

# Lakeland Industries, Inc.

## Q1 2021 Results - Earnings Call Transcript

June 9, 2020 (Unedited)

### Company Participants

Charles Roberson - President & CEO

Allen Dillard - CFO

### Operator

Good day, ladies and gentlemen, and welcome to the Lakeland Industries First Quarter 2021 Financial Results Conference Call. All lines have been placed in 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 can contain forward-looking information within the meaning 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 June 9, 2020.

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, expected 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 in 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 attributable to the company or persons acting on its behalf are expressly qualified in their entirety by these cautionary statements.

At this time, I would like to introduce your host for this call, Lakeland Industries Chief Executive Officer, Charles Robertson, and Lakeland's Chief Financial Officer, Allen Dillard. Mr. Roberson, you may begin.

**Charles Roberson**

Thank you. Good afternoon to you all, and thank you for joining our fiscal 2021 first quarter financial results conference call. I'm joined today by Lakeland's Chief Financial Officer, Allen Dillard.

During our yearend conference call we talked about Lakeland expanding and transforming to advance its leadership position in the global Personal Protective Equipment or PPE market. We believe our results for the first quarter of fiscal 2021 validate our commitment to leveraging our diverse manufacturing facilities and resilient supply chain, with our new centralized data driven planning systems to propel Lakeland into a leadership position within the global PPE market.

With our first quarter fiscal 2021 performance, there should be no question that we have the necessary personnel, facilities, equipment, supplier relationships and vision to be at the forefront of this elite group. Challenged by pandemic of unprecedented proportion, our people rose to the occasion aided by our investments in manufacturing facilities and information technology.

As a result with our performance in the first quarter, we provide a glimpse of what our financial performance could be, as we utilize our materially improved financial position to continue process and systems improvements throughout Lakeland, and work to expand and develop our manufacturing capabilities for the future.

More importantly, we provided relief amid the COVID-19 outbreak, both here and abroad. We're grateful to our global workforce and management team for their dedication to their coworkers, our customers and those in need. Their adherence to our safety protocols, at work and at home, and their willingness to work extended hours, led to record quarterly sales which increased by an impressive 85% to nearly \$46 million.

Leveraging our newly centralized operating systems and emerging data-centric planning processes, we were able to respond to the demand for our products relating to the COVID-19 pandemic, while continuing to support and expand our traditional industrial customer base. Globally in the first quarter, we have added in excess of 150 new industrial end users, with demand resulting from shortages that are attributable to increased COVID-19 demand, but not necessarily associated with COVID-19 applications. While over 180 new customers were added in the healthcare and pharmaceutical sectors for what we believe are orders relating directly to coronavirus defense.

Gross margin and profit also were at record levels. Several factors contributed to our increase in gross margin. These include higher prices for new customers. Many of these new customers were unable to secure products from other manufacturers amid the stress of dealing with COVID demand. But because we own our manufacturing, and have built a durable and flexible production platform, we were able to flex and deliver when others could not.

You've heard us say this before and we can't say it enough, as a branded PPE provider, we are unique in owning our manufacturing facilities around the world. We do not rely on outsource contractors, and therefore own our supplier relationships and can shift our manufacturing in a matter of weeks, sometimes within days. We do not require months as is frequently the case with contractors. This important differentiator enabled us to scale our production output to achieve if

not exceed our organic growth targets, while contributing to the global pandemic response for emergency protective apparel.

Coronavirus related demand added approximately \$11.2 million to our fiscal 2021 first quarter sales. Approximately \$6 million of these orders were fulfilled with products already in inventory. Gross margins benefited from improved manufacturing efficiencies, resulting from a management decision to limit our product offering to only a few core styles during the pandemic period. This increased our manufacturing throughput beyond the increase in manufacturing capacity due to extended plant operating schedules.

Gross margins also benefited from sales of inventory that had been fully or partially reserved in previous periods. On a consolidated basis for the first quarter gross margin as a percentage of revenue reached a record 48.6%, compared to 30.6% in the prior year period and 37.7% in the fourth quarter of last year, when we had \$1 million of COVID-19 related sales.

The primary elements of our fundamental gross margin improvement strategy include development of flexible manufacturing capacity, increased market penetration into high value markets, significant improvement in manufacturing efficiencies, and extension of higher margin product lines into foreign markets. In our first quarter of fiscal 2021, sales volumes and factory floor utilization contributed to our record gross margin.

Having previously built up staffing and inventory over the preceding 18 to 24 months in anticipation of potential disruptions while deploying a new ERP system, we drew down the staffing in the middle of last year. With the higher inventory levels, we were able to deliver on COVID-related demand and post record revenues, as I mentioned a moment ago.

In fact, a majority of the COVID-related orders were fulfilled with products already in inventory, enabling us to attain a sales volume that is significantly above our normal manufacturing capacity and not sustainable quarter-over-quarter.

Finally, amid this incredible demand environment, we reduced the number of SKUs or product variations in our offering. This enabled our manufacturing staff to improve yields and manufacturing efficiencies, as we focused on fewer products for larger runs. We were able to make quick decisions in the quarter due to the business intelligence and production planning tools afforded us by our new ERP system. In turn, we experienced greater efficiencies and factory floor utilization to drive incremental gross margins on a percentage basis and in dollars.

Given all of the aforementioned, gross profit in dollars set a quarterly record at \$22.1 million in the first quarter of fiscal year 2021, a 190% increase from \$7.6 million for the same period of the prior year, and up 108% from \$10.6 million in the fourth quarter of fiscal year 2020.

As previously disclosed, in anticipation of continued heightened demand relating to COVID-19, we commenced manufacturing capacity expansion efforts. More recently, we encountered significant price increases in available raw materials and briefly adjusted our manufacturing schedules in Vietnam and China, from a maximum schedule of 12 hours per day, to a normal

schedule of 10 hours per day for disposable products, until we could confirm the level of demand at those higher prices.

We have since returned to a maximum capacity operating schedule. As raw material prices increased, we pass those increases on to customers, which led to some deferral or reducing of speculative orders. Still, while we last reported order backlogs, filling our manufacturing capacity through July and August for some products, we are now quoting deliveries out to August and September and continue to develop significant new accounts for the second-half of the year.

Benefiting from higher sales, elevated gross margins, resilient manufacturing capabilities, and effective management of operating expenses, our operating leverage was magnified. Our pre-tax operating margin was in excess of 27%, another record as compared with less than 6% in each of the last two fiscal years.

Net income in the first quarter jumped to a record \$8.6 million, up from a loss in the prior year. With this high level of profitability and minimal capital investment, we paid off our remaining debt and added \$9 million to our cash balance to end the quarter with \$23.5 million in cash, or about \$2.95 per share in cash.

While COVID-19 has presented unprecedented conditions that have materially improved our financial position. We remain on a higher trajectory for organic growth and are building an environment of global operational excellence, that will benefit our financial performance and organic market share attainment for the foreseeable future. COVID-19 likely will impact our business through the entirety of fiscal 2021.

We anticipate continued strong demand through Q2, and believe that higher than normal sales will continue into Q3. We believe that once the pandemic subsides, there will likely be secondary government driven demand, as governments around the world seek to replenish and perhaps increase their PPE stockpiles prior to a possible second wave of virus outbreak in the fall. The timing for this as always in crisis situations and the aftermath is uncertain. Some RFQs from government agencies have already been released, while others may take up to a year to surface. Additionally, we believe the private sector will also engage in stockpiling of PPE as supply channels catch up to demand.

And finally, we are seeing the emergence of institutional cleaning as a new market segment as countries, states, municipalities, schools, sports and entertainment complexes, the travel industry, private businesses and building owners reopen and seek to prevent any type of infection, whether it be from COVID-19 or some other outbreak.

For the financial analyst and other investors among our listeners, it is an imperfect exercise to attempt to eliminate the positive and negative effects of COVID-19 to arrive at a normalized first quarter financial performance for Lakeland. Pandemic response equates to healthcare on an industrial scale, and as such sales are for the most part may through our ordinary distribution channels and are not distinguishable from regular business, unless the distributor discloses the

end user or application, which they are not normally prone to do and are even less so, during times of allocated supply.

The takeaways for Lakeland are that we have developed a resilient and flexible global manufacturing platform, a diversified and expanding customer base, growing brand power for high-quality competitively priced PPE, and exceptional balance sheet and an operating model with tremendous leverage.

That concludes my remarks. I will pass the call to Allen to provide a more thorough review of the company's financial results.

### **Allen Dillard**

Thank you, Charlie. The following addresses my review of the financial results for our fiscal 2021 first quarter, ended April 30, 2020.

Net sales for a record \$45.6 million for the three months ended April 30, 2020 as compared to \$28.2 million for the three months ended January 31, 2020, and \$24.7 million for the first quarter of last year. For the fourth consecutive quarter, our revenues have exceeded \$27 million.

Coronavirus-related demand as best we can tell, added approximately \$11.2 million to our fiscal 2021 first quarter, and approximately \$1 million in our fourth quarter fiscal '20 sales. For a more balanced view of our financial performance with COVID demand contributions in both first quarter '21 and fourth quarter '20 period, but not in our first quarter '20 period, I'm including certain fourth quarter '20 numbers for comparison purposes, where it might be more helpful.

On a consolidated basis for the first quarter of fiscal 2021, U.S. sales were \$23.1 million or 51% of total revenues, and international sales were \$22.5 million or 49% of total revenues. This compares with U.S. sales of \$12.9 million or 52% of the total, and international sales of \$11.8 million or 48% of the total in fiscal 2020. While our revenues are significantly larger, our business remains very well-balanced from a geographic diversification standpoint.

Drilling down in fiscal first quarter '21 versus first quarter '20, sales in the U.S. increased by approximately \$10.2 million or 80%, while international sales increased \$10.7 million or 90%. Among our major international operations, sales in the UK were \$3 million versus \$2.4 million last year, sales in Mexico more than doubled to \$1.4 million from \$600,000, sales in Asia were up 136% and over \$9 million from \$3.8 million, Canada sales of \$4.3 million were up from \$2.5 million, and Latin America increased to \$2.4 million from \$1.7 million.

Now let's look at our product mix diversification. Disposables, which continue to be our largest product group increased by nearly 153% or \$18.9 million to \$31.2 million from \$12.4 million last year. Chemical sales were up 75% or nearly \$4 million to \$8.9 million from \$5.1 million last year. Both product groups benefited from organic growth, as well as significant COVID-19 demand.

Flame Resistant or FR products grew modestly to \$1.5 million from \$1.4 million. Gloves were just slightly higher in nearly \$800,000. High performance wear products, our newest line, which is marketed to utility companies and similar organizations were up nearly 25%. But this is still a small component of our overall business.

And large part our channel check suggests that PPE purchasing was focused, if not refocused, in the immediate-term to pandemic efforts at the expense of certain traditional industrial usage. Furthermore, during a significant duration of our first quarter, certain end market customers, such as those in the construction industry and the automotive sector, which typically contribute about 10% or more for our annual revenues were shut down voluntarily or by government mandate.

The energy sector also has had some disruption as we addressed in our fourth quarter commentary. So we're keeping a close watch on this segment. Although, we are not reporting any meaningful changes in sales that occurred in the first quarter.

As a result of the aforementioned issues, we experienced year-over-year declines in sales for our wovens and high-visibility or reflective product groups. As of June, certain of these trends including workplace closures and purchasing of disposable and chemical garments over other product groups in the wake of the pandemic have persisted.

Moving onto gross profits, gross profit of \$22.1 million for fiscal 2021 first quarter increased by \$14.5 million or by 190% from \$7.6 million for the same period of the prior year. Gross profit as a percentage of net sales was 48.6% for the fiscal 2021 first quarter, an increase of 18 percentage points from 30.6% in the prior year period and 11 percentage points from 37.7% in the fourth quarter of last year, when we had \$1 million of COVID-19 related demand. Charlie reviewed the key drivers for our gross margin improvement, so I won't repeat those comments.

With our substantially higher sales volume and gross margin contributions to leverage and our operating model drove substantial increases in profit and cash flow. As expected under the circumstances, operating expenses increased in the quarter, but decreased as a percentage of revenue. OpEx increased 24% to \$9.8 million for the three months ended April 30, 2020 from \$7.9 million in first quarter fiscal '20 and \$8.9 million in fourth quarter fiscal '20.

Operating expenses as a percentage of net sales was 21.6%, for the three months ended April 30, 2020, compared to 31.9% in first quarter '20, and 31.6% in fourth quarter '20. The increase in operating expenses primarily relates to higher shipping and commissions and compensation related to the higher sales volumes, partially offset by reduction in travel and other associated expenses year-over-year.

Lakeland reported operating profit of a record \$12.4 million in first quarter '21, up from a loss of \$315,000 in the prior year period and a profit of \$1.7 million in fourth quarter '20. Operating margins were 27.1% for the first quarter of 2021, 1.3% loss for the prior year period and 6.1% in fourth quarter 2020. All major operating regions were profitable in the first quarter of fiscal '21, which shows a slight reversal for Mexico, which was the only unprofitable major country operation in the fourth quarter of fiscal 2020.

On the higher pre-tax income, overall taxes increased tax expense consists of federal state and foreign income taxes. Income tax expense was \$3.7 million for the first quarter of fiscal '21, as compared to \$100,000 in the first quarter of fiscal '20. As a reminder, we have substantial tax yields pertaining to our U.S. and corporate income tax. However, we are subject to taxation on profits of certain of our foreign subsidiaries.

Lakeland's net operating loss for federal purposes is estimated to be \$6.6 million at April 30, 2020, down from approximately \$15 million at the beginning of the fiscal year. First quarter fiscal '21 net income was \$8.6 million or a \$1.08 per basic and a \$1.07 per diluted share, compared to a net loss of \$465,000 or \$0.06 per basic share in the prior year. The improved results reflect higher sales and margin expense management and the enhanced operating efficiencies leverage and factory utilizations.

The company had 7,972,423 basic shares outstanding at April 30, 2020. We did not repurchase any shares in the first quarter as a part of the company's \$2.5 million stock buyback program that was approved in July of 2016. As a reminder to-date we have spent \$1.7 million to repurchase shares and still have over \$800,000 remaining available in that buyback program.

As of April 30, 2020, Lakeland had cash and cash equivalents of \$23.5 million, up from \$14.9 million at the end of fiscal 2020. Inventories were reduced by \$6.7 million from the beginning of the fiscal year, due largely to a sale through of sealed seam finished goods driven by COVID demand. This product line remained slightly below normal stocking levels in all of our warehouses around the world. And we are now quoting deliveries into August and September for new orders in many cases.

As we have stated, we are servicing coronavirus orders only to the extent that we have capacity beyond what is required to service our traditional customers and organic growth targets. We believe this process of upholds our long-term growth strategies, supports our commitment to our customers and contributes to the COVID-19 response.

Accounts receivable at quarter end increased by nearly \$7.6 million due to higher sales, as DSOs remained steady at approximately 50 days. Accounts payable and accrued expenses decreased by approximately \$1 million. And shareholders' equity was increased by \$8.5 million. Total Assets increased \$8.3 million in the quarter from \$99.4 million to \$107.7 million.

The company has essentially no debt outstanding at April 30, 2020, which resulted from paying off the \$1.2 million term loan that we had at January 31, 2020. The company has no borrowings outstanding on its \$20 million revolving credit facility. The company is currently negotiating a new revolving credit facility agreement that will provide even greater financial flexibility and reduced administration.

Working capital was \$77.9 million at April 30, 2020, increased from \$66.9 million at the beginning of the fiscal year. Capital expenditures were approximately \$200,000 during the first quarter of fiscal 2021, flat from the prior year period. CapEx for the year is expected to be approximately \$2 million as compared with \$1 million in fiscal '20 and \$3.1 million in fiscal 2019. The majority of our CapEx in the current fiscal year will be for strategic capacity increases

as needed, continued enhancement of our manufacturing efficiencies and extending the phased rollout of our ERP system.

Adjusted free cash flow in first quarter '21 was \$11.9 million, an increase of over \$12 million from the prior year period, driven by higher sales margins and operating efficiencies, as cash expenditures in both periods were approximately flat.

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

**Charles Roberson**

Thank you. And we appreciate your participation on Lakeland's fiscal 2021 first quarter financial results conference call. As we look ahead to the balance of fiscal 2021, we continue to be well-positioned as a leading player in the more globally recognized and growing PPE industry. Thank you again for your time, for joining us on today's conference call. And goodbye.

**Operator**

Ladies and gentlemen that will conclude today's call. We thank you for your participation. You may disconnect at this time. And have a great day.

Source: SeekingAlpha