Lakeland Industries, Inc. (LAKE)

Q2 2022 Results - Earnings Call Transcript

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Corporate Participants

Charles Roberson - President and Chief Executive Officer

Allen Dillard - Chief Financial Officer

Conference Call Participants

Alex Fuhrman - Craig-Hallum

Mark Imbertson - Private Investor

Operator

Good day and welcome to your Lakeland Industries Fiscal 2022 Second Quarter Financial Results and Conduct Conference Call. All lines have been placed on a listen-only mode and the floor will be open for your questions and comments following the presentation.

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, September 9, 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 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, risks, 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 the 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 persons acting on its behalf are expressly qualified in their entirety by the 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 second quarter financial results conference call.

Lakeland's performance improvements are proving to be sustainable as we have again delivered on our margin, expense controls and cash management objectives as reported in our fiscal 2022 second quarter financial results. We shared the basic tenets of our five-year growth plan on our last quarter earnings conference call. And you'll see many of the progress points addressed in our remarks today.

Our performance in the second quarter is more impressive when considering the significant global business challenges being encountered in the wake of the COVID-19 pandemic last year and more recent unpredictable waves of global outbreaks.

In Q1 of fiscal year ‘22, we noted an initial recovery in the industrial markets in the U.S. We now believe that the perceived strength of the recovery was magnified by freight delays, extending order lead times, leading distributors, and end users to place additional orders as industry activity surged. As these delayed shipments arrive throughout Q1 and Q2 of fiscal year '22. an excess of inventory was created within the U.S. distribution channels. We believe that the current wave of COVID-19 and the subsequent high rates of hospitalizations in the U.S. will draw down this inventory as we move forward.

While we believe that COVID-19 will continue at some persistent level of sales for at least the coming year, we do not believe that it will be the significant driver to sales that it has been. And that going forward industrial growth will replace it as our primary sales driver.

During the second quarter, we have witnessed traditional industrial economic growth strengthening outside of the U.S. market, with increasing domestic industrial demand being satisfied primarily by overstocked channel inventory. Our revenues have benefited from our international diversification and also from COVID-19 related sales of approximately $3.5 million in the second quarter of fiscal year '22 driven by demand from Southeast Asia.

Our revenue shortfall is almost entirely attributable to the U.S. market, as evidenced by U.S. sales revenue falling to 37% of consolidated sales in the second quarter of fiscal year '22 from 46% in the first quarter of fiscal year '22. We have seen evidence of overstocking within U.S. distribution channels, along with logistics challenges, which collectively resulted in postponement of significant orders, but not loss of accounts.

Despite these headwinds, our performance remains very strong and indicators for normalized business conditions are favorable. Our ability to maintain gross margins is key to our profitability strategy. We're proud to say that our sales and manufacturing teams have risen to the challenge, delivering a Q2 fiscal year '22 gross margin of 46.3% even as revenue declined as expected from both the first quarter and the prior year periods.

Ocean freight rates are likely to remain inflated for the coming year and we are beginning to see inflationary pressures in the form of raw materials price increases, primarily in the United States. We will continue to take actions to mitigate or recover these increases as we did throughout the last year.

In the second quarter of fiscal year '22, significant COVID demand for our disposable and chemical garments shifted to Southeast Asia. This demand is being addressed by manufacturing of garments in our China facilities. While our international sales have been growing, the new Asia demand was able to partially offset the reduced revenue in the U.S. None of our global facilities have been shut down or materially impacted by staffing issues in connection with the global pandemic. For this, we want to recognize the value and efforts of our global team members for their dedication and adherence to health and workplace guidelines, to keep our supply lines open, and our people in related constituencies safe.

COVID-19 business conditions continue to create both opportunities and challenges. Yet its anomalies cannot hide the value generated by the fundamental operational and organizational improvements that like when is made. As previously discussed, the critical elements of our plan include the strengthening of our leadership team, investing in capacity expansion, and higher margin product development and focusing on profit enhancement initiatives led by a new data centric approach to planning and supporting our addressable markets.

All of these elements came into play during our second quarter, significantly increasing our profitability over pre-COVID levels on nearly identical sales. Among our bright spots for top-line growth and product development initiatives, is high performance wear, fire, and glove product lines.

Second quarter fiscal year '22 sales of these product lines increased over second quarter fiscal year '21 sales when PPE demand had already shifted to disposables and chemical garments for COVID-19. High performance wear or HPW is one of our newest garment lines, which is somewhat unique in the marketplace, given the materials used and the design and purpose for the products in protecting those exposed to electricity and power lines. This could become a very interesting product line in the U.S. as the new infrastructure bill takes hold.

Quarterly revenues for HPW exceeded $1 million for the first time and were up about 10% sequentially from the first quarter of this fiscal year, while nearly doubling from last year second quarter. The industrial sector is indeed coming back strong in product categories that were depressed by COVID-19 and Lakeland is benefiting from that resurgence.

Among other actions taken as part of our plan, additions have been made to our executive team and global staff, as investments have been directed at ushering in our new operating culture. This provided the insight to shift production capacity from Vietnam to China in a matter of weeks of identifying new demand in the most optimized costs and tariff structure.

At the same time, operating expenses remained under $9 million for the quarter after layering in additions that will enable us to further expand organically as well as inorganically as part of our overall global growth strategy. We are managing our expenses and maximizing our cash flow. Cash is up over 7 million from the beginning of the year, and just modestly lower than the end of the first quarter.

Through the first half of fiscal 2022, our operating income of 9.8 million is greater than the full year operating income for any of the three years prior to our COVID-19 enhanced fiscal 2021. This further demonstrates the impact of our sustainable performance improvements and resiliency in our operations. While the majority of COVID-19 related demand is behind us, we look forward to governments and the private sector around the world recognizing the need for greater levels of protection and more specialized PPE outside of COVID. Lakeland is pleased to stand in the spotlight and we're well positioned to capitalize on this new demand as well as benefiting from the expansion of our traditional industrial marketplace.

For all of fiscal 2021, COVID-related sales accounted for 30% to 35% of consolidated revenues. In each of the first two quarters of this fiscal year, we estimate approximately 13% of sales were related to COVID. 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.

India and other areas of Southeast Asia outside of China have been experiencing outbreaks that drove up demand while simultaneously resulting in a decline in industrial sales brought on by lockdowns and quarantines. Outside of COVID demand, we see the potential for meaningful improvement in market penetration, as we seek to retain as many of our 500 new industrial customers develop during the pandemic as we can.

First half fiscal '22 data is encouraging even in light of COVID demand volatility, which necessitates prioritization of customer retention, and new customer development going forward. Similar to the first quarter of this year, at the end of the second quarter, we have demonstrated resiliency in our operations, and the sustainability of our financial performance. Continued investments in our IT systems and planning processes, along with organic growth are expected to drive ongoing improvements in productivity, efficiencies, and profitability. These aspects of our business should be complemented by the inorganic growth opportunities and increased R&D spend that we are now pursuing.

Our business transformation plan was initiated in 2019 but because of the pandemic, much of our progress and performance improvement due to the implementation of our plan has been masked, attributed to the pandemic until now. We believe our shareholders, our target customer base, our supply chain partners, and even our competitors are now beginning to see the magnitude of our performance improvements. And we are now far more respected and formidable leader in the global PPE market.

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.

From a financial results perspective, fiscal 2022 second quarter continued to show consistency based on the progress made to improve our performance amid the anticipated reduced revenue levels as the COVID impact declines. For the second consecutive quarter. key measures track to expectations as our operating metrics and balance sheet remain extremely strong. We are winding down from the heights of COVID-related demand, even as additional outbreaks emerge throughout the world. We reiterate 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.

As Charlie addressed during his remarks, shipping of finished goods and transportation logistics around the world has been challenging in the second quarter of fiscal '22, and is expected to remain a headwind for at least the remainder of fiscal year '22.

On a consolidated basis for the second quarter of fiscal 2022. domestic sales were 10.1 million, or 37% of total revenues and international sales were 17.3 million, or 63% of total revenues. This compares with domestic sales of 14.5 million, or 41% of the total and the international sales of 20.6 million or 59% of the total in the same period of fiscal 2021. As these numbers show, our international revenues have remained in excess of our domestic revenues for the past three quarters.

Our investments in the business parallel the growth of Lakeland's revenue base, with the majority of our focus on our international operations. Continued investments are being made in the international rollout of our ERP and related IT systems, while production capacity enhancements will be targeted in Vietnam, India, and Mexico. Fungibility of our capacity remains at the forefront of our thinking, which enables us to leverage our investments to target demand for our key product lines, primarily disposable chemical, and critical environment in the shortest period of time and with the highest margins net of all costs, including shipping and commissions.

Efforts to improve gross margins have shown durability, even as our revenues have shifted, gross profit of 12.4 million for fiscal 2022 second quarter decreased 28% from 17.3 million for the same period of the prior year. Gross profit as a percentage of net sales was strong at 46.3% for the fiscal 2022 quarter as compared with 49.5% a year ago. As compared with fiscal 2020 quarter gross margin, we improved from 37.9% on 27.5 million in sales in that period to 46.3% this year. At the end of the first quarter, we had reached our target SKU reduction of about 40% from pre-COVID levels.

Our revenue mix along with our international reach targeted efforts to manage our BOM cost, pricing strategies, and factory floor efficiencies are delivering intended and sustainable results. We are reporting more normalized revenue in gross profit levels, which as we discussed have improved substantially, except as compared to fiscal 2021, which was the height of the pandemic when we benefited the most.

Lakeland reported operating profit of $3.6 million in second quarter fiscal '22 as compared to 9.8 million for the prior year period. Operating margins were 13.1% for the three months ended July 31 2021, down from 28% for the first quarter of the prior fiscal year. Through the first half and as COVID demand has significantly declined, operating margins were 15.9% this year, versus 27.4% last year. The first half of fiscal 2022 operating margin of 15.9% is vastly improved from the pre-pandemic levels of 5.5% for all of fiscal 2020, 3.6% for fiscal 2019 and 8.8% for fiscal 2018.

Income tax expense consists of federal, state and foreign income taxes within an effective income tax rate of approximately 34.8% in second quarter fiscal '22, our income tax expense was approximately 1.4 million. This differs from the U.S. Federal rate of 21% primarily due to recording a discrete item in second quarter fiscal '22 related to a change in state tax a portion of factors and from foreign tax rate differences.

Lakeland's net operating loss for U.S. federal tax purposes was fully utilized during fiscal 2021. Net income of 2.6 million or $0.32 per basic common share in second quarter fiscal '22 was down from 9.3 million or $1.17 per share in second quarter fiscal '21. We generated $4.8 million in cash flow from operations in the fiscal 2022 second quarter for a total of 13.1 million during the first half of the year. Amid our flexing of production in fiscal 2021 to record levels, Lakeland remained a relatively asset light business.

Capital expenditures for fiscal 2022 are targeted at approximately $2 million. With only 100,000 spent in the first quarter, and 400,000 spent in the second quarter. So we are very near our plan. 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 operating solutions to the balance of our global business and to enhance manufacturing capacities.

Moving to the balance sheet, working capital was 111.1 million at July 31, 2021, down slightly from 112.7 million at April 30, 2021 and up from 108.2 million at the beginning of the fiscal year. The company's current ratio at the end of the second quarter was 7.5 to 1, which remained relatively consistent since the beginning of the year. Cash of 59.8 million was down slightly from 60.3 million at April 30 2021 but up 14% or 7.2 million from the beginning of the fiscal year. The company has no debt outstanding at the end of the second quarter and has up to $25 million available from Bank facilities.

During the first quarter of this 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 fiscal second quarter. On July 6, 2021, the board authorized an additional $5 million for the program. This amount remained unused as of the end of the second quarter even after this capital allocation, the company has more than enough capital available to engage in our growth pursuits, continued investments in our global platforms, targeted R&D efforts, and potential M&A transactions.

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

Question-and-Answer Session

Operator

Thank you. The floor is now open for questions. [Operator Instructions] We'll take our first question from Alex Fuhrman with Craig-Hallum. Please go ahead.

Alex Fuhrman

Great. Thank you, guys, for taking my question. Charlie, you touched on this a little bit during your prepared remarks, but I'm wondering if you can give us a little bit more color on kind of the timeline of the overstocking in the U.S. when that started? Are we still kind of in the midst of that? It sounded like from your comments maybe there was some optimism that unfortunately with everything going on with the resurgence of COVID here in the States maybe that would help to draw it down so as inventory levels, have you started to see that yet? Just trying to get a sense of where the equilibrium here is in terms of inventory levels in the U.S. and when you think your business going forward is going to reflect normalized condition?

Charles Roberson

Certainly, Alex. As I mentioned earlier, we believe that the inventory situation actually began in Q1, where we a lot of -- and we've seen this in some other companies' earnings calls where orders placed in Q4 went unfilled until the end of Q1 or into Q2, that was not the case so much for us, some delays moved us from Q1 to Q2, but not -- we didn't skip an entire quarter. We believe that we thought we interpreted our increased ordering from our customers as increased industrial demand. And I think that it was actually a result of our competitors having encountering freight issues even worse than we had. Now as those goods have arrived, at the end of Q1 and Q2, that's created the glut of inventory that's currently in the supply chain. As to how far we are into it, in talking with our distributors, most feel that we have two to three months to work through here.

Alex Fuhrman

Okay, that's really helpful. Thanks. And then on the supply chain side of things, it sounds like container costs are obviously through the roof and that's likely to continue for some time. How should we think about your ability to pass these costs on to customers? Are you considering price increases or other sort of surcharges along as long as inbound freight remains very high? Is there an opportunity to make some of that back in future quarters? Just trying to get a sense of how big the -- it could be to see your margins and when we should expect to see that?

Charles Roberson

Alex, that's part of our new culture. Our sales team has done an excellent job through last year and even the first half of this year in recovering cost increases and manufacturing has helped by reducing costs where we couldn't do that. But to answer your question, we are seeing price increases in the market. Our customers, the whole world is aware of what has happened in the United well to ocean freight globally, and to LTL freight costs in the U.S., everyone is aware of that, no one is surprised by it. And we are taking actions to address that. Also number of people, everyone is seeing inflationary pressures as well. So this isn't just an issue for Lakeland, and consequently, we're confident in our ability to pass these increases along.

Alex Fuhrman

Great. That's really helpful. Thank you, Charlie.

Charles Roberson

Thank you.

Operator

[Operator Instructions] We'll take our next question from Mark Imbertson, Private Investor. Please go ahead.

Mark Imbertson

Hello, guys. With the large cash balance on the balance sheet currently of almost $60 million and the stock down 15% after the close today, that's over 30% of the market cap. Is there any reason not to double the current $5 million authorized as well for a total of $10 million with such an undervalued 30% on the balance sheet?

Charles Roberson

We'll go to our Board for authorization on that, but there's no need authorizing another $5 million until we've spent what we have if the situation, as you say, merits.

Mark Imbertson

Okay. Another question, is there -- in the last two conference calls by management, there's been statements of just trying to retain the accounts that were earned from COVID last year. Is there actually a focus right now on trying to gain market share, not just trying to retain the accounts that were gained from 2020 COVID?

Charles Roberson

That is exactly correct, Mark. We're shifting -- especially in light of revenues in this quarter, we're shifting from retention to new customer development again.

Mark Imbertson

Got it. Okay. I'm hoping that the market at some point here looks at the balance sheet and shows a little bit better valuation. Thanks for your guys efforts.

Charles Roberson

Thank you, Mark.

Operator

[Operator Instructions] We'll take our next question from -- oh and my apologies, one moment. [Operator Instructions] And at this time, we'll turn the floor back over to Mr. Roberson for any closing comments.

Charles Roberson

Thank you. We appreciate your participation on Lakeland's fiscal 2022 second quarter financial results conference call. As we look ahead to the balance of fiscal 2022, we continue to be well positioned as the new standard of excellence for PPE manufacturers anywhere in the world. Our healthy balance sheet and bolstered operating position are enabling sustainably improved performance that we will utilize to support our growth initiatives going forward. We remain excited for what lies ahead and look forward to sharing our story at the D.A. Davidson Industrial Conference, a first-time appearance for us on September the 22nd. Thank you again for joining us on today's conference call and have a nice day.

Operator

With that this does conclude today's teleconference. We thank you again for your participation. You may disconnect your lines at this time and have a wonderful day.