

Lakeland Industries, Inc. (LAKE) CEO Charles D. Roberson on Q1 2022 Results - Earnings Call Transcript

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Company Participants

Charles D. Roberson – President and Chief Executive Officer

Allen Dillard – Chief Financial Officer

Conference Call Participants

Alex Fuhrman – Craig-Hallum Capital Group

Operator

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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.

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 his 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 D. Roberson

Thank you and good afternoon. I'm joined here today by Lakeland's Chief Financial Officer, Alan Diller. We appreciate you taking the time to join our fiscal 2022 first quarter financial results conference call. After a tremendous fiscal 2021, the sustainability of our financial performance was on display as we delivered very strong results in the first quarter of fiscal 2022 ended April 30, 2021.

We're now beginning to see the impact of the improvements made to our business over the past year, as COVID-19 demand subsides. Business process improvements accelerated due to COVID-19 and we believe that our first quarter fiscal year 2022 results demonstrate the durability and magnitude of these improvements. In fact, while there's no question that COVID-19 pandemic had a positive impact on our performance through the entirety of fiscal year 2021 and into the first quarter of fiscal year 2022, we believe it has also largely masked the value we derive from the significant operational and process improvements we have made.

Only now in the second consecutive quarter of declining pandemic sales does the significance of our improvements become apparent. Through my formal remarks on today's conference call, I'd like to provide some perspective on our progress and strategy for our post-COVID business environment. Later, Allen will review our financial results for the quarter and related developments in more detail.

Prior to the onset of the global pandemic, we began a business transformation and put in place a five-year growth plan that assumed successful implementation of our development plans. COVID-19 accelerated the pace of progress by approximately one year and in the process elevated our cash balance to over \$60 million today. We expect continued free cash flow generation for the foreseeable future, which factors in, the elimination of all COVID-19 demand as early as the end of the present quarter. The critical elements of our plan include, the strengthening of our leadership team, investing in capacity expansion in higher margin product development and focusing on profit enhancement initiatives led by a new data centric approach to planning and supporting our addressable markets.

During the past several quarters, we made additions to our leadership team that allow us to maximize our investments grow organically at rates in excess of global industry rates and now to grow inorganically as well. Most recently, we added our first Vice President for Corporate Development. This move is intended for Lakeland to put a sizeable cash position to work increasing shareholder value. The actionable elements of our plan are to utilize our manufacturing, operations and data centric culture as the cornerstone of our ongoing success as we seek new market opportunities and synergies in our corporate development opportunities.

Lakeland has always owned its manufacturing operations. And in this way, we're fairly unique in the PPE industry. Manufacturing is one of our critical differentiators, since no other player in the industry possesses similar capabilities on a global scale. Sure we can make mask, it's easy to do that. And there are virtually no barriers to entry. As we saw last year, even automotive manufacturers and home furnishings companies were able to jump into that arena virtually overnight. Because Lakeland Industries has a 40-year history of manufacturing protective apparel, we remained focused on what we do best, manufacturing high quality, highly-specified garments for customers who value the safety of their employees.

Furthermore, in the past few years, we significantly improved and expanded our global capacity in India, Vietnam and China. Our expansions are largely directed at higher growth niche markets with significant barriers to entry, specifically our critical environment and High Performance Electrical Utility product lines. As a result, when the pandemic hit, we were reluctant to chase what we knew to be short-term gains at the expense of the growth strategy that we believed to be

sound with long-term sustainable performance improvement. This drove our decision to focus on the industrial market during the pandemic.

Our first quarter fiscal year 2022 results validate this decision as our revenues are significantly higher than pre-pandemic revenues as our gross margin and income from operations, Allen will provide more color on the contrast between Lakeland's pre and post-pandemic performance in his remarks. Last year, fiscal year 2021, as we focused on the industrial market and our higher margin niche products during the pandemic, we saw a temporary pause in the growing demand for these specialized products, as customers understandably favored COVID defense spending over other high-end PPE purchases and as other customers were locked down or operating under curtailed production schedules.

Now for more than the past two quarters, we've been – we have seen increasing industrial spending on PPE as the global economy emerges from the pandemic. This is the future of Lakeland. And while we have sustainability in our financial performance today, we see the potential for meaningful improvement in market penetration as we seek to retain as many of our over 500 new industrial customers developed during the pandemic as we can. Q1 fiscal year 2022, data is encouraging on this front. We estimate that 68% of these new customers placed reorders in Q1 alone. On the strength of this performance we're optimistic that we will attain a 75% to 80% retention rate as fiscal year 2022 progresses.

In expanding our manufacturing capacity and support of our pre-pandemic growth forecast we have shown that with under \$2 million in capital investments for production capacity expansions, we are able to increase revenues by approximately \$50 million. Again, owning our manufacturing makes this possible. Lakeland has tremendous operating leverage, and we have learned how to utilize it to accelerate growth during black swan events and to sustain a higher level of performance afterward. Overall, our ERP installation has only been a factor for our U.S. operations, which are now less than 50% of our revenues.

As we implement this system globally, we expect incremental benefits from the balance of our business. The timing of our investment could not have been better. The current forecast for economic growth and the return of industrial demand in most major markets around the world bodes well for Lakeland to realize post-pandemic gains from increased market penetration, rationalization of our product lines and our emphasis on higher margin specialized protective apparel. Lakeland has already elevated its profitability levels where we have fixed overhead, enabling us to flex production for even greater returns as variable expenses are limited primarily to success based sales commissions and freight costs.

This is further confirmation of how actively managing expenses and driving costs out of our business through investments in technology and process improvements results in sustainability of our performance in a post-COVID business environment. Our first quarter sales performance indicates in large part that the decreased demand for direct-COVID applications is largely being offset by continuing increases on our core industrial businesses. Leading economic indicators suggest a relatively robust industrial market recovery, although potential headwinds exist in excess supply chain inventories and ongoing freight challenges. As we've discussed absent-

COVID demand, other recovery pressures are expected to be more than offset by growth from our diversified and expanded global reach and other vertical markets.

We use COVID-19 to our advantage as a catalyst for transformation. At the end of the first quarter of fiscal 2022, we have demonstrated resiliency in our operations and sustainability of our financial performance. Continued investments in our IT systems and data centric planning processes along with organic growth are expected to drive ongoing improvements in productivity, efficiencies and profitability. These aspects of our business should be complimented by the inorganic growth opportunities that we are now pursuing.

The key to this strategy will be identifying candidates that are not only accretive, but can be integrated without delaying or impairing our ability to continue the rollout of our technological and process development, and are synergistic with our manufacturing and sales platforms. These are quite exciting times in the PPE industry. That concludes my remarks. I will 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 first quarter showed consistency based on the progress made to improve our performance as key measures, track to expectations and our balance sheet strength improved. For each of the past five quarters our revenues have been in excess of \$34 million. We are indeed winding down from COVID related sales and are benefiting from a strong resurgence in traditional industrial demand, while we also tap into certain opportunities in the healthcare segment for non-pandemic related needs that historically we would not have attempted to enter.

For all of fiscal 2021 COVID related sales accounted for 30% to 35% of consolidated revenues. In Q1 2022, we estimate 13% of sales were related to COVID. As Charlie mentioned, we expect to continue to see decreases in this demand in the current quarter, since most regions have sufficient supply, except India, which is still experiencing outbreaks resulting in demand that may outpace the traditional availability of PPE from the healthcare supply chain. We reiterate that our fiscal year 2022 revenue will not decline proportionally to declines in COVID-19 sales by focusing on the industrial market early on and throughout the pandemic, we believe we have set the stage to emerge post COVID-19 well-positioned with a larger book of business that targets a much larger and faster growing overall market.

Our first quarter results indicate our successful execution of this strategy thus far. Due to the scaling back in most major markets for COVID-19 related product. Our first quarter sales for disposables and chemicals were down 30% as compared with our first quarter 2021 sales, which represented our highest level of COVID sales. As we have already rapidly emerge from the COVID impacted sales periods, one of our more recent garment lines known as high-performance ware grew last year and was up nearly 200% in the first quarter of fiscal 2022, as compared to the prior year period. At nearly 900,000 in the first quarter 2022 sales, revenues

were more than half of all high-performance wear sales in fiscal 2021, \$1.7 million, and fiscal 2020, \$1.6 million.

Of course as we noted, last year we saw a curtailment in spending on non-pandemic related PPE purchases. So the year-over-year comparison is a bit uneven as many economies are returning to traditional industrial purchasing. High-performance wear, fire apparel and woven's all increased in the first quarter of fiscal 2022 as compared to the prior year. While all of these garment lines typically have higher margins than disposables, high-performance wear in particular contributes to our efforts to increase gross profit over the long-term with differentiated PPE. I'll speak more to our gross margin improvements in a moment.

On a consolidated basis for the first quarter of fiscal 2021, domestic sales were \$15.7 million or 46% of total revenues and international sales were \$18.4 million or 54% of total revenues. This compares with domestic sales of \$23.1 million or 51% of the total and international sales of \$22.5 million or 49% of the total in the same period of fiscal 2020. While fourth quarter 2021 domestic sales were \$16 million or 43% of total revenues and international sales were \$20.9 million or 57% of total revenues. As these numbers show, our international revenues have remained in excess of our domestic revenues for the past two quarters, while we believe we have been taking industrial market share in the U.S. our growth prospects overall are far more compelling than the higher growth international arena, this place our strength on the manufacturing side of the business.

Our growth plans from manufacturing perspective 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 particularly for our domestic business. All capacity expansions will be fungible between our primary product lines for disposable, chemical and Critical Environment. Efforts to improve gross margins involve the manufacturing of far fewer products than we had offered in the past, which provides ancillary benefits through operational efficiencies and reduced inventory.

We also 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 were 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.

At the end of the first quarter, we had reduced our targeted SKU reduction of about 40% from pre-COVID levels. We are benefiting from these gross margin improvement strategies, which have relied in large part on our IT driven decision making. First quarter 2022 gross margin as a percentage of sales was 42.2%, that's down about 48.5% in Q1 2021 when sales were 25% higher. For further reflection, our gross profit as a percentage of sales was 30.6% in Q1 fiscal 2020 versus 42.2% this year for an improvement of nearly 12 points in two years. So we have been and continue to focus on improvements in terms of supply chain efficiencies, pricing strategies, SKU reductions, and product mix variations.

Pricing in the PPE market has been elevated as a result of COVID, and we believe we will continue to see pricing above the pre-pandemic era, even after certain settlement on the pricing side that we've already experienced through the first quarter of this year. For fiscal 2021, the company's operating leverage was elevated on the higher revenues driven by COVID demand and gross margins, which more than offset increases in sales commissions and freight out. In the first quarter of fiscal 2022 with more, more normalized revenue and gross profit levels, Lakeland reported operating profit of \$6.2 million as compared to \$12.4 million for the prior year period.

Operating margins were 18.3% for the three months ended April 30, 2021, down from 27.1% for the first quarter of the prior fiscal year, but substantially higher than the negative 1.3% in the fiscal 2020 period, when we were struggling with our ERP implementation and 9.9% in the fiscal 2019 first quarter. As we had lower variable costs from the lower sales, as compared with heavier COVID sales impacted periods, operating expenses of \$8.1 million in Q1 2022 were down from \$9.8 million in Q1 2021 and \$8.8 million in Q4 2021. Income tax expense consists of federal, state and foreign income taxes with an income tax rate of approximately 25% in first quarter 2022; our income tax expense was \$1.6 million, down from \$3.7 million in fiscal 2021 period.

Lakeland's net operating loss for U.S. federal tax purposes was fully utilized during fiscal 2021. However, the company had at the beginning of this fiscal year approximately \$22.7 million and net operating losses for state purposes across multiple jurisdictions. Net income of \$4.6 million or \$0.58 per basic common share in Q1 2022 was down from \$8.6 million or \$1.08 per share in Q1 2021. On the 25% reduction in sales and 46% reduction in net income, we generated \$8.3 million in cash flow from operations, down by only 19% or \$10.3 million from the prior year period.

Amid our flexing of production in fiscal 2021 to record levels Lakeland remained relatively asset-light business. Capital expenditures for fiscal 2022 are targeted at \$2 million with only 100,000 spin in the first quarter. This annual level is relatively consistent with the spending last year of \$1.7 million, yet we have shown how we can ramp production. Meanwhile, the majority of our spending this year will be on the IT and technology investments to further expand these data-driven solutions to the balance of our global business. In turn similar to the benefits we have experienced already for our domestic operations, we'll look forward to cost savings and efficiencies that are higher growth, and now larger international operations. These objectives support our manufacturing resiliency and flexibility, while complimenting the existing methods of factory floor efficiencies yielded by our ERP systems and data-centric planning.

Moving to the balance sheet, working capital was \$112.7 million at April 30, 2021, up from \$108.2 million at the beginning of the fiscal year and \$66.9 million at the beginning of fiscal 2021. The company's current ratio at the end of the first quarter remained at 7.8-to-1 from the beginning of the year. Cash of \$60.3 million and April 30, 2021 was up by \$7.7 million or 15% from the beginning of the fiscal year. The company had no debt at the end of the first quarter and has up to \$17.5 million and available borrowings from its current bank facilities, all of which is currently available.

As Charlie mentioned during his remarks, we intend to use these financial resources to pursue strategic acquisitions that provide accelerated access to higher margin products or where our manufacturing capabilities can lead to other synergies or an even greater incrementally accretive addition to our business. During the first quarter, 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. No shares were repurchased under this program during the first quarter.

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

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] Our first question comes from Alex Fuhrman with Craig-Hallum Capital Group. Please state your question.

Alex Fuhrman

Great. Guys thanks for taking my question and congratulations on a very nice start to the year. You know, wanted to ask about the breakdown of revenue between the COVID and the non-COVID related business. It sounds like you had about \$30 million of non-COVID related revenue here in the first quarter. Can we be thinking about that as sort of the baseline that you're going to be growing off of as industrial production starts to pick up? Or is it maybe a little bit higher as customers start making more non-COVID purchases and you start to bring some SKUs back?

Charles D. Roberson

Alex, I don't think that we have seen the economic recovery in the industrial market come to fruition yet. So I don't think that, 30 million is the new baseline industrial sales number for us. It will be a little bit higher than that.

Alex Fuhrman

Okay. That's helpful, thanks. And then on the M&A front, it looks like you guys made a great hire bringing Josh onboard. Can you talk a little bit more about what you're seeing out there in terms of opportunities? Are there any particular product categories or distribution channels that you have in mind that you're targeting?

Charles D. Roberson

We're not quite that far down the road with Josh yet, Alex. Right now we're still making sure that we have our own objectives and the potential benefits that we would be interested in acquiring. We're still in that defining process. He's also working to put in place the processes and procedures internally that we'll use for evaluation. That said we have seen some opportunities

come our way and we're starting a funnel already. We are aware of the challenges that an acquisition brings given our current multiple and what that might mean for us. So we are quite cognizant of the fact that we need to look for acquisitions that are going to be synergistic as well. And that's kind of what we're working for as to how we define those synergies and where they might be.

Alex Fuhrman

Okay. Thanks. That makes sense. And then, I'd love to ask about the 500 new customers that you brought on in the past year. I mean, it sounds like you're on a path to retain something close to 80% of those customers. Can you give us a little bit more sense of who these new customers are? Are there any particular industries that they gravitate or cater towards, and then just thinking about the COVID demand that you saw last year and the \$4 million and change of COVID demand that you saw in Q1, how much of that demand were coming from those 500 new customers?

Charles D. Roberson

Quantifying that because of our lack of transparency is pretty difficult. We estimated earlier at the end of Q4, I believe we – Allen, we put their sales revenue at between \$10 million and \$12 million?

Allen Dillard

That's correct.

Charles D. Roberson

I can't remember exactly whether it was \$10 million or \$12 million, but it was in that range. As to what kind of customers they are. They largely resemble our existing customer base Alex. We've had our sales team focused on taking orders for industrial applications before we took COVID applications. So they're not very readily distinguishable. What I will say about them is, 75% of those are only order of that are international new customers. And that's reflected of course in our revenue distribution, both in domestic and international sales. So that's also why we keep referring to our increased market penetration internationally as that's where we were most successful.

Alex Fuhrman

Okay. That's really helpful. Thanks. Thanks guys.

Charles D. Roberson

Thank you, sir.

Operator

Thank you. And our next question comes from Cam Johnson[ph] with Phoenix Capital Management. Please state your question.

Unidentified Analyst

Hi, thanks for taking the call. Can you discuss the newer products in the portfolio, what they're made from, where are the raw materials sourced from? And talk a little bit about the gross margin profile and how it relates to the rest of the business?

Charles D. Roberson

All right. I can talk about the raw materials pretty readily as there's no issues with competitors there. I don't want to get too deep into details on our margins other than to say that they typically run about 10% to 15% above our target margin. So, which is, we've said repeatedly, we expect to emerge from COVID with a gross margin that begins with four probably in the lower half of the 40%.

As for the fabrics, they are actually laminated constructions. The raw materials for which it's a – polyethylene and microporous film on spun-bonded polypropylene sourced in China, but easily sources in India or anywhere in the world. These are products that are largely used by the diaper business. So anywhere they have disposable diapers, we can source it. The barrier to entry the hard part of this market is validation of your clean manufacturing process and product sterility that's a minimum of a six month long process and requires that you conform to statistical process control, which means you have to make a full run. Let it age for three months to grow bioburden and you may fail it, and if you do, you've got a whole run of trash.

Unidentified Analyst

Okay. Thanks. One another question I had is, is can you discuss the near shoring strategies you mentioned and the benefits it brings to your competitive positioning and cost basis?

Charles D. Roberson

Sure. We are watching the U.S. Congress very closely. The U.S. stockpiling efforts have gone – for lack of a better word have gone dormant for the last month – six weeks that has been predicated by the rejection of 25 million of 26 million garment source for the stockpile that didn't meet the AAMI Standards for isolation gowns. As a result, they're not rushing out to replace those products right now. Congress is in the process of writing what it means – what made in, how made in USA is defined or the USA PPE Act. All of the variations of that legislation that we've seen to date starts off with at least a Berry Amendment or Made in USA if U.S. grown or sourced materials. And then provides exceptions, should pricing quality or availability not be a problem for you to go to a Tier 2, which is a foreign Made of U.S. product tier and failing that if they still have unmet demand, it is foreign made of foreign raw materials.

So what we're looking to do is to come in where we can enter into that Tier 2 level, which would be foreign made of U.S. raw materials, which makes manufacturing in the Caribbean base in

Canada or Mexico very attractive. We are not looking. We do not believe that we can be successful long-term manufacturing in the United States, while initial stockpiling orders will be huge. They will only turn 20% of that stockpile every year. So in year two, your volume falls to 20% of that level, and that's just not sustainable for a continuing operation. And it is highly unlikely that the private sector will pay the prices that the government is going to have to pay to get Made in USA.

Unidentified Analyst

Thank you.

Operator

Thank you. There are no further questions at this time. I'll turn it back to management for closing remarks.

Charles D. Roberson

Okay. Thank you. We appreciate your participation in Lakeland's fiscal 2022 first 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. Within even stronger balance sheet from the beginning of the year, and an outlook for continued free cash flow for the foreseeable future. Our data centric, operating culture is enabling sustainable financial performance to unlock additional growth opportunities. We're excited for what lies ahead and look forward to sharing our story at the Sidoti Virtual Investor Conference on June the 24th.

Thank you again for joining us on today's conference call, and have a nice day.

Operator

Thank you. And 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.