. Capital expenditures were approximately $500,000 during the second quarter of fiscal 2021, up slightly from $400,000 in the prior year period. CapEx for the year is expected to be $2 million as compared to $1 million in fiscal 2020 and $3.1 million in fiscal 2019. The majority of our CapEx in the current year is for strategic capacity increases as needed, enhancing manufacturing efficiencies and extending the phase global rollout of our ERP system.

Adjusted free cash flow in the second quarter of fiscal 2021 was $9.3 million, an increase of $7.7 million from the prior year period driven by higher sales margins and operating efficiencies as capital expenditures in both periods were relatively similar. Our fundamentals of growth, profitability and efficiency will survive beyond COVID-19.

That concludes my remarks. I'll turn the call back to the operator to open the call for questions.

Operator

And at this time, I'd like to turn the call back over to management. Thank you very much.

Charles Roberson

Thank you. We appreciate your participation on Lakeland's fiscal 2021 second quarter financial results conference call. As we look ahead to the balance of fiscal 2021, we continue to be well-positioned as the new standard of excellence for PPE manufacturers anywhere in the world. We look forward to sharing our exciting outlook as we meet with institutional investors at the Sidoti Virtual Conference on September the 24th, and the Craig-Hallum Virtual Alpha Select Conference on November the 17th. Thank you again for joining us on today's conference call and goodbye.

Source: SeekingAlpha