

Lakeland Industries, Inc. (NASDAQ:[LAKE](#)) Q3 2022 Earnings Conference Call December 9, 2021 4:30 PM ET

Company Participants

Charles Roberson - President and CEO

Allen Dillard - CFO

Conference Call Participants

Alex Fuhrman - Craig-Hallum Capital Group.

Operator

Before we begin, parties are reminded that statements made during this call contained 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, December 9th, 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, the COVID 19 pandemic and subsequent variance expected future developments and other factors that management believes are appropriate under circumstances.

These statements are subject to a number of assumptions, risk and uncertainties that are factored into the Company's filings with the Securities and Exchange Commission, including 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 that actual results or developments may differ materially from those projected in any forward looking statements. All subsequent forward-looking statements attributed to the Company or person acting on its behalf are expressly qualified in their entirety cautionary statements.

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. I'm joined here today by Lakeland's Chief Financial Officer, Allen Dillard. We appreciate you taking the time to join our fiscal 2022 third quarter financial results conference call. In our fiscal 2022 third quarter, Lakeland reported another quarter of

consistently strong financial performance, further reinforcing the sustainability of the improvements that we have made to our business over the past two years.

Revenues exceeded \$30 million for the quarter, an increase of 9% sequentially from the second quarter. We maintained our gross margin improvement over pre-pandemic margins and continued to exercise discipline in our operational expenses resulting in another profitable quarter.

Concurrent with these efforts we developed and implemented strategies to mitigate current business threats and prepare for our long-term growth and sustained profitability. We increased our finished goods and raw materials inventories, bringing them in-line with anticipated lead times to mitigate threats posed by increasing freight costs and supply chain disruptions.

We continued moving forward with our planned near market manufacturing expansion that will be re required to meet future growth targets and to improve product lead times. We made a strategic investment in the Connected Worker Market that we believe to be one of the fastest growing segments in worker safety. And we repurchased approximately \$900,000 of outstanding shares.

Allen will provide greater detail about these developments and his comments, but we take pride in the fact that all of this has been accomplished amid the volatility and global business conditions resulting from the COVID 19 pandemic and its variance.

In fact, we experienced this volatility in the third quarter. Previously, we anticipated that COVID driven sales would continue to diminish quarter-over-quarter as the pandemic ran to its conclusion. But this is not the case in Q3, third quarter fiscal year '22, COVID 19 sales were in estimated \$6 million or 20% of revenue, compared to our second quarter fiscal year '22 COVID sales of \$3.5 million or 13% of revenue. This is a significant deviation from our expectation for a continuous decline in pandemic related sales.

We attribute this variance to regional differences in COVID 19 preparedness and response. Our third quarter saw a wave of COVID outbreaks in Southeast Asia that resulted in greater pandemic driven sales than we had in the previous second quarter, which was the height of the Delta variant outbreak in the U.S. As a result, we now anticipate that COVID 19 outbreaks in developing regions of the world are likely to generate greater pandemic related sales due to lower vaccination rates, less access to therapeutics and lower quantities of PPE stocking or stockpiling.

In developed regions of the world like North America, Europe, and other regions, where access to medicine and healthcare is better and stockpiles are larger, we believe demand will be lower and less urgent, if not consuming product that is already in the distribution supply chain. Additionally, we anticipate there will also continue to be a difference in the use of shutdowns and regional quarantines between the developing and developed regions of the world.

Absent more robust healthcare systems, developing regions have little choice, but to lean more heavily on shutdowns and regional quarantines to stem the spread of outbreaks. Greater access to

testing vaccines therapeutics and medical care makes developed regions of the world less dependent on quarantines and lockdowns.

The use of shutdowns in Southeast Asia during the third quarter of fiscal year '22 resulted in flat quarter-over-quarter, non-COVID sales. More recently with the discovery of the Omicron variant, we have noted that while use of shutdowns and developed regions of the world is frequently discussed, there is an increasing resistance to putting them in place, allowing industrial recoveries to continue without significant interruption.

We believe this trend will likely repeat itself as the pandemic runs to conclusion. This does not change our strategy in terms of pandemic response and traditional industrial growth. We are well positioned to address spikes and demand for COVID 19 PPE around the world, having adjusted our inventory levels to accommodate longer lead times, we can respond quickly and without delay to any additional outbreaks as they unfold and given how significantly the distribution of our geographic sales favours developed regions of the world.

Approximately 57% of our year-to-date for through the third quarter sales were into the U.S., Canada and Europe. We believe our projections for recovery of the industrial market and our subsequent sales projections remain accurate. This being the case, we now regard COVID 19 outbreaks as additive to our sales and growth projections. And we have the inventory and manufacturing capacity to service both spikes and COVID demand and industrial market growth.

In the second quarter of fiscal year '22, we reported excess inventories accumulating within the U.S. distribution channels this negatively impacted Q2 and Q3 revenues. During the third quarter of fiscal year '22 distribution channel inventory levels in the U.S. continued to correct themselves, based on with key distributors and on available data sales and order data.

We believe that one more quarter of correction will be required before sales begin to return to normal rates in the U.S. In the latter half of Q3 fiscal year '22, we saw a similar situation emerge in our European markets and received confirmation from several of our -- several of our larger distributor partners. It is too early to determine if this will be a recurring event, it will also emerge in China and then other parts of the world. Or if this event is driven by the length of the supply chains, we will monitor the situation going forward.

But either way we believe the impact of our -- on our consolidated sales will diminish as the U.S or North American more markets represent approximately 50% of our consolidated fiscal year-to-date sales and is already beginning to recover other regions of the world that may be impacted account for considerably lower percentages of year-to-date consolidated sales.

Europe accounts for approximately 9.6% of year-to-date sales, China, Asia Pacific, approximately 24.5% and Latin America, approximately 9.7% based on our geographic sales dispersion, we believe that our consolidated sales will continue to recover as the North American market recovers. Even if this pattern repeats itself around the world, simply because other regions represent significantly smaller components of consolidated sales to summarize, we believe that we have adjusted well to the decline in pandemic sales and that future out rate driven sales should be accretive to revenue.

As we had anticipated COVID sales diminishing to less than 10% of sales in the third quarter and even less in subsequent quarters based on increased vaccination rates, development of therapeutics and medicines to treat COVID 19 team, we believe that future economic shutdowns will be limited and are likely to only flatten industrial recovery, not reverse it. And that the worst of distribution channel inventory issues will be behind us sometime near the end of the fourth quarter fiscal year '22.

That concludes my remarks. I'll now pass the call to Allen to provide more insight into the Company's financial results.

Allen Dillard

Thank you, Charlie. Our fiscal 2022 third quarter clearly demonstrates the resiliency, durability and consistent of the progress made to improve our performance. Year-to-date, we continue to deliver results that reflect changes implemented beginning a few years ago, with the impact of COVID 19 and its variance making our improvements harder to distinguish from traditional business operations.

For the third consecutive quarter, key measures track to expectations as our operating metrics and balance sheet remained extremely strong. During last quarter's earning call, we talked about the reduced COVID related demand from the heights of the pandemic, even as additional outbreaks and variance emerge throughout the world, causing both acute demand for our products and potential deterrent from reversion to normal industrial growth, where our products are traditionally used.

We reiterated that our fiscal year 2022 revenue will not decline proportionally to declines in COVID 19 sales. This assumes all of our other business operations remain fluid, which to date has not been the case. As previously disclosed, it is becoming increasingly difficult to distinguish COVID and non- COVID demand as the amounts are smaller, the distributors are more dispersed and COVID response often negatively impacts local industrial sales.

Shipping of finished goods and transportation logistics around the world has been challenging since early in our fiscal year and is expected to remain a, a headwind for at least the remainder of fiscal year '22.

In addition, we are dealing with excess disposable and certain chemical products on hand with our distributor customers in developed countries and at least in the second and third quarters, new demand related to COVID driving sales in South East Asia.

On a consolidated basis for the third quarter of fiscal 2022, domestic sales were \$10.6 million or 35% of total revenues and international sales were \$19.4 million or 65% of total revenues. This compares with domestic sales of \$17.0 million or 41% of the total and international sales of \$24.4 million or 59% of the total in the same period of fiscal 2021.

Our international revenues have remained in excess of our domestic revenues for the past four quarters.

So our growth as a company is primarily based on our efforts as a global distributor, which is in-line with our strategic priorities, since industrial growth is greater in developing nations as compared with more mature countries, such as the US, where the industrial economy is not only growing more slowly, but there is a heightened competitive marketplace.

The revenue disclosure, I just provided compares year-over-year sales. During fiscal 2021, the company experienced significant growth in sales of disposable and chemical garments, primarily relating to COVID 19 demand. And as a result of cultivating new industrial customers who could not procure these products from incumbent manufacturers or their subcontractors, which is partially offset by a decline in traditional industrial spending on these and other protective apparel product lines.

A comparison of fiscal 2022 third quarter to the fiscal 2022 second quarter provides a more insightful view given the more normalized business environment during these periods, although certain atypical circumstances continue to be experienced. For the sequential comparison, our third quarter, domestic sales of \$10.6 million in international sales of \$19.4 million improved from the second quarter of this fiscal year, when we had domestic sales of \$10.1 million and international sales of \$17.3 million.

Sequential growth was over 9%, which includes nearly 12% growth from the international sales where we benefited from COVID demand in Southeast Asia and 5% domestic growth. This domestic growth mass true demand for more current PPE needs. Since there is inventory that had been stockpiled by our customers and they are now selling through it as a traditional economic growth surges.

Within our domestic sales, we have disposables and chemical products which been had been the primary lines used in the defence of COVID. Yet many of our other product lines are showing strong growth, albeit of smaller base. As in the first half of the year efforts to improve gross margins have shown durability revenue shifting into certain international markets and into diversified product lines, particularly outside of disposables carry better margin profile characteristics.

Gross margin of \$12.6 million for fiscal 2022 third quarter match that of the second quarter, even though we have been dealing with significant shipping challenges and supply chain limitations where our materials are derived largely from North America.

Gross profit as a percentage of net sales was 42.1% for the fiscal 2022 third quarter, down from 46.3% for the fiscal 2022 second quarter and 52.3% for the third quarter of fiscal 2021. Gross profit performance in the fiscal 2021 period benefited from higher volumes including direct container shipments, related factory utilization and an improving product mix with pricing power. Certain of these advantages have partially abated through the end of the third quarter of fiscal 2022. The gross margins as a percentage of sales in all periods continue to track above 40%.

Certain of these advantages have partially abated through the end of the third quarter of fiscal 2022. The gross margin as a percentage of sales in all periods continues to track above our stated

goal of 40% as compared with the fiscal 2020 Q3 gross margin. We improve from 33.9% on 27.5 million in sales in that care, the 42.1% on 30 million in sales in 2022 Q3.

Our revenue mix along with our international reach target efforts to manage our bomb costs, pricing strategies and factory floor efficiencies are delivering intended and sustainable results. Lakeland reported operating profit of \$4.1 million for the three months ended October 31, 2021, up from \$3.9 million for the three months ended July 31, 2021 and down from \$12.5 million for the quarter ended October 31, 2020. Operating margins were 13.6% for the three months ended October 31, 2021, compared with 14.3% for the three months ended July 31, 2021 and 30.1% for the third quarter of the prior fiscal year.

For the first nine months of fiscal 2022, when COVID demand has significantly declined, we maintained operating margins of 15 points, 6% versus 28.3% last year, the first nine months of fiscal 2022 operating margin of 15.6% is vastly improved from the pre pandemic levels of 5.5% for all of fiscal 2020; 3.6% in fiscal 2019 and 8.8% in fiscal 2018.

Income tax expense consists of federal state and foreign income taxes, with an effective tax rate of 31.7% in the third quarter of 2022. Our income tax expense was approximately \$1.3 million. This differs from the U.S. federal rate of 21%, primarily due to foreign tax differences. Lakeland's net operating loss for U.S. Federal tax purposes was fully utilized during fiscal 2021.

Net income of \$2.8 million or \$0.36 per basic Common share increased from with \$2.6 million or \$0.32 per basic common share in second quarter 2022, and was down from \$9.3 million or a dollar 16 per share in third quarter, fiscal 21.

Amid our flexing of production and fiscal 2021 to record levels, Lakeland remained a relatively asset lie business capital expenditures for fiscal 2022 are targeted at approximately \$1 million with \$100,000 spent in the third quarter and more than \$500,000 spent in the first nine months of the year. This annual level is relatively consistent with the spending last year of \$1.7 million.

The majority of our spending this year will be on technology infrastructure to further extend these solutions to the balance of our global business and to enhance strategic manufacturing capacities. Moving to the balance sheet working capital was \$111.0 million at October 31st, 2021 unchanged from July 31st, 2021. And up from \$108.2 million at the end of the fiscal year.

The company's current ratio at the end of the third quarter improved to 9.0 to 1 from 7.5 to 1 at the end of the second quarter, which was similar to the beginning of the year. Cash of \$55.5 million at October 31st was up by 6% from the beginning of the fiscal year. But down from the end of the second quarter, as we repurchase shares and made a strategic investment.

The company continues to have no debt at the end of the third quarter and has up to \$25 million available from bank credit facilities. During the first quarter of this fiscal year, our board authorized an increase in our share repurchase program to a total of \$5 million. During the second quarter of fiscal '22, we expended that \$5 million purchasing a total of 227,454 shares during the second quarter.

On July 6th, our board authorized an additional \$5 million for our repurchase program, bringing the total amount to spend on repurchases in this fiscal year to \$10.8 million. During the fiscal 2022 third quarter, the company repurchased \$900,000 or just over 43,000 shares of common stock under this repurchase program.

Total shares repurchased in the nine months ended October 31st, 2021, total 270 1024 shares at a total cost of \$5.9 million. At October 31st, a total of \$4.1 million is available to the company for the repurchase of its outstanding common stock.

Our current available capital along with the expectations for future cash from operations are adequate to continue to engage in our growth initiatives. These efforts include continued investments and global technology platforms, strategic manufacturing, capacity expansion, and potential M&A transactions. As previously disclosed, we commenced our M&A initiatives. We're our first investment for a strategic minority position in body track for \$2.8 million.

As Charlie discussed in his remarks today, we are very excited about this investment and we are just getting started with the development of our opportunity pipeline. This concludes our remarks. I will turn the call back to the operator to open the call for questions.

Question-and-Answer Session

Operator

Thank you, ladies and gentlemen, the floor is open for questions. [Operator Instructions]. Our first question comes from the line of Alex Fuhrman with Craig-Hallum Capital Group. Your line is live

Alex Fuhrman

Great. Thanks very much for taking my question. I wanted to ask, I guess, first and foremost about the revenue that you saw in the third quarter. Obviously it sounds like you, got more than an expected more than you were expecting to get in terms of a bump from some of these COVID outbreaks that have been half happening around the world.

On the flip side of that, have you seen any sort of a I guess not maybe reversing to your point, but maybe slowing down of the economic recovery. Just curious if we were to back out that \$6 million of, of pandemic related sales, that would put pretty close to where you were in the second quarter, if we backed out the pandemic sales there just kind of curious your thoughts on that as you move through next year, would, would you expect to see just kind of a slow, steady rebuild of the non COVID related sales?

And then obviously, the COVID sales kind of are with, they are when they are but should we expect that kind of \$24 million quarterly run rate of non COVID related revenue to kind of continue as is and, and build slowly over the course of next year?

Allen Dillard

Hey Alex, this is a yeah. It's to, Charlie's remarks earlier; it really depends on how these develop through each of these regions. If you look underneath the, those numbers basically you'll see that the non COVID revenues in Southeast Asia remained relatively stable which is what we expected.

If you look at the rest of the world those numbers would show a decline as they essentially consumed stockpiles, because we began to see the development and enhancement of those stockpiles in the rest of the world market, which is primarily Europe.

But if you look at the North American market, we began to see the uptick. And so, if you, if you kind of follow Charlie's remarks we're beginning to see more of the stockpiling consumed in the North American markets.

And, our expectation is that we'll continue to see that begin, that uptick continue. And we should, we hope to begin if the European rest of world market follows the U the North American market, we should begin to see that turn much as we did in Q3 and North America. And know China has got a pretty, stable base in the, in the industrial activity.

So I don't think we're going to see a decline there. And at some point we'll begin to see that up to hopefully in the next quarter or two. I don't know if Charlie's got any additional comments there. No, that's exactly right. what, what we're seeing is, we saw the North American market begin to pick up in non COVID sales that was offset by downturn during the second half, primarily in Europe with Southeast Asia, staying flat in spite of increased lockdown.

So, the net of that is, I think that the industrial economic recovery is underway. I, if you look at our sales, it's masked by the, the plot or the distribution channel inventory in the us primarily that is clearing, given the percentage of our sales that is north America. Once that clears, you're, you're talking about 50% of our sales versus 9.7, I think, or 9.6 in Europe. So, the, the inventory levels are going to be a lot lower, but...

Alex Fuhrman

Yeah. Okay. That's, really helpful. Thank you both for that. And then, I guess just thinking about gross margin, I mean, you guys, you guys obviously put up some pretty extraordinary gross margin numbers in, last year and, and in the first half of this year starting to settle into, I guess, a more, a more normalized rate, but, but, also a very strong, gross margin at 42% in Q3.

Based on everything, today, I mean, what, what should we expect over the next couple of quarters? I mean, is it, is it fair to assume that the inventory you have on your balance sheet right now reflects even higher container rates than, than what you were selling in the third quarter? I mean, I'm just wondering, should we, should we expect leg down here in gross margin as you sell through what, presumably was the, the most expensive inventory to position over the past few months?

Charles Roberson

Alex, there are two elements to answering that question and I can, I'll speak to the first one when it actually gets to, the, the percentage of, of our inventory that's represented by freight and I'll let Allen talk about that. But, we have, we did begin realizing those increased costs in our margin in Q3 but the other element that is helpful to our margin as product mix and, Allen in his comments discussed the difference between our disposable and chemical with the distribution channel stuff. And the fact that that does not necessarily apply to our other product lines that have a higher margin that is part of, what's helping us.

So, now, as far as freight, we've begin to, we've begun to see some freight costs decline. They certainly are not back to where they were, but they're not four X what they were now. I think it's three X. So, we are seeing getting some relief in that regard right now our biggest problem is, just the, the time consumed in that ocean freight, we can pass the costs on to customers. What we can't do is get it any faster. And that's why we keep harping on the addition, the additional inventory that we have laid in; we currently have our lead times, our forecast for existing lead times adequately covered with inventory.

Alex Fuhrman

Okay. That's, that's really helpful as well. And then, my last question for you, you guys is, certainly seems like a big opportunity that you're just scratching the surface of with biometrics, I'm curious, are any of your competitors already doing this in a big way? And, and, just from a high level, can you talk about what you're hoping to get out of your investment in body track and, and, and, when we might see those learnings start to impact your product offerings?

Charles Roberson

Yeah, I thank thanks. That's a, a good question. Biometrics is, is still a nascent technology in our industry. So I wouldn't say that there's anyone that is, leaps and bounds out front yet. I think people are still trying to realize how this is going to be where the value is for the end user. All right? And for us, it's not just biometrics though. That's certainly the, the focus of the body track and investment, but the broader aspect of it is the connected worker and where this, we envision this ultimately leading is biomonitoring, that, is passive on the part of the worker and allows you to build individual profiles over time.

And then as experiences gained with accidents, comparing, profiles of people that had accidents, you can actually use, artificial intelligence or predictive algorithms, to, for the first time ever really say that all accidents are preventable.

And I think that is going to have a tremendous impact for instance, in the transportation industry; hazardous material handling and processing obviously the, the greater, the impact of, whatever's being used or engaged in the greater, the value of this. But, it goes down to, someone getting burned or breaking a leg, even. So it's by, is one smaller part of the connected worker. And, all we've got right now is our toe in the water.

Alex Fuhrman

Well, that's great. We'll be, excited to see how that unfolds. Thank you. Thank you very much.

Operator

[Operator Instructions] there seems to be no further questions at this time. So I would like to turn the call back over to management for any closing remarks.

Charles Roberson

Thank you. We appreciate your participation on Lakeland's fiscal 2022 third quarter financial results conference call. As we look ahead to the balance of fiscal 2022, and next year, we are excited by our sustainably optimized financial performance and the leadership position we are taking with a future view of safety in the workplace. There are many attractive growth segments within this market, and we have the team, the capital base and the operational footprint to have a global impact. 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.