Lakeland Industries, Inc.

Q3 2021 Results Earnings Call Transcript

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Company Participants

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Conference Call Participants

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Operator

Before we begin, parties are reminded that statements made during this call contain forward-looking information within the meaning of the Securities Act of 1933 and the Securities Exchange Act of 1934.

Forward-looking statements are all statements other than statements of historical facts, which reflect management's expectations regarding future events and operating performance and speak only as of today December 10, 2020.

Forward-looking statements are based on current assumptions and analysis made by the company in light of its experience and its perception of historical trends, current conditions, including business affairs pertaining to the COVID-19 pandemic, expected future developments and other factors that believes are appropriate under circumstances.

These statements are subject to a number of assumptions, risks and uncertainties that are factored in the company's filings with the Securities and Exchange Commission; general economic and business conditions; the business opportunities that may be presented to you and pursued by the company; changes in law or regulations; and other factors, many of which are beyond the control of the company.

Listeners are cautioned that these statements are not guarantees of future performance and the actual results or developments may differ materially from those projected in any forward-looking statements. All subsequent forward-looking statements attribute to the company or persons acting on its behalf are expressly qualified in their entirety by these cautionary statements.

At this time, I would like to introduce your host for this call, Lakeland Industries Chief Executive Officer, Charles D. Roberson. Mr. Roberson, the floor is yours.

Charles Roberson

Thank you and good afternoon to you all. We appreciate you taking the time to join our Fiscal 2021 Third Quarter Financial Results Conference Call. I am joined here today by Lakeland's Chief Financial Officer, Allen Dillard.

We had a blowout third quarter, where I believe, we sent an indelible message to the global PPE marketplace, and hopefully to our shareholders and investors alike, that Lakeland is the source for protective apparel, not only during Black Swan events, but any time of any year when quality and delivery are critical.

Our production capacity, resiliency and flexibility are unparalleled and our production lines are expanding to generate long-term traction with customers around the world to drive sustainably improved profitability absent any Black Swan events such as COVID-19.

No discussion of our third quarter performance would be complete if we did not recognize the great links our global team has gone to in support of the healthcare community's defense against COVID-19.

While taking measures to ensure the safety and well being of our staff and their families, our partners and our customers around the world, we are fortunate to have a team that has repeatedly risen to the challenge.

Our ability to meet and surpass Lakeland's obligations as a global supplier of personal protective equipment for PPE during the COVID-19 pandemic has helped to alleviate PPE shortages and protected healthcare workers and first responders around the world.

As a result of the dedication of our people, the scalability of our manufacturing and efficiency improvements, we are unfortunately or fortunately depending on one's perspective, a significant beneficiary on the business front as a result of the pandemic.

Aside from our financial results being reported today, which may draw the attention of many, we realize that more important news relates to the FDA's review of the Pfizer/BioNTech and Moderna COVID-19 vaccine candidates. These are two of the vaccines that are under consideration for use around the world.

Regardless of which vaccines are used and when or where they are administered, we believe the requirements for PPE will remain intact. The vaccines will take about six months for initial patient injection and throughout that process, there will be demand for protective apparel for those administering the vaccine, as well as continued usage and dealing with the care of those infected and all associated cleanup and remediation activities.

When the COVID-19 crisis is behind us, which we believe may be substantially but not entirely the case by mid-2021. Lakeland will emerge with revenue and sustainable performance attributes. These include, number one, scores of new industrial customers.

Number two, a globally strengthened brand as a personal protective equipment manufacturer that can deliver quality garments in large quantities in times of industry shortage unlike anyone else.

Number three, an enviable position is perhaps the most global of any PPE manufacturer in the world that actually owns its manufacturing, setting us apart from the largest players in the market.

Number four, new higher margin products targeting large market segments, which have suffered unreliable delivery prior to the entry of our products.

Number five, our existing product lines outside of disposables and chemical suits, including wovens, FR garments, high visibility and other apparel are likely to see demand resurgence as customer spending allocations transition from COVID-19 to traditional industrial spending.

Number six lessons learned throughout the pandemic on how we can best utilize our investments in technology, manufacturing and product planning. This includes but it's not limited to our gross margin strategy.

Industry dynamics have put a face on PPE. No longer will it be a back office purchasing function. Now it is become a mainstream frontline necessity that is foregoing -- that is forging a new market opportunity in the form of institutional cleaning.

And number seven, a cash war chest that as of October 31, 2020, was over $4 million and growing.

Lakelands third quarter of fiscal 2021 further improved upon the record performance levels achieved earlier this year. We have demonstrated our ability to flex our global manufacturing capacity in response to surging PPE demand around the world during critical times.

The Lakeland brand is strengthening as our reputation for reliable delivery and quality continues to grow, as evidenced by the unprecedented number of direct container shipment orders placed with us from new customers and existing customers alike during the third quarter.

While we set a new standard of excellence for PPE manufacturers around the world at the end of our second quarter, in our third quarter, we raise that bar further. Through sustainable improvements and continued COVID-19 demand, our performance led to record Q3 levels of revenues, gross profit and margin, operating income and free cash flow.

On an all time quarterly basis, we set records for gross margin as a percentage of sales, operating income and margin, EBITDA and EBITDA margin and free cash flow. More importantly, we believe we will exit the COVID-19 era with critical market share gains, a brand synonymous with reliability and an enhanced visibility into sustainable improvements that are expected to significantly elevate our business performance from what was reported before the pandemic set in.

Global economic activity again recovering in the third quarter, which led to our traditional industrial business growing from the second quarter, even though our base revenues remained below pre-pandemic levels.

According to the Conference Board, the U.S. economy alone, which as a reminder has typically accounted for approximately 50% of our consolidated revenue, contracted 5% in Q1 of calendar year ‘20 and 31.4% in Q2 of calendar year ‘20. In the third quarter, there was a rebound of 33.1%.

And according to data from the Bureau of Economic Analysis, the BEA, the U.S. economy was 3.5% smaller in the third quarter of calendar year ‘20 than it was in the fourth quarter of calendar year 2019.

Our traditional core business consisting primarily of industrial markets was off by an estimated 19% globally in our third quarter as compared to the prior year period, but is expected to continue to improve from the lowest levels in our fiscal second quarter as COVID-19 sales taper off and industrial activity continues to improve.

Amid the sequential quarter improvement, our traditional industrial business growth continues to be eclipsed by PPE demand for the COVID-19 response. For the fourth consecutive quarter, we experienced increased demand for our products relating to COVID-19, an estimated 35% of our fiscal 2021 third quarter sales are related to COVID-19 demand.

Demonstrating our global diversification, revenues from our international markets outpaced our domestic growth. International sales in our third quarter increased by 19% sequentially from our second quarter and by 84% from the prior year period.

While total U.S. revenues grew 20% from the third quarter of the last fiscal year, we attribute this lopsided growth to greater opportunity and success in increasing market penetration in foreign markets, a development that will further diversify our sales as we move forward.

Demand for disposable and chemical garments remains heightened. This is evidenced by the number of new customers we have amassed over the past nine months and the significant increase in container sized orders in our third quarter, as we delivered product when many others could not.

Two key new product lines, for Critical Environment and High Performance Wear gained relatively meaningful ground. This is significant as they are part of our long-term strategy for continued revenue growth and sustainably higher gross margins.

The supply of product from manufacturers in key markets like the U.S. has been catching up with demand. We have been successful in navigating the demand profile to capture sales and pivot our manufacturing accordingly. Globally, pricing and order flow related to COVID-19 demand are expected to remain elevated from pre-pandemic levels are -- but are expected to decline through mid-2021. In the interim, the pricing power has been favorable for us.

Other factors that contributed to our third quarter results include increased direct container shipments, higher consolidated volume, continued improvement in manufacturing efficiencies and our product mix management. All of these factors led to our strong gross profit performance and we will continue to manage these areas to drive margins above our pre-pandemic levels.

For example, we anticipate our disposable and chemical SKUs will increase by approximately 50% from COVID response levels, as we settle into our post-COVID sustainable product mix strategy. The result will be a sustained reduction in SKUs of about 40%, which will result in the expected benefits to inventory efficiencies and ultimately profitability.

We have learned a lot during the past four quarters, which we believe will provide for sustainable growth in both revenue and profitability. SKU rationalization is critical to our sustain -- sustaining elevated financial performance in a post-COVID-19 business environment.

A reduction of underperforming SKUs and the launch of new higher margin product lines for critical environment and high performance ware are a few examples of our efforts. These higher value advanced product lines are unique within the industry, so we expect less global competition as compared to lower priced traditional disposable garments.

The target markets for both product lines are largely insensitive to economic trends and independent of COVID-19 response, and therefore, will serve as a solid platform for expansion of our core business product offering well into the future.

Also factoring into our forward revenue growth strategy is a new era of institutional cleaning and a broader acceptance of PPE, which has begun to emerge and may provide for a large permanent market opportunity.

Stockpiling requests for disposable and chemical apparel by government entities in U.S., Europe and other developing countries have already been made public. Because we own our own manufacturing and continue to invest in facilities, technology processes and personnel, we have gained significant ground and are poised to further benefit from this favorable market dynamics.

More than just record financial performance for the past two quarters, our results demonstrate a quality of earnings and cash flow, which has benefited from improvements and profitability measures, factory floor and distribution efficiencies and operating leverage. As we mentioned last quarter, COVID-19 provided us with a proving ground for change that will benefit Lakeland well into the future.

The sustainable leverage and scalability in our business which we have clearly demonstrated in the third quarter can be deployed not only in future Black Swan events, but because so many of our improvements have staying power we will utilize them to drive improved future performance.

With our cash in excess of $40 million at the end of the third quarter, we are primed for continued growth on a traditional basis and for any emergency situations that may arise.

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 Dillard

Thank you, Charlie. Net sales for our third quarter of fiscal 2021 were $41.5 million, up over 18% from $35 million in our second quarter of this year and 51% from $27.5 million in the same period of the prior year. For the sixth consecutive quarter, our revenues exceeded $27 million. For the past three quarters we have revenues in excess of $35 million.

On a consolidated basis for the third quarter of fiscal 2021, U.S. sales were $17 million or 41% of total revenues and the international sales were $24.5 million or 59% of total revenues. This compares with U.S. sales of $14.2 million or 52% of the total and international sales of $13.3 million or 48% of the total in third quarter of fiscal 2020.

The geographic dispersion remains similar to that of the second quarter of this year. Year-over-year third quarter sales were up significantly over the prior year period, as our business remains very well balanced and benefits from geographic diversification.

Third quarter year-over-year sales among our major international operations were as follows; in the U.K. $5.6 million this year versus $2.4 million last year; sales in Mexico more than doubled to $1.9 million from $0.9 million; sales in Asia were up 39% at $6.4 million from $4.6 million; sales in Canada were up over 60% at $4.2 million from $2.6 million last year; Latin America increased nearly 90% to $3.6 million from $1.9 million; and sales in other foreign markets were up 120% at $2.7 million from $900,000 a year ago.

As compared to the second quarter of this fiscal year, U.S. and all international markets except China were higher in the third quarter due to COVID-19 sales. As mentioned, sales for traditional industrial use by our mainstream customers were up from the second quarter when the pandemic shutdown factories adding to our non-COVID related sales was growth in our new market -- in our new product categories and our winning business from new customers for disposable and chemical product lines when they could not get supply from other manufacturers anywhere in the world.

Now let's look at our product mix diversification. Disposables, which continues to be our largest product group increased to $25.8 million from $23.8 million in the second quarter of this year and $12.5 million in the third quarter of last year; chemical suits were $9.7 million from $6.2 million in the second quarter of this year and $5.7 million in third quarter of last year. Both product groups benefited from organic growth, but the primary driver was COVID-19 demand; fire products declined to $1.6 million in third quarter of this year from $1.7 million in second quarter of this year and $2.8 million in third quarter of last year; gloves were $0.5 million in third quarter of fiscal 2021, flat with the second quarter this year, but lower than point $0.7 million in the third quarter of fiscal 2020; high visibility products of $1.4 million was higher than $1 million in second quarter of fiscal 2021, but lower than third quarter of fiscal 2020 of $2.2 million and wovens also were higher at $1.7 million versus $1.3 million in the second quarter of fiscal 2021, but lower than $2.9 million in third quarter fiscal 2020.

All of these markets reflect the COVID-19 impact on economic activity with the second quarter of fiscal 2021 bottoming due to temporary closure of many industrial businesses, particularly in the automotive and transportation sectors and the oil and gas sector, which has remained under pressured due to the price of oil.

High performance ware one of our newer product lines contributed $740,000 to the third quarter fiscal 2021 sales, up from $500,000 in this year second quarter and $600,000 in the third quarter of fiscal 2020.

As was the case in the first half of the year, we believe PPE purchasing continues to be focused, if not refocused in the third quarter, the pandemic efforts at the expense of certain traditional industrial usage. This pattern has appeared to ease during the third quarter with further improvement going into the fourth quarter.

Moving to gross profits. Gross profit of $21.7 million for the third quarter of this year increased by $12.4 million or 133% from $9.2 million for the same period last year. Gross profit as a percentage of sales was 52.3% for the fiscal 2021 third quarter, a company record for any quarter and an increase of over 18 percentage points from 39.3% last year. As compared with the second quarter this year, when revenues were $35 million and gross profit was $17.3 million, our third quarter gross margin increased by 2.8 percentage points.

The key drivers for our gross margin improvement over the 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 a higher margin specialized product lines.

As compared to the second quarter of this year, our third quarter gross margin benefited from even higher revenues and more direct container sales, which drove incremental manufacturing efficiencies.

We have begun to resume production of a small amount of disposable and chemical SKUs or product variations that had been curtailed or eliminated in the first half, more will be added back in during the fourth quarter and some thereafter, but we expect 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 that we have realized and the resulting impact on margins.

Ultimately, we will offer fewer products than we did prior to COVID and the majority of those eliminated are lower selling lines and less profitable products. Although, the streamlining has led to reduce customer lead times, more efficient and higher volume manufacturing, stronger growth margins and improved inventory turns.

Similar to the first half of the year, we have been running our factories that make disposable and chemical products at near maximum capacity, a schedule of 12 hours per day and six days per week. As a result during the third quarter, we were once again able to deliver products when our competitors many of whom used third-party contractors could not.

Our ability to provide timely delivery of product enabled us to convert new customers to Lakeland lifelong products. During the second quarter we saw 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.

In the third quarter, we experienced even more container sale -- container − direct container orders to accommodate the increased order flow, as well as growth in newer, higher margin products and reintroduction of certain SKUs we added nearly 100 staff members to our manufacturing facilities. Our factories have been reducing the amount of time when they are running at near maximum capacity during the fourth quarter.

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.

OpEx increased due to higher sales and volume incentives resulted in greater sales commission, compensation expenses, due to the higher container load shipments freight out was reduced. We also had lower travel and marketing expenses from COVID-related restrictions.

Bad debt reserve reduced while we incurred some higher professional services fees associated with the upgrade and extension of our ERP system, which helps improve our margins and efficiencies.

Operating expenses of $9.2 million in our third quarter were up from $7.5 million in the same quarter last year, with the most notable increase relating to a $700,000 non-cash expense or recapture of stock-based compensation dating back to 2018 grants.

The company had previously reverse stock-based compensation expense for equity awards that were granted in 2018 and prior years, as it was estimated at the time that the company was not likely to meet the performance threshold required for vesting.

Based on FY '21 performance today and associated benchmark achievements, this estimate was revised, and accordingly, the company recognized the stock option expense associated with these awards in the third quarter.

Operating expenses as a percentage of net sales was 22.2% in our third quarter, as compared with 21.7% for the second quarter this year and 27.2% for the same period last year. Lakeland reported record third quarter operating profit of $12.5 million, as compared with $9.7 million in the second quarter of fiscal 2021 and $1.8 million in last year's third quarter. Operating margins were 30.1% for our third quarter, up from 27.8% in our second quarter and 6.7% in the prior year.

EBITDA margin which excludes non-cash expenses such as the catch up on stock-based compensation was 33.5% in our third quarter, up from 30.6% in our second quarter and 7% in the third quarter of fiscal 2020.

Free cash flow for the quarter grew to a record $12.6 million, up from $9.3 million in our second quarter and $1.1 million in the third quarter of fiscal 2020.

Overall, taxes increase due to higher operating income, income tax expense consists of federal, state and foreign income taxes. With an income tax rate of 25.9%, our income tax expense was $3.2 million in the third quarter of fiscal '21, up from $423,000 for the second quarter of fiscal 2020, when the tax rate was 4.3% and $700,000 in the third quarter of fiscal 2020, with a tax rate of 36.3%.

It is estimated that Lakeland's NOL for federal tax purposes will be fully utilized during FY '21. The estimated NOL for state purposes is estimated to be approximately $20 million at October 31, 2020.

The third quarter fiscal 2021 net income was $9.3 million or a $1.16 per basic share and a $1.14 per diluted share, compared to net income of $1.1 million or $0.14 per basic and diluted share in the prior year. The improved results reflect higher sales and gross margin, expense management, enhanced operating efficiencies and factory utilization, all of which was partially offset by higher GAAP taxes and the non-cash stock-based compensation expense.

The company had 8,019,980 basic shares outstanding at October 31, 2020. No share for repurchase in the third quarter as part of the company's $2.5 million stock buyback program approved on July 19, 2016. To-date $1 million has been spent to repurchase shares with approximately $800,000 remaining available under that buyback program.

As of October 31, 2020, Lakeland had cash and cash equivalents of $40.2 million, up from $34.9 million at July 31, 2020 and $14.6 million at the beginning of the fiscal 2021.

Inventories were $44.9 million at October 31, 2020, marginally higher than at the beginning of the fiscal year. With an increase of raw materials of over $2 million, we had an ending inventory with $6 million of finished goods product in transit. Upon conversion, we look forward to our cash balance further increasing.

As compared to the beginning of the fiscal year, accounts receivable at the end of the third quarter of fiscal 2021 increased by $9.2 million due to higher sales, as DSOs remained steady at approximately 53 days. Accounts payable and accrued expenses increased by $5.2 million from the beginning of the year and shareholders' equity increased by $28.5 million.

Total assets increased nearly $33 million from $99.4 million to a $132.3 million, which also is an increase of nearly $13 million from the end of second quarter fiscal 2021. The company had no debt outstanding at October 31, 2020, and no borrowings on its $12.5 million revolving credit facility with Bank of America.

Working capital was $98.7 million at October 31, 2020, was up from $86.6 million at July 31, 2020 and $66.9 million at the beginning of the fiscal year. The company's current ratio improved to 6.7 to 1 at October 31st, up 8.9% from January 31, 2020.

Capital expenditures were approximately $600,000 in the third quarter, up from $500,000 in the second quarter and $100,000 in the prior year period. CapEx for the year is expected to be approximately $2 million, as compared with $1 million in fiscal 2020 and $3.1 million in fiscal 2019. The majority of our CapEx in the current fiscal year is for a strategic capacity increases as needed, enhanced manufacturing efficiencies and extending the phase global rollout of our ERP system.

On manufacturing infrastructure alone, our plans call for continued investments to increase production capacity of new product lines in Vietnam, India and Mexico. Expansions will be fungible between our primary product lines or disposable chemical and critical environment, which supports our manufacturing resiliency and flexibility and complements existing methods of factory floor efficiencies aided by our ERP systems and data centric planning processes.

Outside of the U.S., our ERP system deployment will continue on a country-by-country basis among our larger international operations during the next 12 months to 24 months. Thus, along with our topline growth initiatives, we expect to extract even greater profitability from our international operations roughly half of our total business in the years ahead.

In fiscal 2021, year-to-date we generated $30 million of free cash flow or 10 times the amount from last year against the current enterprise value of about $120 million. This shows tremendous performance and value for our shareholders.

We are incredibly proud of our expanding global team. While we had a really strong third quarter, we are poised for continued growth outside of COVID-19, while significantly benefiting from the pandemic as we continue to deliver for the global healthcare community, as well as our industrial base of customers.

Now this concludes my remarks. I will turn the call back to the Operator to open the call to questions.

Operator

That was our final question. So I'd like to turn the call back over to you, Mr. Roberson.

Charles Roberson

Thank you. We appreciate your participation on Lakeland's fiscal 2021 third 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. Thank you again for joining us on today's conference call. Have a nice day.

Source: SeekingAlpha