

Transcript of  
Lakeland Industries, Inc.  
Fiscal 2023 Third Quarter Financial Results and Conduct Conference Call  
December 8, 2022

**Participants**

Charles Roberson - Director, Chief Executive Officer, President and Secretary, Lakeland Industries, Inc.

Allen Dillard - Chief Operating and Chief Financial Officer, Lakeland Industries, Inc.

**Analysts**

Alex Fuhrman - Craig-Hallum Capital Group

**Presentation**

**Operator**

Good day, and welcome to the Lakeland Industries Fiscal 2023 Third Quarter Financial Results 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.

During today's call, we may make statements relating to our goals and objectives for future operations, financial and business trends, business prospects, and management's expectations for future performance that constitute forward-looking statements under federal securities laws.

Any such forward-looking statements reflect management expectations based upon currently available information and are not guarantees of future performance and involve certain risks and uncertainties that are more fully described in our SEC filings. Our actual results, performance, or achievements may differ materially from those expressed in or implied by such forward-looking statements. We undertake no obligation to update or revise any forward-looking statements to reflect events or developments after the date of this call.

During today's call, we will discuss financial measures derived from our financial statements that are not determined in accordance with U.S. GAAP, including EBITDA and adjusted EBITDA. A reconciliation of each of the non-GAAP measures discussed on this call to the most directly comparable GAAP measure is presented in our earnings release.

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

**Charles Roberson - Director, Chief Executive Officer, President and Secretary, Lakeland Industries, Inc.**

Thank you, John. Good afternoon and thank you all for joining. I'm joined today by Lakeland's Chief Operating and Financial Officer, Allen Dillard. As you saw in this afternoon's press release, Lakeland delivered another quarter of sequential improvement with net sales of \$28.4

million and a gross margin of 43.3%. Our sequential revenue growth was primarily volume driven, and our gross margin continues to exceed our long-term target threshold of 40%.

While we're proud of the sustained profitability we've delivered macroeconomic headwinds have continued to hold back our revenue growth potential in fiscal 2023, as global industrial markets remain pressured, a continuation of demand trends we have seen year-to-date. This is particularly true in our European and Asian markets as rising inflation in energy costs, along with zero tolerance COVID policies, respectively, weigh heavily on industrial markets in these regions.

While we anticipate these conditions will continue through the first half of next year, we believe that the industrial decline in these regions will be somewhat mitigated by a transference of some industrial activity to other geographic regions, specifically, India. India recognizes the opportunity it has to replace China as manufacturer to the world and is aggressively working to attract manufacturing from China. We are responding by increasing our sales presence in India and leveraging our India manufacturing with the goal of accelerating our growth there.

Despite these ongoing global market complexities, and industrial headwinds, our team has been successful and accelerating the initiatives we have in place to stabilize or enhance our operating model. Allen will touch on this in more detail, but I would note that these efforts cut across our organization and include manufacturing and cost structure rationalizations, as well as targeted resource allocation between our human and technical assets. These efforts continue to flow through our bottom line results. And we remain focused on positioning Lakeland for continued growth regardless of broader economic conditions.

As I indicated last quarter about our results for that period, in which I reiterate today about our performance this quarter, we remain proud of our near-term results and the foundational changes we are putting in place to ensure success in achieving our long-term strategic goals. However, we're not satisfied with our results in the short-term, though we recognize it's mostly macroeconomic-related headwinds that are holding back our revenue growth in the short-term, and note importantly, that we continue to outperform the overall industry in terms of growth, we must continue to adapt and react to the near-term environment, while remaining focused on achieving our long-term targets.

For the past several quarters, we've invested in maintaining a high level of in-process and finished goods inventory to enable us to serve our customers across the globe, focusing on quality, reliability, and customer responsiveness. This overall strategy remains unchanged. But with demand in certain overseas markets coming in weaker than originally anticipated, we will look to proactively but selectively accelerate the reduction of our overall inventory levels over the next few quarters to better align these with current end market demand levels, and to free up capital for additional investments in our growth strategies. Allen in his prepared remarks will provide a little more detail on this strategy in a few minutes.

Turning back to our long-term growth strategy. Last quarter, we emphasized the importance of continuing and accelerating our shift to fire, high performance and critical environment product lines, which present the greatest opportunity for long-term sales growth and margin potential,

while at the same time reducing the overall cyclicalities of our results and achieving our long-term performance targets.

In that regard, I'd like to spend a few minutes discussing the acquisition we announced earlier this week subsequent to quarter's end. This represents an important step in positioning Lakeland to execute this strategy more effectively. We announced the acquisition of Eagle Technical Products, a UK based provider of fireman's turnout gear and flame-resistant arc flash protective garments to global markets.

The addition of Eagle to Lakeland's platform is an important step in our pursuit of sustainable above market growth with high overall margin profile. This acquisition expands our global reach and enhances our product offering, particularly as it relates to firefighting applications outside of the North American market. Historically speaking, Eagle's revenue has been a mixture of European, Middle East and Asian sales.

Looking ahead, this geographic mixture will stay the same in terms of regions served, but Eagle's and now Lakeland's Middle East presence beginning in calendar year 2023 is expected to increase significantly as a result of a number of new important contract wins across this region that are expected to drive significant revenue growth for Eagle going forward. This growth is driven by important new contract wins for Eagle's core products which are CE certified firefighting gear, and industrial FR garments.

We believe, as does Eagle's management team that these recent important wins set the stage going forward for further growth in sales for these products in the Middle East, as well as parts of Asia and Africa. From a manufacturing standpoint, Eagle has developed relationships with several quality contract manufacturers, and in the near-term Lakeland intends to continue to utilize this strategy. Eagle currently has a healthy order backlog and sales funnel, and its supply chain is well positioned to meet current and anticipated future growth potential.

With that said, Lakeland does have in place a strategic and flexible global manufacturing footprint. And over time, we could shift some portion of this production to our own facilities. From a design standpoint, Eagle has an in-house team of specialists focused exclusively on European CE certified products, and we believe that their expertise can be brought to bear on other Lakeland offerings to increase sales opportunities and geographic markets not currently serviced by Eagle.

In short, the acquisition of Eagle fills gaps in our international high value product offering, our geographic market served, and in product development skill sets. We're excited about the additional revenue growth potential that could emerge over time as we integrate our product design and sales teams. But importantly, we have not assumed any benefit from this in our models as of this time. We acquired the business for approximately \$10.8 million in an all-cash transaction, and we fully expect the business to be accretive to Lakeland's top and bottom line results beginning in early fiscal 2024. Eagle has a high degree of free cash flow generation, a diverse customer base, many of which are on multiyear contracts and innovative proprietary product designs.

As I mentioned earlier, our goal is to expand into higher growth, higher margin markets, and this is a crucial step that will accelerate that journey. I'm excited to see our team execute on this opportunity and we look forward to sharing more about the integration of the Eagle business onto the Lakeland platform in the future. I'd like to welcome the Eagle team to Lakeland, and we're very excited to have you as part of our team and the potential for the future. I also want to thank my team here at Lakeland, for all of their work recently in closing this deal.

I'll now pass the call to Allen to provide more insight into the company's operations and financial results. Allen?

**Allen Dillard - Chief Operating and Chief Financial Officer, Lakeland Industries, Inc.**

Thanks, Charlie, and good afternoon, everyone. Lakeland was pleased to deliver another quarter of sequential revenue growth and strong profitability as our performance in the post-pandemic era continues to benefit from our strong product portfolio, end market and geographic diversity, financial strength, and a continued focus on operational efficiency.

On a consolidated basis for the third quarter of fiscal 2023, net sales were \$28.4 million, domestic sales were \$14 million or 49% of total revenues, and international sales were \$14.4 million or 51% of total revenues. This compares with domestic sales of \$11.9 million or 42% of the total and international sales of \$16.3 million or 58% of the total in the second quarter of fiscal 2023, while fiscal 2022 third quarter, domestic sales were \$10.6 million or 35% of total revenues, and international sales were \$19.4 million or 65% of total revenues.

Similar to last quarter, European and Latin American industrial markets are still challenged, which has accelerated the geographic shift in our revenue towards the U.S. On a consolidated basis, compared to fiscal 2022, currency fluctuations negatively impacted revenues by approximately \$1.6 million. In terms of product mix for the quarter, disposables represented 50% of total revenues for the period compared to 60% in the year ago quarter. As we discussed last quarter, this is a result of our strategy to more aggressively shift our product mix towards higher value, higher margin, and less commoditized non-disposable products in specific markets.

Gross profit as a percentage of net sales was 43.3% for the fiscal 2023 third quarter, as compared with 41.3% for the fiscal 2023 second quarter and 42.5% a year ago. During the quarter, our gross margin benefited from improved product mix and pricing power, lowering freight rates and an increase in direct container sales.

Lakeland reported operating profit of \$2.2 million in Q3 2023 as compared to \$1.8 million in Q2 2023 and \$4.2 million in the third quarter last year. As a result, operating margins were 7.8% in the third quarter, up from 6.4% for Q2 2023, down from 14.1% for the third quarter of last year. Operating income was negatively impacted by currency fluctuations, primarily related to the Chinese yuan, which totaled approximately \$800,000. Operating expenses also increased due to increased sales expenses of \$400,000, and admin expenses of \$400,000. Operating expenses also included \$200,000 of severance associated with staffing adjustments.

Lakeland delivered net income of \$1.4 million or \$0.19 per basic and diluted share during the quarter. This compares to a \$900,000 loss or \$0.11 loss per basic share and diluted share for Q2

2023 and \$2.9 million profit, or \$0.37 per basic and \$0.36 per diluted share in the prior year period.

EBITDA for the fiscal 2023 third quarter was \$2.6 million, compared with \$2.1 million for the fiscal 2023 second quarter and \$4.7 million for the prior period. Adjusted EBITDA for the fiscal 2023 third quarter was \$3 million, compared with \$2.5 million for the fiscal 2023 second quarter, and \$5.1 million in the prior year period. Adjusted EBITDA margin for the quarter was 10.4% as compared to 9% last quarter, and 16.9% in the third quarter last year.

Capital expenditures for the 3 and 9 months ended October 31, 2022 were \$500,000 and \$1 million, respectively. Year-to-date, our capital expenditures principally relate to purchases for expansion of our manufacturing facilities in Mexico, Vietnam and India, and a continued enhancement of our global IT infrastructure. We expect CapEx to be approximately \$2 million for the full fiscal year as we continue to make these investments.

Moving to the balance sheet, Lakeland ended the quarter with cash and cash equivalents of approximately \$34.9 million. The company continued to have no debt at the end of the quarter, and has up to \$25 million available from bank credit facilities. During the fiscal 2023 third quarter, the company repurchased approximately \$2.3 million or just over 194,000 shares of common stock under its repurchase program. This leaves approximately \$400,000 remaining under the existing authorization.

Subsequent to quarter's end, Lakelands Board of Directors authorized an increase in the overall capacity of the share repurchase program, approving an additional \$5 million for this program going forward. This new program will become effective upon exhaustion of the current program, and again, exemplifies our confidence in the company's growth potential, and showcases our commitment to optimizing shareholder value. As it relates to broader industry inventory levels, stock levels are decreasing, albeit at a slower pace than we expected earlier this year. Given the slower than expected normalization of channel inventory, global inventory levels remain in an elevated state.

In terms of Lakeland's inventory level, our stock levels remained flat quarter-over-quarter, and we have begun to proactively reduce these levels heading into fiscal 2024. Not only will this better align our inventory levels with current demand levels, and free up capital for additional growth investments as Charlie alluded to, but this strategy is a reflection of our commitment to shifting into higher growth products and markets, as a significant portion of this inventory is made up of disposables.

While certain pricing levers may be used to reduce disposable inventory levels, these efforts will be highly targeted and recoverable. We remain confident that given current market conditions, we will be able to orderly implement this plan and still be able to maintain our gross profit margins at or above our consolidated global target of 40%.

I'd like to provide an update on the progress made on our key strategic initiatives as it relates to our global manufacturing operations. During the second quarter, we continue to build out of our new facility in Monterrey, Mexico. This facility will incorporate modern manufacturing

processes, and automations that do not exist in our current facilities. It will also focus on the high value strategic products in our portfolio. This facility should be operational in our mid-fiscal year 2024. Also in this quarter, we continue to build out our cleanroom capabilities in Vietnam, and initiated a realignment plan in our China facility.

Additionally, as a part of our strategic initiatives, and as Charlie already discussed, we were pleased to announce the acquisition of Eagle Technical Products this week. Operationally, Eagle currently utilizes contract manufacturers to source their proprietary products and utilizes a highly leveraged back office to support sales and administration. Their EBITDA margin is a significant enhancement to current overall EBITDA margins for Lakeland, and is aligned with our stated 3 to 5 year aspirations for Lakeland.

As we look to the future, we're developing a migration path to utilize our existing manufacturing capabilities to service this business, which will provide opportunities for margin enhancement and increased profitability.

With that overview, I'd like to now turn the call over to John to open the line for questions.

**Operator**

Thank you. Ladies and gentlemen, the floor is now open for questions. [Operator Instructions] Our first question is coming from Alex Fuhrman with Craig-Hallum. Please proceed.

**Q:** Hey, guys, thanks very much for taking my question. It sounds like you're positioning for quite an opportunity over the next couple of years in India. I was wondering if you can give us an update on how big your businesses in India currently and what the next couple of years could be, and if there could be an opportunity for perhaps growth in India to offset some of the macro-related weakness that that you're seeing over the next couple of quarters.

**Allen Dillard - Chief Operating and Chief Financial Officer, Lakeland Industries, Inc.**

Hey, Alex, this is Allen. I'll start off with kind of the size, and then I'll let Charlie jump into the market. So, currently, India is kind of a midsized facility for us, we have just under 100 employees and the manufacturing operations there. And it serves the European market and the American markets in addition to the India domestic market. And so, where we see the growth primarily in the near-term is in the India domestic market. And as we bring the Eagle portfolio to the table, we see an opportunity to enhance our operations there.

**Charles Roberson - Director, Chief Executive Officer, President and Secretary, Lakeland Industries, Inc.**

Yeah, Alex, the current size of India is relatively small percentage of Lakeland's total revenue. And that's largely because of bureaucracy and some conflict as far as which products they want to utilize. It's a developing country. The use of disposables is a difficult sell there, all right. We do believe that with the acquisition of Eagle and their new product lines, we'll have a CE and NFPA fire service gear to sell there. The state, meaning their airports and state firefighting prefer NFPA gear. Industrially, CE gear is preferred because it's lighter weight and about 30% less expensive than NFPA gear. So we think the acquisition there is going to help us. I would also



add that half of our manufacturing there is in a special economic zone to facilitate the import of foreign raw materials economically.

**Q:** Okay. That's really helpful. And then thinking about the Eagle deal here, I mean this is the first real meaningful acquisition, and as long as I can recall, it seems like you have a nice balance sheet to do continued M&A if you wanted to. Are there other good targets out there that you're looking at that that could be bolted on here during this downturn?

**Charles Roberson - Director, Chief Executive Officer, President and Secretary, Lakeland Industries, Inc.**

Yeah, we're aware of the opportunities that the economic conditions may present. We are focused right now on a balanced approach to our use of capital. I won't rule out M&A, but it's not a priority over any other options as we pulled more cash out of inventory. Our situation changes, and that's going to be largely opportunity driven.

**Q:** Okay. That's really helpful. Thank you very much.

**Operator**

[Operator Instructions] Okay, I'd now like to turn the floor back to Charlie Roberson for closing remarks.

**Charles Roberson - Director, Chief Executive Officer, President and Secretary, Lakeland Industries, Inc.**

Thank you all for joining us in today's call. We look forward to closing out a strong year for the company and preparing for growth in calendar year 2023 and beyond. Thank you and have a good day!

**Operator**

Thank you, ladies and gentlemen. This does conclude today's conference call. You may disconnect your phone lines at this time, and have a wonderful day. Thank you for your participation.