

Transcript of
Lakeland Industries, Inc.
Fiscal 2024 Second Quarter Financial Results Call
September 7, 2023

Participants

Charles Roberson - Director, President and Chief Executive Officer, Lakeland Industries, Inc.
Roger Shannon - Chief Financial Officer, Lakeland Industries, Inc.

Analysts

Gerard Sweeney - ROTH Capital Partners, LLC
George Melas-Kyriazi - MKH Management Company LLC

Presentation

Operator

Good day, and welcome to the Lakeland Industries Fiscal 2024 Second Quarter Financial Results Conference call. All lines have been placed on a listen-only mode, and the floor will be open for questions and comments following the presentation.

During today's call, we will 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 adjusted EBITDA and adjusted EBITDA margin. 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, President and Chief Executive Officer, Lakeland Industries, Inc.

Thank you, Holly. Good morning, and thank you all for joining us for our second quarter fiscal 2024 earnings call. Please note that we also have an earnings presentation posted on our IR page of our website at www.lakeland.com.

Our second quarter results were very encouraging as we continued to see strong improvements in growth within our strategic product lines and markets. Lakeland delivered net sales of \$33.1 million, up 17.3% year-over-year. This growth was driven by organically and by Eagle Technical Products, which contributed \$3.4 million in revenue to our results this quarter. Notably, our fire service product category continued to see very significant growth with sales up 202% compared to last year. This growth highlights the significant momentum, Lakeland is building in our strategic product lines, and our goal to increase penetration in high value markets is producing positive results.

In terms of profitability, our second quarter gross margin remained strong at 42.9%, and importantly, our adjusted EBITDA grew by over 50% to \$4.2 million in the quarter. Our Eagle Technical Products acquisition, which makes European Standard Fire Services gear, produced \$900,000 of EBITDA in the quarter, helping elevate Lakeland's consolidated adjusted EBITDA margin to 12.6% this quarter compared to 9% in the prior year.

With regard to our key geographic markets, we saw similar demand trends to the first fiscal quarter with strength in the U.S., Europe and Latin America. The U.S. benefited from continued strength in the oil and gas sector as refinery turnarounds continued well into Q2. Sales of turnout gear into the U.S. market were particularly strong, as mentioned earlier, largely due to the lead time advantage that we have over our competitors as a result of our proactive raw materials planning and manufacturing efficiency improvements.

Our European sales strength continued as in Q1, meeting its performance targets and on the strength of the Eagle acquisition. Latin America also experienced strong fire service sales as a result of a large order delivered during the quarter. Despite strengthen those markets, our Asian markets have been weaker than expected, primarily driven by continued weakness in China. China's economy struggled throughout our fiscal second quarter as exports were at multiyear lows and unemployment increased.

China's distribution channels for PPE remain in an overstock position, as China works through its overstock of disposables, we are focusing on new end users to grow sales. Biopharma, semiconductors and batteries are among our targeted applications.

As I already mentioned, Eagle contributed very positively to our results during the quarter. Our integration efforts continue to generate significant cross organizational strategies and we expect the Eagle platform to continue to enhance our adjusted EBITDA performance going forward.

Eagle's fire glove and particle blocking hood are progressing through the certification process and we will soon be including Eagle's designers in the development of our next generation NFPA turnout gear. Additionally, samples of Eagle products have been produced in Lakeland facilities and are being used to certify those facilities to make some of Eagle's products.

Shifting gears to our capacity expansion initiatives, as we have previously communicated, we currently have an expansion project underway in Monterey, Mexico. Due to damage experienced during the second quarter at our newly leased Monterey site, we are currently evaluating our

leasehold improvement buildout schedule which may impact our go live production timing. This evaluation is still underway, however and importantly, we do not anticipate an adverse impact to our financial results and operations or our ability to meet our forecasts. We believe our expectations going forward are not at risk.

As it relates to our strategic priorities for the remainder of the fiscal year, we remain committed to driving revenue growth in key strategic markets, while via executing a shift in our sales resources towards higher value products. Our shorter lead times are resulting end market gains in our fire service and woven products, and we are utilizing our core strength in disposables and chemical garments combined with our manufacturing flexibility to attract new end users, to our container program and higher value strategic products.

The fact that we can supply a full range of safety and PPE products from a single manufacturing facility is attractive to our large customers. We are leveraging our core products to help our customers, fill containers more easily, which increases the frequency with which they can order high value products by container. This improves customers planning and reduces their freight and inventory costs.

Moving forward, our leadership team is committed to identifying and maintaining a robust acquisition pipeline with opportunities that enhance Lakeland's strategic product portfolio and expand our geographic reach.

Our M&A efforts are focused on finding opportunities like Eagle that meet our SSQ, small, strategic and quick acquisition strategy by identifying targets that are similar in size, highly strategic, and accretive to our bottom line in a short period of time.

I'll now pass the call to Roger to provide an overview of our financial results. Roger?

Roger Shannon - Chief Financial Officer, Lakeland Industries, Inc.

Thanks, Charlie, and good morning, everyone. Lakeland delivered sales of \$33.1 million in the second quarter ended July 31, 2023. Domestic sales were \$15.2 million, or 46% of total revenues, and international sales were \$17.9 million, or 54% 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.

As we noted in our earnings press release issued yesterday afternoon, we continued to see very strong growth within our fire service product category, with sales up 202% year-over-year. In terms of product mix for the quarter, fire service increased to 27% of sales for the quarter, up from 11% in the same quarter of last fiscal year.

As a reminder, our fire service product category was up 101% last quarter. Disposables continued to decrease as a percentage of Lakeland sales and represented 38% of total revenues compared to 45% in the year-ago period. This reflects the efforts we've made to shift our product mix toward higher value, higher margin and less commoditized products as we've discussed in prior calls.

From a segment reporting standpoint, Lakeland saw strong sales growth in our U.S., European and Latin American markets. This growth was partially offset by softer Asian sales, particularly in China, which is a continuation of what we saw last quarter.

Gross profit as a percentage of net sales was 42.9% for the fiscal 2024 second quarter, as compared with 41.3% a year ago. As Charlie already highlighted, our gross margin improvement has been driven primarily by a deliberate sales focus on strategic products supported by manufacturing efficiencies that have resulted in reduced lead times as well as decreases in transportation costs.

Lakeland reported operating profit of \$3.7 million in Q2 2024 as compared to \$1.8 million in the second quarter of last year. As a result, operating margins were 11.3% in the second quarter, up from 6.4% in the second quarter of last year.

Our operating profit benefited from improved gross margins resulting from our product mix shift and operating leverage resulting from higher revenue as previously discussed. This was partially offset by an increase of approximately \$600,000 in operating expenses compared to last year. The increase in OpEx is attributable to currency fluctuations, one-time expenses related to severance and startup cost, increased depreciation and amortization and OpEx related to the Eagle acquisition and year-over-year labor cost increase.

Currency fluctuations primarily related to the Chinese yuan and Argentinian peso totaled approximately \$600,000. One-time expenses related to severance and startup costs were approximately \$500,000, and increased D&A and OpEx related to Eagle totaled approximately \$300,000. These increases were partially offset by a reduction of \$700,000 in the earnout consideration accrual related to the Eagle acquisition, which was recorded as a reduction in operating expenses.

Lakeland delivered net income of \$2.5 million, or \$0.33 per basic share and \$0.32 per diluted share during the quarter. This compares to a net loss of \$900,000, or \$0.11 per basic and diluted share in the prior year period.

Adjusted EBITDA was \$4.2 million in Q2 2024 compared to \$2.5 million in second quarter 2023. Lakeland delivered operating cash flow during the quarter of approximately \$200,000. Our robust balance sheet provides us with significant flexibility as we continue to explore acquisition opportunities, organic growth investments and returning capital to our shareholders.

Lakeland ended the quarter with cash and cash equivalents of approximately \$24.3 million compared to our FY 2023 year-ended cash balance of \$24.6 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.

Capital expenditures for the 3 months ended July 31, 2023 were \$400,000. For the full fiscal year, we now expect capital expenditures to be approximately \$2 million, down from our previous estimate of \$3 million as we replace existing equipment in the normal course of

operations and pause the Monterey expansion to assess the damage to our leased building as Charlie previously discussed.

We expect to fund capital expenditures from our cash flow from operations. Inventories declined slightly quarter-over-quarter from \$57.9 million to \$57.4 million at the end of the second quarter of fiscal 2024. Raw materials inventory increased by [\$990,000] [ph], while finished goods inventories decreased by approximately \$360,000. The increase in raw material inventory is driven by growth in our higher value strategic products as we continue to strategically position ourselves to take market share from competitors.

More specifically, much of our success in these end markets can be attributed to having more favorable lead times versus our competition and having raw materials on hand is key to the strategy. While the overall decrease in inventory during the quarter was minimal, we remain committed to accelerating the reduction of our finished goods inventory this year as previously communicated.

We are aggressively pursuing additional sales channels, marketing programs and price deviations on excess inventory to drive these reductions. We expect these efforts to accelerate in the second half of this fiscal year.

With that overview, I'd now like to turn the call back over to the operator to open up for questions.

Operator

Certainly. At this time, we will be conducting a question-and-answer session. [Operator Instructions] Your first question for today is coming from Gerry Sweeney at Roth Capital.

Q: Good morning, Roger and Charlie. Thanks for taking my call.

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

Please, Jerry.

Q: I want to start the high value products and even a little bit on the fire products and wovens. But to start off, obviously, you're getting some great momentum there. Can you give a little bit more explanation? Is this obviously you talked about lead times and raw materials and that giving you advantage? But what can you do to keep this momentum going, or even accelerated to some degree in terms of maybe sales resources or things along those lines? Or are we looking at sort of a steady state and in a good shape from the momentum standpoint?

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

Well, let me start by saying this market differs from our core markets in disposable and chemical, and it's got its own distribution channels. And a number of those distributors are exclusive to a specific manufacturer of turnout gear. And this is true, not just in North America, but globally as well. And what has happened is our operations, people, planning and sales have

done a very good job. Over the last three quarters of managing raw materials availability that's kind of the long pole in the tent for lead time in the market. As a matter [ph], they've done an excellent job, our lead times will continue to be below our competition even though the early lead times are coming down.

And as a result of that, competitors lead times have been extended now for over a year in some cases. And a number of large distributors that were exclusive to other competitors are taking Lakeland product now. That's one of the nice things about lead time reduction is it becomes a weapon as long as you have a product that is a quality product, which we had before, they just wouldn't break the relationship even if it was a great product. Now, they have reason to do that, and we have our foot in the door.

As far as maintaining the lead time, I've never seen the lead times that we have in that market right now delivered by anybody. I know that our operations, planning and salespeople are committed to regular cross-functional meetings to continue to replicate the planning that they've done in that market. And the sales team is continuing to pursue additional opportunities that are out there. I think that the main avenue for growth, we maintain what we've done, we will continue to see growth in U.S. But, expanding this and replicating it with Eagle Internationally will be a very interesting, well, a great opportunity for us.

Roger Shannon - Chief Financial Officer, Lakeland Industries, Inc.

Hey Gerry...

Q: On Eagle – yeah, sorry go ahead.

Roger Shannon - Chief Financial Officer, Lakeland Industries, Inc.

Yes, we just had briefly that Charlie referenced Eagle and that really was the strategic rationale behind that acquisition. And also the strategic opportunity that we've identified within fire service, and as we've talked about on previous calls, we see a significant addressable market, but a market that is very fragmented. So, although, we are seeing advantages versus the major competitors on lead time. The major competitors still make up a fairly small part of the overall addressable market. So we see globally the opportunity to increase our market share and that really was the strategic rationale, we're pleased to see execution on that.

We do expect that to continue and just kind of taking Eagle as an example, it's a tremendous product that we acquired with the European standard that we're able to add to our portfolio, which is the NFPA standard put that into our global sales distribution channel, and kind of increasing that opportunity around the world. And we've found products within the Eagle portfolio, Charlie mentioned, gloves and particulate hoods that we're running through qualification and certification now. So I think that kind of validates that acquisition strategy. And like Charlie and I mentioned, we believe a robust acquisition pipeline, where we're looking to identify similar opportunities and grow that market.

Q: Yeah, actually the Eagle acquisition was what I wanted to ask next about. On the last call, you really talked about, I think, ramping up some of the cross-selling or some of the sales on the

Eagle products and vice versa. And I think into Latin America, South America, there was an opportunity. I'm just curious as to how that's going and if you could touch upon that.

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

We have some of the Eagle products already being offered in South America through Eagle's current manufacturing channel. Those opportunities should really accelerate once we have certification of our own facilities to make those products. We're also getting some traction in Europe with Eagle products. And we're kind of still in our infancy in North America, as far as bringing in the gloves and the hoods, but that is moving forward. And we should see results from that within the next 6 to 12 months.

Q: Got it. So in the North America hoods, gloves, I mean, that's still on yet to come, which is a positive.

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

Correct. As I mentioned in the call, another important part, while it's not quick cross-selling, but the involvement of Eagle's designers and the development of our next generation NFPA gear, that's North American gear. So we are going to have an entirely different perspective on our next-gen gear. That is a huge synergy for us.

Roger Shannon - Chief Financial Officer, Lakeland Industries, Inc.

Hey, Gerry, just a specific example, during the past quarter, we had a sales conference, sales trading with Eagle products and Eagle personnel for our Latin American team in country. So that was very well received.

Q: Got it. And then final question, acquisitions, you had the SSQ strategy. And you actually just touched upon it with the Eagle. Obviously, you have a global distribution footprint. I'm curious as to what that acquisition pipeline looks like? And I would suspect it's a little bit more maybe gear or product-driven over maybe geographic expansion. Could you touch upon that?

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

You are correct that it is more product focus. We do have companies that our primary interest might be geographic. We have a healthy pipeline, not to quantify, but there are plenty of opportunities out there in the Eagle size range, particularly the fire market is such a stratified fragmented market globally that they're actually more manufacturers there, I think, in the Eagle size range than there are behemoths. I mean, our estimation is that the largest player globally in the market only has a 10% market share. The next one after that's down to five, so that gives you some idea of how fragmented it is. So it is a market that is right before that repeating that the Eagle process.

Roger, do you want to add to that?

Roger Shannon - Chief Financial Officer, Lakeland Industries, Inc.

Gosh, that's exactly right. And like I mentioned in the call, we currently have no debt. We saw the contribution that Eagle made to [\$2,000] [ph] EBITDA, so that's also supportive of being able to build on that strategy.

Q: How much competitive advantage maybe the fire and turnout gear? Obviously, I think you talked about the hood and gloves for Eagle, but if you start building out additional products, how much advantage does that give you versus some of that stratified fire market?

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

Good question, Gerry. One of the issues that the end users deal with is selection of the garment and what certification to go with. Currently, there's only two other, well, there are a number of people trying, but there's only two other companies that are actually offering European certified gear and North American certified gear globally. Having that global reach and the ability to offer both product lines and explain the features and benefits of both is a tremendous service to the end users. There is confusion, for instance, in EMEA, there's a lot of use of NFPA gear, but CE is also coming in. So it's mixed and people don't necessarily understand the trade-offs they are making.

The differences in pricing of the gears as much as 30% or 40%. So for the savings in CE, what are you giving up, it's a tremendous amount of credibility within individual markets and the ability to supply from a global manufacturing base makes us cost competitive. There are a lot of advantages, a number of people that are trying to do it, the problem is they don't have the global footprint that Lakeland has to support it, we already have that. So the products are what we're looking for.

Roger Shannon - Chief Financial Officer, Lakeland Industries, Inc.

Yeah, what I would add to that, I think this is probably intuitive as well. We talked about, Charlie talked about, getting additional distribution channels due to our lead times, having that full suite of products both NFPA and CE and then being able to be head to toe just kind of strengthens that position with distributors. And we've also seen, and we expect to continue to see advantages in RFPs, because these smaller to medium size customers certainly would favor someone who's able to deliver the full ensemble.

Q: Got you. Super helpful. I appreciate it. I'll jump back in queue. Thanks, guys.

Roger Shannon - Chief Financial Officer, Lakeland Industries, Inc.

Thanks, Gerry.

Operator

[Operator Instructions] Your next question for today is coming from George Melas at MKH Management.

Q: Good morning, Charlie and Roger. Congratulations, looks like a great quarter. Quick question on operating leverage, it seems like you had really nice leverage this quarter and Roger your breakdown of the OpEx and the OpEx increase was quite interesting, because it seems like there

was sort of a lot of one-time expenses, of course, there was a reduction in the earn out as well, but it seems like you're maintaining good control over OpEx? Do you see that continuing to the future? Or do you feel like you're going to have to sort of spend more money as you try to expand share?

Roger Shannon - Chief Financial Officer, Lakeland Industries, Inc.

Great question, George, and thank you for the question. We've alluded to having operating leverage in previous conversations in the past, including with you, I recall fairly recently. It was very good to see that be the case. And like you said, a significant amount of the OpEx we saw in the quarter was either one-time or currency related and we are obviously like any company with taking measures to manage the currency risk. But we do believe we have operating leverage. We think our platform is currently scaled well to be able to manage this growth. So it was very nice to see that.

And the other thing that I would add is we're going to continue to put an even sharper focus on OpEx and OpEx reduction. And as I'm sure you've heard Charlie and me say before, we're very intently focused on free cash flow, and we're looking to make improvements in that across the company and we'll continue to focus on those items and hopefully drive additional efficiencies.

Q: Okay, great. That's good to hear. And maybe can you tell us a little something on the issues with the monetary clients. I don't know how much you can say, but I don't know if just sort of explain a little bit what happened, and where you are, where you stand, and what are the options that you're considering?

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

Yeah, George, we're very early in this process. As we said, there's not much that we can add because quite frankly, we were still investigating and have a lot of questions ourselves that we're still looking to answer. Suffice it, I think the best thing I can say about it is, while we are delayed and we are on pause, we don't see an impact to future earnings or our operations or our ability to meet our forecast. That was our first concern. And we believe that we have that handled. There was a startup time associated with that business anyway. So it's not an immediate impact to our projections.

But right now, unfortunately, we're waiting on some engineering reports. And once we have those, we'll know more. But at this point, there's not much else we can share.

Q: Very well. Thank you.

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

Thank you, George.

Roger Shannon - Chief Financial Officer, Lakeland Industries, Inc.

Thank you, George.

Operator

We have reached the end of the question-and-answer session. And I will now turn the call over to Charlie for closing remarks.

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

Thank you, Holly, and thank you all for joining us on today's call. I would also like to thank our employees for their commitment and hard work to execute on our strategic vision, which help drive strong results in the fiscal second quarter. We look forward to capturing the large opportunity ahead of us and building on the momentum we have achieved so far this year. Have a great day.

Operator

This concludes today's conference and you may disconnect your lines at this time. Thank you for your participation.