

Lakeland Industries, Inc. (NASDAQ:[LAKE](#))

Q4 2021 Earnings Conference Call

April 15, 2021 4:30 PM ET

Company Participants

Charles Roberson - Chief Executive Officer

Allen Dillard - Chief Financial Officer

Operator

Before we begin, parties are reminded that statements made during this call contain forward-looking information within the meanings 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, April 15, 2021.

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, expect 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 into 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.

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At this time, I would like to introduce you to 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 your taking the time to join our Fiscal 2021 Fourth Quarter Financial Results Conference Call. I'm joined here today by Lakeland's Chief Financial Officer Allen Dillard. Lakeland's Fiscal 2021 has proven to be the most complex, yet most rewarding year since our founding in 1982. In our nearly 40 years, we have been through many black swan crisis situations, never have we emerged from any of those prior events with consolidated annual revenues in excess of \$100 million. And none of them could have adequately prepared us for the COVID-19 global pandemic.

Having an entire year of COVID-19 behind us, I would like to begin our Fiscal 2021 year-end earnings call with a brief review of the year in order to put our financial performance into context with regard to Lakeland's current strategies and outlook for Fiscal 2022.

At the onset of the COVID-19 outbreak, we put in place a strategy, dedicating our manufacturing capacity to our industrial customer base and serving the COVID-19 market only to the extent that we had capacity beyond the requirements of our core customers. Knowing that black swan events frequently leave industrial end users short of products they need to carry out their work safely. Lakeland sought to secure a new every day industrial customers and increase market penetration before pursuing sales into what we knew would be a transient COVID-19 market.

Focusing on servicing our existing customer base first not only provides for increased market penetration, but it ensures that capital and resources invested in expansion are directed toward long-term growth and not ephemeral opportunities like mass manufacturing. This was a key lesson learned from the West Africa Ebola outbreak in 2015 and 2016.

Our sales to new customers increased market penetration with existing customers and orders for direct COVID applications are largely indistinguishable from one another because we sell through distribution, which clouds transparency as to the end user and application in most cases. [Indiscernible] all three cases are related to COVID-19 either for direct use, or as a result of supply issues caused by the pandemic.

Consequently, when we report that COVID-related sales account for 30% to 35% of our Fiscal Year 2021 revenue, that figure includes our increased market penetration from new and existing customers, as well as direct COVID sales. Sales to new and existing customers that increase market penetration were our first priority, precisely because these sales are stickier than direct COVID sales and therefore result in increased potential for long term growth post COVID-19.

For Fiscal Year 2021, our strategy worked incredibly well. Lakeland booked sales to over 500 new customers, both distributors and/or end users globally. Say also these news new customers were in excess of \$12 million, of which we believe approximately 80% have the potential to result in ongoing post COVID business. These figures relate to new customers only and do not include increased COVID-related sales to our pre-existing customer base that may also continue post pandemic.



Having successfully executed our pandemic strategy, we believe that even though our COVID-19-related sales are approximately 30% to 35% of our record \$159 million in revenue for Fiscal Year 2021, our Fiscal Year 2022 revenue will not decline proportionally to declines in COVID-19 sales in the coming year. In fact, we believe that by focusing on the industrial market early on and throughout the pandemic, we will emerge post-COVID-19 well-positioned with a larger book of business composed of fewer products, which provides ancillary benefits that improve margins and operational efficiencies.

This outlook, when combined with projections for economic growth worldwide, should serve to minimize the impact of any overstocking or price pressures that we encounter. All told, we're relatively excited about our progress and our strengthened position in the global PPE market. We are grateful for the perseverance and dedication of our global workforce, which increased by nearly 10% during the year to over 2,000 personnel. This team has led the company to unprecedented growth and improvement in operating performance in Fiscal 2021 while remaining steadfast in its efforts to provide a healthy and safe work environment in the workplace for our customers, and business partners and our families. After all, the company's slogan is 'protect your people', so it comes with the territory.

Following an unprecedented and historic year for Lakeland, we'd like to discuss how the COVID-19 pandemic provided a launching pad for the company to set itself apart within the PPE industry and provided us with the opportunity to create sustainable improvements in our business. Numerous financial performance records were achieved in fiscal 2021. We reached record annual revenues, gross profit, operating profit and net income among other key metrics. More importantly, we demonstrated the resiliency of our operations, our global supply chain and the sustainability of our improved financial model, which positions us well for a post COVID-19 business environment.

Revenues of \$159 million for the year grew by 47%. Our consolidated revenues have increased for the fourth consecutive year with Fiscal 2020 being our previous record year at \$107 million in revenue in Fiscal 2021, far exceeding that record. Gross margin as a percentage of sales was a record 49.8% for the year. Operating profit benefited from the leverage in our business by increasing 650% for the year, while operating expenses increased only marginally by 10%.

Throughout the year, Lakeland was able to flex its manufacturing unlike other PPE providers in the world. We showed how owning and operating your manufacturing facilities is a sustainable, strategic advantage and the cornerstone to build a resilient supply chain. Having multiple manufacturing locations around the world, coupled with sourcing, core raw materials from a diversified base of suppliers affords Lakeland capabilities and manufacturing resilience that cannot be matched by our competitors who used contractors.

Owning our manufacturing provides us with the ability to rapidly scale up production to meet emergency demand, to shift production between locations to take advantage of new trade agreements, or avoid complications that may arise from trade and geopolitical disputes. And to maintain the highest levels of product quality while doing so.



This superior competitive positioning was validated during the COVID-19 pandemic. Through this event, Lakeland was able to rebalance manufacturing and its facilities and make use of its diversified supplier network to deliver products to its traditional customers and new customers alike without major interruption. Importantly, not only did we expand manufacturing capacity during the year through capital investments, we were also able to increase our output through improved efficiencies, including SKU reductions and other data-centric planning decisions. This is another lesson learned and a critical advantage for owning your manufacturing operations.

As a result of our successful campaign during the most challenging of global business, social and healthcare scenarios that we may see in our lifetime, our brand value has been magnified. On this global scale, we provided high quality garments at competitive prices through our manufacturing facilities at strategically beneficial locations; we experienced double digit growth in sales in all seven of our global sales regions, with Fiscal 2021 domestic revenues increasing 26% while our international sales regions increased by an impressive 70%.

Our customer count grew during the year with the addition of over 500 new distributors and/or end users. Most of these accounts are traditional customers who are not ordering for pandemic defense purposes. Our competitors, who came out of the woodwork during the pandemic with low cost and low quality products did not fare as well. The importance of owning your manufacturing is significant in terms of quality control and supply chain management. And this should play to our advantage given the recent events. A story that seems to have been kept quiet except for reporting by Bloomberg last month, addressed the U.S. Strategic National Stockpile authorities' removal of 25 million of 26 million isolation gowns from its inventory while experts determine if they meet the Association for the Advancement of Medical Instrumentation, or AAMI Level 2 standard as required. The U.S. stockpiling effort resulted in the purchase of more than 80 million isolation gowns from a variety of untested companies toward the end of Fiscal 2020.

Lakeland did not jump into this fray, so none of our garments were in the isolation gown stockpile. We only recently completed our product development process, assuring, as with all Lakeland products, that this product meets the required standards for both performance and ongoing quality control. According to the report, an independent health and safety organization found that half of the set of disposable hospital gowns that tested didn't meet the minimum barrier requirements specified for Level 2 protection by AAMI. The decision to pull the gowns for further testing follows concerns raised over the government's contracting processes and safety of personal protective gear, critical for workers on the front lines. With our strong global presence and quality manufacturing, will be able to replace and meet new requirements for virtually any country's stockpiling efforts.

The progress made in Fiscal 2021 sets the stage for Lakeland to exit the COVID-19 era with market share gains, a strengthened domestic and international brand, and an enhanced visibility into sustainable improvements that are expected to significantly elevate our business performance from what was reported prior to the pandemic onset. The company's positive trajectory may further benefit from the data driven and technologically-enhanced culture we have



embraced. We are no longer a \$100 million company with a \$1 billion footprint. We are now \$159 million company seeking to grow into its footprint.

Some other organizational moves made during the year that facilitate long-term growth include a new post we created and filled for the company's first executive to lead a coordinated global sales, marketing and customer service strategy. And we appointed our first Global Supply Chain Manager to further enhance our manufacturing resilience and flexibility.

With these enhancements and additions, we'll be better-suited to address the long-term opportunities for the PPE market as well as the near-term global pandemic which will likely continue to impact our business for the first half of Fiscal 2022. We anticipate decreased demand for direct COVID applications being largely offset by a continuation of increases in our core industrial businesses that began in Q2 of Fiscal Year 2021. This upward trend continued through Q4 of Fiscal Year 2021.

Through the second half of Q2, and through the end of the fiscal year, our core business sales have been recovering steadily. Based on recent reports on economic growth, and our increased market penetration in new customers, we expect our core business sales to not only recover fully, but to exceed pre-pandemic levels and continue to grow through Fiscal Year 2022. We anticipate the COVID-19 related sales will continue into the first half of Fiscal Year 2022, however, not at the levels experienced in Fiscal Year 2021. As demand for immediate use diminishes and gives way to stockpiling demand, and increased core business sales.

While leading economic indicators suggest a relatively robust industrial market recovery, potential headwinds to revenue as we emerge from the pandemic sales include customer stockpile inventories, as well as a potential decline in the oil and gas and industrial sector and pricing pressures. But these are expected to be more than offset by growth from other vertical markets and new products where we are progressing with proprietary high margin PPE gear.

Additionally, we have initiated a major strategic company-wide objective to accelerate growth by marketing products and using sales tools that have proven successful in the key U.S. and China markets to other international operations, which have traditionally more limited product offerings. To facilitate this, the company is evaluating and redeploying sales and marketing assets into regions that have seen the most significant increases in market penetration as a result of our COVID response strategy. We have integrated the U.S., Canadian and Mexican sales teams into one coordinated unit, a strategic recognition that the three countries are increasingly part of a greater North American market with interrelated industries and companies throughout, and our sales teams are sharing opportunities with each other.

In Fiscal Year 2021, we began installation of Salesforce CRM software to facilitate this strategy globally. Our marketing efforts are being significantly upgraded in terms of personnel and technological resources, better sales collateral materials, and increasingly effective use of social media. The company plans to continue its efforts to align its global markets in terms of sales, collateral sales software, and ecommerce in the coming year and beyond.



These developments are consistent with our continued vertical alignment of our operational functions which are intended to provide agility within business disciplines to capitalize on market opportunities while yielding productivity efficiencies and generating improved returns for capacity expansions at our production facilities. Each of these focus areas complements the others and collectively when combined with the continued investment in our ERP system, Salesforce roll out and data centric planning processes is expected to serve as a catalyst for continued growth, while providing greater productivity, efficiencies and profitability.

Much of our technology investment has only been partially implemented with the balance directed at our international operations. Leveraging this base, our growth plans call for continued investments to increase production capacity in Vietnam, India and Mexico. To the extent possible, we will be investing in near-shoring certain manufacturing to shorten lead times, add customer value and improve inventory turns. All capacity expansions will be fungible between our primary product lines for disposable, chemical and critical environment, one of our more recent garment lines, which grew during the year and contributes to our efforts to increase gross profits with differentiated PPE.

In the most challenging business climate in decades, we are pleased to have exited Fiscal 2021 far better positioned than how we entered. We did not simply respond to the crisis, we used it to our advantage. Our prospects may be further bolstered by the burgeoning of a new era of institutional cleaning and a broader acceptance of PPE globally, which has begun to emerge and may provide a larger permanent market opportunity.

Now as we enter Fiscal 2022, Lakeland has a road map to drive top line growth ex-COVID while meeting the needs of its expanding customer base, optimizes manufacturing and supply chain and deploy its substantial capital base to deliver solid returns for shareholders. With our cash, cash position of nearly \$53 million at the end of Fiscal Year 2021 and our continued outlook for free cash flow generation, we are able to pursue both organic and inorganic opportunities.

While new product introductions and increased market penetration as a result of the pandemic will position us well for organic growth, the cash it generated makes inorganic growth very attractive. To that end, Lakeland is currently in the process of adding an in-house corporate development function to seek out acquisition opportunities as they emerge in a post-pandemic world. Key to this strategy will be identifying candidates that are not only accretive, but it can be integrated without delaying or impairing our ability to continue the roll out of our technological and process development.

Additionally, after the end of the year, our board authorized a \$5 million share repurchase program, which leaves more than enough capital to engage in our growth pursuits and continued investments in our global platforms. All of this has set the stage for an exciting Fiscal 2022, with Lakeland as the new standard of excellence for PPE manufacturers around the world.

That concludes my remarks. I will now pass the call to Alan to provide more insight into the company's financial results.



Allen Dillard

Thank you, Charlie. From a financial results perspective, Fiscal 2021 was an incredible year. For the seventh consecutive quarter, our revenues exceeded \$27 million. For each of the past four quarters, our revenues have been in excess of \$35 million. Our Q4 press release and 10-K will provide a detailed review of our financial performance. Rather than repeat that, I'd like to talk today about some of the more important issues that shaped the year's performance and provide the framework for the future.

We believe we will exit the COVID-19 era with critical market share gains and an enhanced visibility into sustainable improvements. Collectively, we envision these elevating our business performance from what was reported before the pandemic set in. One critical area has been at fixed [ph] management through investments in manufacturing facilities and IT systems. Charlie touched upon this and I'll talk further to it, particularly as it impacts inventory.

We continue to diversify our raw material and component suppliers, qualifying multiple suppliers whenever possible to enable us to press for price reductions and better payment terms as well as providing for continuity of supply. We are sourcing raw materials and components from most of the countries in which we have operations in order to reduce freight costs and inventory levels. The insights gained from managing the complexities brought on by the pandemic, through our ERP system have proven to be extremely valuable.

We are re-engineering many products to harmonize designs to meet the requirements of multiple global markets, while reducing the raw materials used and reducing the direct labor required as much as possible, thereby eliminating a number of SKUs based on local search or preferences. The result is improved manufacturing throughput and reduced inventory levels. Disposable and chemical SKUs are expected to increase by approximately 50% from COVID response levels as we settle into our post-COVID product mix strategy. The result will be a reduction in SKUs of about 40% from pre-COVID and benefits our inventory efficiencies.

Sustainable improvements are being realized from these ongoing efforts. Early benefits were improved pricing strategies and international market entry while more recently, we have benefited from IT-driven decision making. Consider that our gross profit as a percentage of sales was 27.7% in Q4 2019, followed by 37.7% in q4 2020, and then increasing to 49.2% in Q4 2021. That's an improvement of over 20 points in two years. At present, raw material supply appears to have caught up with demand, albeit at prices above pre-COVID-19 pricing. We anticipate raw material pricing to continue at inflated levels through most of our FY 2022. As noted we did experience significant price increases for fabric during FY 2021 and managed through our available manufacturing capacity to lower cost and increased pricing to meet customer demands at these higher prices.

Customers responded and have to drive our record performance as we saw growth in sales from our diversified geographic footprint and focused product offering. For the year, U.S. sales were up 26% to nearly \$71 million; internationally, UK European sales were up 80% to \$16.8 million;



Mexico's sales were up over 100% to \$5.7 million; Asia sales were up 71% to \$31.2 million; Canada sales were up 42% to \$13.6 million; Latin America sales were up 45% to \$12.1 million in sales; and other foreign markets were up 147% to \$9 million. Sales for traditional industrial use by our mainstream customers were up from the second quarter, following pandemic shutdowns of factories and also up from the third quarter. We have been winning business for new customers for disposable and chemical product lines when they could not get supply from other manufacturers.

In terms of our product mix diversification, disposables, which continues to be our largest product group, increase to nearly \$108 million for the year, up from \$53 million in Fiscal 2020. Chemical suit sales were \$29.1 million, up from \$23 million in the prior year. Both disposables and chemical product groups benefited from organic growth, but the primary driver was COVID-19-related demand. As businesses redirected ordinary purchasing to COVID defense related products, sales in our other product categories declined. We saw improvement as the year progressed. Fire products declined to \$6.2 million in Fiscal 2021 from \$8.6 million in Fiscal 2020. Gloves were \$3 million in Fiscal 2021, down from \$3.1 million in Fiscal 2020.

High vis [ph] products were \$4.1 million, which was down from \$7.8 million in Fiscal 2020 and wovens were \$7.1 million versus \$10.3 million in Fiscal 2020. High Performance wear, one of our newer product lines with higher margin contributions to the complexity of the garments contributed over \$1.7 million in sales, versus \$1.6 million in the prior year. Operating expenses as a percentage of net sales was 22.1% for Fiscal 2021, as compared to 29.7% for prior year. Operating margins were 27.8% for Fiscal 2021, up from 5.5% in the prior year. With respect to our SG&A expenses, we certainly spent more in Fiscal 2021 than in the prior year, since sales commissions and freight out cost increased on the higher order levels. We've been actively managing our expenses and driving cost out of the business through investments in technology, and process improvements.

During Fiscal 2021, we entered into an agreement with Bank of America for a new borrowing facility. This required the pay down of prior facility, so we eliminated our remaining debt of \$1.2 million during the year. The B of A facility consists of a senior secured \$12.5 million revolving credit facility, which includes \$5 million Letter of Credit sub-facility, and an option to convert up to \$5 million of the facility into a term loan facility. The facility also includes an accordion feature under which the company may request from time to time, an increase in the revolving commitment of about \$5 million for a total commitment of up to \$17.5 million.

We have aligned the size of our new credit facility to reflect our current capital requirements, while incorporating expansion flexibility. At the same time, we received improved pricing, decreased administration, and will have 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, including being used to augment our financial toolbox as we seek opportunities to deploy capital to fuel organic and inorganic growth.



With a substantial increase in operating profits, our tax expense also increased. Income tax expense consists of federal, state and foreign income taxes. With an income tax rate of 19.9% in Fiscal 2021, our income tax expense was \$8.7 million, up from \$5.8 million in Fiscal 2020. Lakeland's net operating loss for U.S. Federal Tax person purposes will be fully utilized during Fiscal 2021. The net operating loss for state purposes, is estimated to be approximately \$22.7 million at January 31, 2021 across multiple jurisdictions.

Net income for Fiscal 2021 was \$35.3 million, or \$4.40 per basic share and \$4.33 per diluted share, compared to Fiscal 2020 net income of \$3.3 million or \$0.41 cents per share. No shares were repurchased during Fiscal 2021 as part of the company's stock buyback program. The company did increase the amount available under this program to \$5 million, which we announced in February to increase our flexibility. Free cash flow from operations for the year grew to a record \$39.4 million, up from \$3.6 million in Fiscal 2020. The company's cash position grew with each successive quarter in Fiscal Year 2021. Our cash balance at January 31, 2021, was a record \$52.6 million, an increase of \$38 million from the end of the prior Fiscal Year. While our market capitalization doubled during the course of the year, cash per basic common share increased to approximately \$6.58 at January 31, 2021, from \$1.83 per share at the end of Fiscal 2020.

Lakeland is relatively asset-light business with capital expenditures for Fiscal 2021 of under \$1.7 million, as compared with \$1 million in the prior year. The majority of capital spending in the year was for investments in our technology platform and manufacturing capacity increases. Our CapEx spending is expected to continue to increase in Fiscal 2022 for continuation of our IT investments, expansion of our sales and marketing platforms and additional manufacturing capacity. The company's future manufacturing investments call for increases in production capacity of new product lines in Vietnam, India and Mexico. We continue to create flexibility [ph] among our production facilities for our primary product lines, which include disposables, chemical and critical environment. These objectives support our manufacturing resiliency and flexibility and they also complement the existing methods of factory floor efficiencies yielded 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 9 to 21 months. As a result and based on our experience to date, we expect to extract even greater efficiency from our international operations, which comprises roughly half of our consolidated revenues and will be incremental to our top-line growth initiatives. After paying off our debt and funding capital investments, the increase in cash of \$38 million was primarily a result of increased profitability, improved working capital efficiencies, including AR collections and inventory management that resulted from our investment in our IT systems. This led to an increase in inventory terms. Inventory decreased \$0.4 million during the year even as sales grew, unit volumes increase, our customer base for disposable and chemical garments grew, and certain of our other product lines experienced lower year-over-year demand due to purchasing priorities amid the pandemic. As mentioned, we ended the year with no debt and full availability under our borrowing facilities.



Working capital was \$108 million at January 31, 2021, up from \$66.9 million at the beginning of the fiscal year. The company's current ratio improved to 7.8 to 1 [ph] in January 31, up 26% from January 31, 2020. More than just numerous record financial performance metrics throughout Fiscal 2021, 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 throughout the past year, COVID-19 provided us with a proving ground for change that will benefit Lakeland well into the future.

This concludes my remarks. I will turn the call back to the operator to open the call for questions.

Operator

[Operator Instructions] There seems to be no further questions at this time. So, I would like to turn the call back over to Mr. Roberson for any closing comments.

Charles Roberson

Thank you. We appreciate your participation on Lakeland's Fiscal 2021 Fourth Quarter Financial Results Conference Call. As we look ahead to Fiscal 2022, we continue to be well-positioned as the new standard of excellence for PPE manufacturers anywhere in the world with an incredibly strong balance sheet and an optimized operating platform with further room for improvement. We're excited for the new year. Thank you again for joining us on today's conference call and have a nice day.

Operator

With that, this concludes today's teleconference. You may now disconnect your lines at this time. Thank you for your participation and have a wonderful day.

