Corrected Transcript

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Hamilton Beach Brands Holding Co. (HBB)

Q2 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Tiffany, and I will be your conference operator today. At this time, I would like to welcome everyone to the Hamilton Beach Brands Holding Q2 2018 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

Lou Anne Nabhan, Investor Relations Consultant for Hamilton Beach Brands Holding, you may begin your conference.

Lou Anne Nabhan
Investor Relations Consultant, Hamilton Beach Brands Holding Co.

Thank you, Tiffany, and good morning, everyone. Welcome to the second quarter 2018 earnings conference call and webcast for Hamilton Beach Brands Holding Company. Greg Trepp, President and Chief Executive Officer; and Jim Taylor, Vice President, Chief Financial Officer and Treasurer, will discuss the company's second quarter results. Also with us to participate in the Q&A is, Scott Tidey, Senior Vice President, North America Sales and Marketing for Hamilton Beach Brands.

Yesterday, after the market closed, the company issued an earnings release announcing second quarter 2018 results and filed a 10-Q with the SEC. Both documents can be found on the company's website at www.hamiltonbeachbrands.com. A replay of today's call will be posted on the website this afternoon, and when available, a transcript will be posted.

Today's presentation contains forward-looking statements, which are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in either the prepared remarks or during the Q&A. Additional information regarding these risks and uncertainties was included in our earnings release and 10-Q. The company disclaims any obligation to update these forward-looking statements, which may not be updated until our next quarterly conference call, if at all. Also, certain amounts discussed during today's call are considered non-GAAP. The non-GAAP reconciliation of these amounts are included in our earnings release.

And now, I'll turn the call over to Greg.

Gregory H. Trepp

President and Chief Executive Officer, Hamilton Beach Brands Holding Co.

Thank you, Lou Anne. Good morning, everyone, and thanks for joining the call. My remarks will cover the second quarter performance of our two business segments, Hamilton Beach Brands and Kitchen Collection. At Hamilton Beach, continued progress with our strategic initiatives drove a 6.5% increase in revenues and extended our revenue growth momentum from the first quarter. Our second quarter revenue growth was primarily the result of increased sales of new and higher-priced products, mainly in the U.S. consumer and global commercial markets.

Our sales of new, higher-priced and higher-margin products resulted in gross profit margin increasing to 22.4% from 21.3% in last year's second quarter. While revenues and gross profit improved, our operating profit declined because of higher SG&A expenses. Two items were the main drivers of the $4.1 million increase in SG&A; increased employee-related expenses and an increase in professional and outside services fees.

Higher employee-related expenses included an increase in our accrued incentive compensation, driven by a substantial increase in our stock price during the quarter. We incurred higher professional and outside services fees during the quarter, mostly as a result of patent litigation. While we can't provide the specifics about the litigation, we believe that Hamilton Beach will prevail. But obviously, we're not happy with the impact these expenses had on our bottom line and we're working to offset them in the coming quarters.

We are pleased that our revenues are growing at a solid pace and gross margins are performing well. I'll provide with some additional detail on the drivers of our second quarter revenue growth and the impact of our strategic initiatives. In U.S. consumer market, we continue to realize the benefit of our commitment to consumer-driven product innovation. For example, our FlexBrew coffeemaker line is performing extremely well. FlexBrew allows consumers the flexibility to brew a single cup using either ground coffee or K-cups and some machines allow you to brew a full pot in addition to single serve.

We benefited from our focus on expanding our participation in the only-the-best segment. In this premium segment, we have invested in new products that are sold under the Wolf Gourmet, Weston, Hamilton Beach Professional and CHI brand names. Our CHI line of products continues to expand distribution and sell well. Weston, Hamilton Beach Professional and Wolf Gourmet are all growing and should continue to grow in the back half of this year. Under the Wolf Gourmet brand, we recently introduced a multi-function cooker, the Precision Griddle and later this year, an automatic drip coffeemaker will be introduced, all products that should generate incremental growth.

In our Global Commercial business, we're increasing our presence through enhanced product lines for chains and distributors, serving the global food service and hospitality markets. Our reputation for performance, reliability and differentiated products is driving growth. Examples of our newer commercial products that are expected to generate increased penetration at regional and global chains are our Otto Juice Extractor and our new Quantum high-performance commercial blender. We've also just introduced new line of commercial chamber vacuum sealers that we believe will drive incremental growth.

We're leveraging our sourcing, marketing and e-commerce strengths to drive category and channel expansion. Examples of new products being introduced are our laundry care product line, coffee-serving products and knife sharpeners among others.

As a result of new product introductions and strong promotions and placements anticipated in the second half of this year, based on current customer commitments, we expect sales volumes and revenues to increase moderately over the remainder of the year compared with the second half of last year, provided that consumer spending is at expected levels. Additionally, our overall full-year revenue growth is expected to be slightly more than anticipated industry market growth as a result of increased placements of higher-priced, higher-margin products.

Hamilton Beach has great strength in our comprehensive coverage of the marketplace, including well-known brands, price points from value to luxury and our participation over 50 categories. We believe that this is a significant competitive advantage that will help drive our ability to reach our $750 million to $1 billion in sales goals. As we move towards the target sales levels, while continuing to invest prudently in our strategic initiatives, operating margins are expected to increase over time as a result of leveraging fixed costs.

Next, let me comment on our Kitchen Collection business. Declining foot traffic at retail stores continues to create headwinds and downward pressure on revenues and operating results. At the same time, I'm proud of our team for delivering strong gross margins, controlling inventory and reducing SG&A expenses. Foot traffic trends continued to result in lower comparable store sales. In the second quarter, the closure of 13 underperforming stores since the end of the second quarter last year also contributed to the decline in revenues, but had a modestly positive effect on operating results.

Kitchen Collection currently operates 199 stores. As you know, our principal strategy is to continue to aggressively manage the store portfolio through natural lease expirations and ongoing renegotiations of rent commitments. As we reported, by the end of 2018, we expect the average lease duration to be about 12 months or less for approximately 70% of our stores. This will provide us with flexibility to cost effectively optimize our store portfolio over time to a smaller core group of 100 to 150 profitable stores in more favorable outlet mall locations.

If Kitchen Collection cannot reach acceptable terms with its landlords as leases come up for renewal in the remainder of 2018 and in future periods, and if sales at certain stores continued to deteriorate, necessitating early lease terminations, the pace of store closings could increase.

With that overview of our two segments, let me turn the call over to Jim for more details about our second quarter results.

James H. Taylor

Vice President, Chief Financial Officer and Treasurer, Hamilton Beach Brands Holding Co.

Thanks, Greg, and good morning, everyone. I'll first report on consolidated results for the second quarter of this year compared with the second quarter of last year. And then, I'll provide our outlook for the second half of this year.

Consolidated revenues increased 3.2% to $157.9 million compared with $153 million last year. This amount included revenue growth of 6.5% at Hamilton Beach to $135.9 million, partly offset by a 12% decrease in revenues at Kitchen Collection to $22.8 million.

Operating expenses increased to $40.3 million compared to $36.7 million in last year's second quarter. As Greg mentioned, the $4.1 million increase in SG&A expenses at Hamilton Beach was the main driver for the consolidated increase. The increase in SG&A at Hamilton Beach was driven mainly by two items; a $2.2 million increase in our employee-related cost and a $1.7 million increase in professional and outside service fees.

Greg provided the detail on the legal fees, but let me provide some additional color and specifics on the employee-related expenses. Our employee-related costs increased primarily because of an increase in accrued incentive compensation, including a $500,000 non-cash adjustment, driven by 37% increase in our stock price during the second quarter.

We adjust the estimates for the non-cash equity component of our incentive stock compensation each quarter based on the stock price at the end of the respective quarter. As such, this can cause significant variations in our expenses, both positive and negative, depending on the stock price movement during the quarter.

Consolidated operating profit decreased to $593,000 in the second quarter of this year from $2.2 million in the second quarter of last year. These amounts included operating profit at Hamilton Beach of $4.4 million compared with $5.2 million last year and an operating loss at Kitchen Collection of $3.89 million compared to a loss of $3 million last year.

At Kitchen Collection, the decreases in revenues and operating results were primarily due to lower comparable store sales from reduced customer traffic, which resulted in a decline in the number of store transactions and a modest decrease in the average sales transaction value.

As Greg mentioned, the closure of underperforming stores since June 30, 2017 also contributed to the revenue decline, but had a modestly positive effect on operating results.

Consolidated interest expense was $926,000 in the second quarter compared with $460,000 last year. This increase was driven by an increase in the average borrowings outstanding at Hamilton Beach, as well as higher interest rates.

Other expenses below the operating profit line increased by $1.2 million year-over-year, primarily because of unfavorable currency movements at Hamilton Beach, which resulted mostly from the re-measurement of inter-company balances of our foreign subsidiaries.

Our effective income tax rate decreased to 26.7% from 30.8% last year, primarily because of the reduction of the U.S. federal corporate tax rate. We continue to expect that our full-year 2018 effective income tax rate will be in the 26% to 28% range.

As a result of this activity, we reported a consolidated net loss of $874,000 or $0.06 per share compared with net income of $1.2 million or $0.09 per share last year. These amounts included net income of $2 million at Hamilton Beach compared with net income of $3.2 million last year and a net loss at Kitchen Collection of $2.9 million this year compared to $2 million last year.

Cash on hand was $2 million as of June 30, 2018 compared to $10.9 million at December 31, 2017 and $5.3 million as of June 30, 2017. Debt as of June 30, 2018 was a $105.5 million compared to $51.3 million as of December 31, 2017 and $54.3 million as of June 30, 2017.

Debt increased over 2017, primarily as a result of higher inventory levels at Hamilton Beach that were implemented to support sales growth forecast in both the first and second half of the year. By the end of 2018, we expect these inventory levels to be comparable to 2017 based on anticipated customer demand.

Consolidated EBITDA for the second quarter of this year was $900,000 and $42.5 million for the trailing 12 months.

Turning to our outlook for the second half of this year. We expect revenues and operating profit at Hamilton Beach to be moderately higher compared to the second half of last year, driven by sales of higher-margin products. Anticipated product cost increases are expected to be offset by price increases and adjustments to product placements.

While the tariffs enacted by the United States in July on imports from China are expected to impact only a small number of Hamilton Beach products, we will continue to closely monitor potential additional tariffs, commodity and other input costs, as well as currency effects, and we intend to continue to adjust product prices and product placements as necessary as market conditions permit.

We expect net income for both the second half and full-year 2018 to be significantly higher than the same period in 2017, mostly as a result of a lower effective corporate income tax rate and the absence of the provisional charge that was recorded in 2017 for the U.S. tax reform legislation.

Cash flow before financing activities is expected to be significantly higher in the second half of the year compared with the second half of 2017, resulting in an overall increase for full-year 2018 compared with 2017. Capital expenditures at Hamilton Beach are expected to be $9.7 million in 2018, of which $4.4 million was expanded in the first half.

At our Kitchen Collection business, our outlook is for revenues to continue to decline moderately in the second half of 2018 compared with the second half of 2017 as a result of anticipated reduced foot traffic and the reduction in store count. Kitchen Collection plans to continue to focus on maintaining strong gross margins, controlling operating expenses and optimizing working capital.

We expect operating profit in the second half of the year to be comparable with the second half of 2017, provided foot traffic does not deteriorate further than expected. While the benefit of the lower effective income tax rate on pre-tax income is anticipated to result in an increase in net income in the second half of 2018, this improvement is not expected to offset the substantial net loss realized in the first half of the year. Without an increase in store traffic, Kitchen Collection expects the full-year 2018 operating and net losses to be significantly higher than in 2017.

Cash flow before financing activities at Kitchen Collection is expected to result in a substantial use of cash in 2018 due to forecasted working capital changes and the anticipated higher net loss. Capital expenditures at Kitchen Collection are expected to be approximately $500,000 in 2018, of which $200,000 was expanded in the first half of 2018.

We believe Kitchen Collection's strategy of focusing on cost effectively optimizing its store portfolio over time will enable the business to operate a smaller group of profitable stores at more favorable outlet mall locations.

So, overall, for the consolidated company, we expect second half and the full-year 2018 consolidated net income to increase substantially over the same period in 2017, including the benefit of a lower effective tax rate and the absence of the provisional tax charges that were recorded in 2017.

That concludes our prepared remarks. I'll turn the line back to the operator for Q&A.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Peter Benedict with Baird. Your line is open.

Peter S. Benedict
Analyst, Robert W. Baird & Co., Inc.
Q

Hi, guys. Good morning. Couple of questions here. First, just on the top-line, obviously the organic revenue growth accelerating nicely here at the HB segment. Was it – is it really predominantly the higher-priced product being placed in the market or is there – are there any new account wins that are happening expanded distribution either on the retail side and then clearly commercial has been good. So, just trying to understand, if you can maybe rank order, what really drove the acceleration here in the first half of the year versus where you've been?

R. Scott Tidey
Senior Vice President-North America Sales and Marketing, Hamilton Beach Brands, Inc., Hamilton Beach Brands Holding Co.
A

Hey, Peter. This is Scott. I think it's been fairly evenly distributed across the different business units. I can't say that certainly from a U.S. consumer and Canada perspective, that there is any one thing in particular, any one retailer or one category. As Greg mentioned earlier, our FlexBrew category focused on single-serve coffee has been doing very well and we're certainly seeing a lot of growth across a lot of our existing retailers on that business. And we feel like we've got a good amount of support going into the back half on that line.

Gregory H. Trepp
President and Chief Executive Officer, Hamilton Beach Brands Holding Co.
A

And Peter, this is Greg. On the commercial front, what I've been happy to see is, it's not being driven by one big win. Our goal has been really to expand distribution with regional and global chains. And we really are seeing nice movement in our food service business, which is where those chains are rolled up into both in the U.S. as well as internationally. So, it's pretty nice broad growth in terms of where it's coming from. And just to close out on Scott's comment, I think again, the nice thing is that it wasn't due to one big win or one big order, it seems to be some nice broad-based growth coming from a number of customers.

Peter S. Benedict
Analyst, Robert W. Baird & Co., Inc.
Q

That's good to hear. Do you think – I mean, as we think going forward, you said you guys clearly can grow faster than the market, I think market has generally been the low single-digit grower. Is mid-single digit is kind of the pace you think is sustainable for this, for HB or I mean, are these higher single-digit growth rates something that you think you may be able to do given the orders you've been seeing?

Gregory H. Trepp
President and Chief Executive Officer, Hamilton Beach Brands Holding Co.
A

Well, just one caveat as we go into back half is, I think what we feel really good about is that we've – now we have more clarity around our promotions, placements, there is so much business being done, there are holidays, the whole dynamic of the consumer coming in and buying at the pace we think they will and then buying our space is a big unknown, but we're assuming that is going to be in a traditionally average level.

So, with that assumption, I think our belief is that we are poised to have something that grows a little bit faster than market. A few big drivers of the market last year that really spiked up a little higher than average and we think that will come back down. So, I think if you think it from a range standpoint, I think sort of assuming a little bit faster than the market that's growing in low-single digits is probably more of a real view, could be a little less, could be a little more, but we think that's probably a fair assumption.

Peter S. Benedict
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. Thanks for that. Moving over to gross margin, obviously, it was up nice again, you've got some mix benefits there, but the gain was a little less than what you saw in the first quarter. How do we think about the trends from here? I mean, I assume mix will continue to be a positive, but are rising input costs, transportation costs, are those things that should have assuming maybe more flattish gross margins year-over-year going forward, how should we think about that?

Gregory H. Trepp
President and Chief Executive Officer, Hamilton Beach Brands Holding Co.

A

Well, I think on the cost side, there are definitely number of moving parts from the input cost, to a less degree, freight cost, but certainly the tariffs. But we think so far, we feel like we've mitigated those through pricing or product switches or things we've talked about in the past that we try to do to keep our margins in line.

I think, Peter, our view is, there is a scenario or two where margins could be a little bit higher than last year. And as you get to the back half, where you're also in a very highly promotional period, so it could be back in line with our kind of our average. So, I think I would just – our general assumption is we're going to drive top-line, hold margin and therefore, get leverage on our fixed cost and that's kind of – there is so much volatility in the back half. I'd sort of say, I don't want to assume or signal that we think it will go higher, because there is too many moving parts to be confident of that. So, we'll sort of keep it in a historical range for now and see how it turns out.

Peter S. Benedict
Analyst, Robert W. Baird & Co., Inc.

Q

Okay, that's fair. On the expenses, the professional fees of $1.7 million, is that something that's expected to continue going forward? I mean, in the prepared remarks, you kind of mentioned, efforts to kind of offset that going forward or is this just more of a one-time thing that just kind of hits this quarter? How do we think about that?

James H. Taylor
Vice President, Chief Financial Officer and Treasurer, Hamilton Beach Brands Holding Co.

A

Yeah, Peter. This is Jim. With respect to the litigation, we can't speak in specifics. But, I will say that it hasn't been resolved at this stage. So, we would expect that there would be ongoing expenses associated with that to defend ourselves, and I think that's baked into our outlook. So, we hope that we can prevail, we think we will and we'll see where it goes. But, we would expect to have some level of ongoing expense associated with it.

Peter S. Benedict
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. Okay. That's fair. Balance sheet, a couple there and then something on cash flow. So, the inventory at HB up 33%. I know you guys – you said that you expect to get it online. Are you buying ahead of the tariff stuff or are the tariffs impacting just so few products that that's not really playing the role?

Gregory H. Trepp
President and Chief Executive Officer, Hamilton Beach Brands Holding Co.

A

Yeah. We're not really buying – we're buying (sic) [we're not really] ahead of the tariffs. I mean, we certainly have some benefit associated with the nominal number of products that are subject to the tariffs given our inventory position. But really, as we said I think in the past, I mean, it's really two things. One is, we have the inventory brought in to correspond to what we feel is higher sales forecast in the back half of 2018 versus the back half of 2017.

And then, the actual sales in Q2, while strong, did lag somewhat the forecasted demand. So, we'll work those inventory levels down. And the expectation is, by the end of the year, we should be in a very good position and relatively comparable to 2017 based on anticipated customer demand.

Peter S. Benedict
Analyst, Robert W. Baird & Co., Inc.

Q

Okay, thanks. And the accounts receivables are growing rapidly. What's driving that? Are there different terms to some retail partners? Are your terms different when you're dealing with commercial versus retail partners? What's – can you give us any color on that?

Gregory H. Trepp
President and Chief Executive Officer, Hamilton Beach Brands Holding Co.

A

Yeah. It's not really terms. I think it's mostly timing. We had a lift in revenues obviously in the second quarter. And depending upon the timing of that within the quarter, you're looking at a point in time. So, we feel good with the receivables quality and it's just really timing.

Peter S. Benedict
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. And then, so last one here. On free cash flow, do you expect consolidated free cash flow to be higher than it was in 2017 this year or how – obviously, I mean you – the cash flows were negative first half, it normally is for you guys. The expectation that you would even do similar or better free cash flow for the year would suggest significant improvement in the back half for the year. I just want to make sure we're understanding that correctly?

Gregory H. Trepp
President and Chief Executive Officer, Hamilton Beach Brands Holding Co.

A

Yeah. I think we feel – as we indicated in the prepared remarks, we feel good about the cash flow, free cash flow generation on the Hamilton Beach side of the business. I think as we indicated, KC will be a substantial use of cash. So, it's always difficult to predict exactly where the free cash flow is going to come in because of the timing of the fourth quarter and you can get some movement on the receivable side. But, it's just – probably, I can't put a number out there, but it's I think going to be in line with 2017, give or take.

Peter S. Benedict
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. And last one and then I'll hop off. Just a sense for where do you guys see the debt sitting as you get to kind of by year-end, what's the leverage kind of look like?

Gregory H. Trepp
President and Chief Executive Officer, Hamilton Beach Brands Holding Co.

A

We expect debt to come down, obviously pretty substantially from where we are at the end of the second quarter, and we'll be in a much stronger leverage position. And we feel good where we're going to be with that sort of free cash flow and the ability to pay-down debt. So, I think we'll be in a very good leverage position at year-end.

Peter S. Benedict
Analyst, Robert W. Baird & Co., Inc.

Q

All right. That's all I have. Thanks so much, guys.

Gregory H. Trepp
President and Chief Executive Officer, Hamilton Beach Brands Holding Co.

A

Thanks, Peter.

Operator: There are no further questions in queue at this time. I will now turn the conference back over to Mr. Greg Trepp for closing remarks.

Gregory H. Trepp
President and Chief Executive Officer, Hamilton Beach Brands Holding Co.

Okay. Thank you, everybody. As you've heard this morning, we're pleased with the continued top-line momentum, driven by our strategic growth initiatives and we expect our progress to continue. If Kitchen Collection continues to operate in a difficult retail environment, we're looking to further right-size the business and better position it to deliver acceptable returns, focused on increasing shareholder value over the long-term. And that concludes our call for today. So, thank you everybody for joining us.

Operator: This concludes today's conference call. Thank you for participating in today's Hamilton Beach Brands Holding Q2 2018 Earnings Conference Call. This call will be available for replay beginning at 12:30 PM Eastern Time today through 11:59 PM Eastern Time on August 9, 2018. The conference ID number for the replay is 3293605. Again, the conference ID number for the replay is 3293605. The number to dial for the replay is 855-859-2056. You may now disconnect.