08-Mar-2018

Hamilton Beach Brands Holding Co. (HBB)

Q4 2017 Earnings Call

CORPORATE PARTICIPANTS

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

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

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

Christina Kmetko
Investor Relations Contact, Hamilton Beach Brands Holding Co.

OTHER PARTICIPANTS

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

Michael Fisherman
Analyst, Zuckerman Investment Group LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Casey, and I will be your conference operator today. At this time, I would like to welcome everyone to the Hamilton Beach Brands Holding Company 2017 Fourth Quarter and Full-Year 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.

Christina Kmetko, Investor Relations, you may begin your conference.

[01RX2S-M Christina Kmetko]

Thank you. Good morning, everyone, and welcome to our 2017 fourth quarter and full-year earnings call. I am Christina Kmetko, and I am responsible for Investor Relations at Hamilton Beach Brands Holding Company. I will be providing a brief overview of our quarterly results and business outlook, and then I will open up the call for your questions. Joining me on today's call are Greg Trepp, President and Chief Executive Officer; Jim Taylor, Vice President, Chief Financial Officer and Treasurer; and Scott Tidey, Senior Vice President-North America Sales and Marketing for our subsidiary, Hamilton Beach Brands.

Yesterday, we published our fourth quarter and full-year 2017 results and filed our 10-K. Copies of our earnings release and 10-K are available on our public company website at hamiltonbeachbrands.com, not to be confused with hamiltonbeach.com, which is our Hamilton Beach subsidiary's website. For anyone who is not able to listen to today's entire call, an archived version of this webcast will be on our website later this afternoon and available for approximately 12 months.

As we begin, I would like to remind participants that this conference call may contain certain forward-looking statements. These statements are subject to a number of risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements made here today in either our prepared remarks or during the following question-and-answer session. We disclaim any obligation to update these forward-looking statements, which may not be updated until our next quarterly conference call, if at all. Additional information regarding these risks and uncertainties was set forth in our earnings release and in our 10-K. Also, certain amounts discussed during today's call are considered non-GAAP. The non-GAAP reconciliations of these amounts are included in our earnings release available on our website.

Now, let me discuss our results for the fourth quarter. I will discuss the highlights first and then get into the details. On a consolidated basis, revenues for the fourth quarter of 2017 increased 2.7% to $265.8 million from $258.9 million last year, driven by a 7.1% increase in Hamilton Beach Brands revenues, partly offset by a 13% decrease in Kitchen Collection's revenues, driven by comp store sales declines and the closure of unprofitable stores. Our consolidated operating profit of $31 million was comparable to last year's fourth quarter.

Finally, our consolidated net income of $13.8 million or $1.01 per share includes a charge of $4.7 million or $0.34 per share related to U.S. tax reform legislation enacted in late December. Excluding the impact to the U.S. tax reform, our adjusted income was $18.5 million or $1.35 per diluted share for the fourth quarter of 2017 compared with $18.6 million or $1.36 per diluted share for the fourth quarter of 2016. Our fourth quarter 2017 consolidated EBITDA was $31.7 million. Those are the consolidated company results.

Now, let me turn to our individual segments. Our Hamilton Beach business had very strong fourth quarter results. Revenues increased 7% to $219.8 million in 2017 from $205.1 million last year primarily because of an increase in revenues in all of our divisions driven by higher sales volume.

Hamilton Beach's operating profit increased 11.2% over 2016 to $26.5 million, resulting from increased sales volumes, reduced product costs, and favorable currency movements, partially offset by incremental costs incurred as a stand-alone public entity and higher advertising expenses and professional fees.

As a result of recognizing a $4.1 million charge related to the tax reform act, Hamilton Beach's net income was $12 million. Excluding this charge, Hamilton Beach's adjusted income of $16.1 million increased over 11% from net income of $14.4 million last year.

Looking forward, we believe changing consumer buying patterns including the shift of sales from in-store channels to Internet sales channels continue to create uncertainty about the overall growth prospects for the U.S. retail market for small appliances.

Despite this uncertainty, the consumer retail market for small kitchen appliances grew modestly in 2017 and is also expected to grow modestly in 2018 compared with 2017. The international and commercial markets in which we participate are expected to continue to grow moderately.

As a result of the current market environment, new or enhanced product introductions and an expected increase in higher-priced, higher-margin product placements resulting from the execution of the company's strategic initiatives, we expect Hamilton Beach's revenues to increase in 2018 compared with 2017 with revenue growth anticipated across all business divisions.

We expect product demand to increase in the first half of the year based on current customer commitments. Firmer commitments for the second half of the year and the holiday selling season are expected to occur in the second and third quarters. As a result, we expect Hamilton Beach to have moderate revenue growth in the first half of 2018 with modest growth in the second half of the year. However, expectations for the second half of the year could change as we gain better visibility of customer demand.

We are expecting some higher operating costs in 2018. Like many other companies, we anticipate cost inflation in 2018, as well as higher cost to implement our strategic initiatives, to partially offset the benefits from increased revenue.

Also, in 2018, we will recognize the full-year effect of incremental public company costs. As a result, we expect Hamilton Beach's 2018 operating profit to improve moderately compared with this year. We will work to mitigate the higher product costs by making adjustments to product placements and pricing. We anticipate that operating profit in the first half of 2018, particularly in the first quarter, will be moderately higher than in the first half of 2017, while operating results from the second half of the year are expected to be comparable to the second half of last year.

While 2018 operating profit is expected to be moderately higher than the past year, we expect net income to increase substantially over 2017 because of a lower effective income tax rate as well as the absence of the charge recorded in 2017 for U.S. tax reform legislation. In 2018, cash flow before financing activities is expected to be higher than 2017.

Moving to Kitchen Collection, the retail business reported net income of $2 million this quarter compared with net income of $4.2 million last year on a revenue decrease attributable to both the decline in comparable store sales and closing 19 underperforming stores over the past year. Despite effectively executing plans to close unprofitable stores, maintain strong gross margins, and generate positive cash flow, these steps could not offset the effect of reduced customer traffic as well as additional charges associated with tax reform and lease termination costs.

We expect the current challenging retail environment with lower foot traffic to physical retail location to result in continued, reduced spending by consumers on housewares and small appliances in mall locations. Given this market environment, our Kitchen Collection business continues to focus on optimizing the store count for current foot traffic trends. Kitchen Collection opened 6 and closed 19 stores during 2017.

Over the past several years, the pace of new Kitchen Collection store openings have slowed and the number of store closings has increased, and we expect this trend to continue. Currently, approximately 75% of Kitchen Collection store portfolio is in outlet mall locations and 25% is in traditional malls. In 2018, Kitchen Collection plans to continue to aggressively manage its store portfolio through natural lease expirations and ongoing renegotiations of rent commitments as well as early lease terminations if sales of certain stores continue to deteriorate.

By the end of 2018, Kitchen Collection has a goal of having approximately two-thirds of its stores of leases of one year or less while also maintaining its focus on decreasing the number of stores to a smaller core group of profitable outlet stores in more favorable outlet mall location. If we cannot reach acceptable terms of landlords as leases come up for renewal, the pace of store closings could increase.

As a result of these initiatives, we expect Kitchen Collection's revenues to decrease in 2018 compared with 2017 as we continue to close nonperforming stores. Kitchen Collection plans to continue to focus on maintaining strong gross margins, reducing operating expenses, and optimizing working capital. However, without an increase in store traffic, we expect Kitchen Collection's 2018 operating and net losses be comparable to this year despite the absence of the 2017 lease termination and tax reform charges.

That said, net losses in the first half of 2018 are expected to be higher than in the prior year and the second half of the year as a smaller tax benefit will be realized on the seasonally higher first half losses due to a lower effective income tax rate as a result of U.S. tax reform.

Due to forecasted working capital changes and capital expenditures, we expect Kitchen Collection's cash flow before financing activities to result in a use of cash in 2018.

Overall, on a consolidated basis, we expect Hamilton Beach Holding's 2018 consolidated net income to increase substantially over 2017 primarily due to lower income tax expense. As a result of U.S. tax reform legislation, we expect our consolidated effective income tax rate to be in the range of 26% to 28% in 2018.

Finally, looking at our balance sheet, we had cash on hand of $10.9 million and debt of $51.3 million at the end of the quarter.

That concludes my prepared remarks. I will now open up the call for your questions.

QUESTION AND ANSWER SECTION

Operator: Great. Thank you. [Operator Instructions] Your first question comes from the line of Peter Benedict with Baird. Please go ahead. Your line is open.

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

Hey, guys. Thanks. A couple of questions here. First, can you give us a sense for how material the timing shift was in the HB segment revenue between the third and the fourth quarter last year? And then related to that, is the combined second half organic growth rate of around 2%, 2.5%, is that a good way to think about the underlying growth expectation for the business in 2018? That's my first question.

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

Yes. It's Greg here. Good morning, Peter. So, your first question, I want to make sure I understood what you're saying, what kind of revenue shift do we have in third quarter to fourth quarter, is that the first question?

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

Yeah , I think there was a shift in the timing of some revenues. It negatively impacted the third quarter and helped the fourth quarter. So, just trying to get a sense for what the real underlying growth rate is as we kind of enter into 2018. I mean, if you combine 3Q and 4Q and look at the growth in aggregate, I think it's something more like 2.5%. So, just curious if that's kind of the right way to think about the view for 2018 or is it stronger than that?

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

Okay. So, [ph] I want (00:12:23) to be sure. That's what I thought you were asking about, yes. We figured it was around $10 million that got carried over. So, that does put you around in the 2.5% or slightly higher than that as far as the HB performance. The data we have, it shows the market is probably at that or a little lower. And I think what we sort of used our view for revenue projection going forward was that we would – from what we can see so far, we've got a pace to be growing a little faster than the market in the first half of the year, and we'll learn more as the assortment decisions and promotional decisions come on here, how the back half looks here probably over the next three or four months.

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

Q

Okay. Good. That's helpful, Greg. Thank you. Shifting over to costs, what are the input costs that are driving the product cost pressures that you're expecting in 2018? Obviously, there's a lot of talk around steel, aluminum in the marketplace right now. I know those are one component in your cost structure, but help us understand what's driving the product cost pressures in 2018 that you expect.

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

A

Yeah, it's really...

[indiscernible] (00:13:32)

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

A

Go ahead, Greg. That's fine.

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

A

Yeah. Sorry. I was going to say just the – really what we're seeing is the suppliers, their input costs, to some degree, their labor costs and their currency challenges are really providing kind of across the board challenge for them. We've got a good strong list of suppliers we work with, and we work closely with them to mitigate that as much as possible.

So, I think our view is, yeah, there's in deflationary times and inflationary times, you've got to work various parts of your abilities from price increases to changing out SKUs, working closely with retailers. And I think that's kind of our plan. But I think it's a pretty broad-based pressure that's coming to really any durable goods product throughout this coming out of Asia.

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

Q

Sure. Now, that makes sense. And you mentioned pricing adjustment as one thing that you think you guys will be able to affect this year. Remind us what your history is with that. Is there a typical pricing lift that you've been able to pass through pretty seamlessly to the retailers historically? And I guess, curious how your expected increase this year kind of compares to that level. Are you expecting that do a similar increase less than you normally do or a little bit more given some of the pressures you just talked about?

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

A

Well, we really don't sort of put a flat number out there I can build on this comment, but really what we do is just work with each retailer. We look at their assortment, our assortment, and sort of come up with a way that they can pass along x amount of costs, and here some options, and we find out what makes sense for each retailer. Of course, then you got to think about the whole marketplace so that doesn't put anything out of balance, but it really is a partnership conversation versus a – here's the new number. Everybody just figure out how to deal with it.

But, Scott, in the U.S. consumer, that seems to be the way you all have been doing this every time this happens.

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

A

Right. And we'll also look at occasionally – because we have a lot of depth in our different categories, we'll look at swapping out SKUs in the assortment that may have a little bit better cost position and may have a different feature set but have a better cost position. And then we'll also focus on, if needed, finding those promotional opportunities that will have a little bit better margin mix for us.

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

Q

Okay. Thank you. That's helpful. Two more. One, you're projecting modest EBIT growth within the HB segment for 2018. I assume that's on a GAAP basis, and I know last year, you had that $2.5 million hit from spin cost. So, just, if we exclude that hit, are you still expecting HB EBIT to grow or will it may be more similar or down slightly. I know there are small changes here, but just trying to understand the nuance there.

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

A

Yeah, Peter. This is Jim. And I think we were expecting to have, like we said, a modest increase, but obviously, there was a [ph] pre-spin (00:17:08) cost element that hit us in Q3 of 2017, so I think it will be kind of in that ballpark year-over-year.

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

Q

Okay. Thanks. And then the last question. I mean, obviously, a strong free cash flow here in 2017, just kind of thoughts on where you see that next year. I know you've got CapEx plans for HB, stepping up to $10 million from $6 million. Help us understand what's driving that, and then as you think about free cash flow in 2018, kind of it looks similar to what you just did or some of these working capital improvements that you saw, do they not recur in 2018? That's my last question. Thank you.

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

A

Yeah. Peter, really the increase in CapEx is really driven by IT and systems. We've got an ERP implementation that we are working through. And so, that's really the incremental cost from a CapEx perspective. And then in terms of just total consolidated cash flow, we feel we're going to have a modest increase in profits. We feel that we can generate some working capital reduction. Tax reform will help us. And so, we feel comfortable that we should be modestly higher in cash flow before financing [indiscernible] (00:18:50).

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

Okay. Great. All right. Thanks, guys.

Operator: [Operator Instructions] Your next question comes from Mike Fisherman with Zuckerman. Please go ahead your line is open.

Michael Fisherman
Analyst, Zuckerman Investment Group LLC Q

Good morning, guys.

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

Good morning.

Christina Kmetko
Investor Relations Contact, Hamilton Beach Brands Holding Co. A

Good morning, Mike.

Michael Fisherman
Analyst, Zuckerman Investment Group LLC Q

We've talked about this in the past a little bit, but with [ph] Happycall (00:19:17) being taken private and now Spectrum Brands looking like they're close to signing their appliance business, why aren't you guys exploring strategic alternatives to maximize shareholder value for all shareholders? Thanks.

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

Okay. Well, this is Greg. That's forefront our minds about trying to make sure we're continually increasing shareholder value, and I think really there's couple of things we look at. One is we have our strategic initiatives, which should provide us a really strong growth path going forward, and it seems to be making progress on most of those fronts.

When it comes to acquisitions, that's one that we've sort of said now recently from a roadshow and since then that we are going to try to step that up to be a tool in our toolbox that we use more often. And we are looking at as many opportunities we can. And we certainly expect to be successful at some sort of acquisition here as we move forward. And sometimes, some of the ones that you mentioned makes sense for us and sometimes, they don't. So, right now, our view is we're going to just keep evaluating them, and then when one makes sense, we're going to be, I think, very strategic and move forward with them. So, acquisitions are part of what we want to do as well as the other parts of our strategic initiatives.

Michael Fisherman
Analyst, Zuckerman Investment Group LLC Q

Right. When do you think we'll start to see some of those investments pay off? I mean, just like five years ago within the Hamilton Beach brand, not the Kitchen Collection, but [ph] you were earning $67 million, (00:20:58) $75 million of SG&A, and I think last year, it was about $95 million, which took away a lot of the profits from all the incremental revenue you've generated. So, when are we going to see a return on those investments?

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

A

Well, we're heading towards our goal. We mentioned we want to get to $750 million to $1 billion in revenue and 9% to 10% operating profit, and we feel that's a very, very achievable goal. And we think these initiatives as well as our core business is going to get us there. So, I think the investments really will prove out over time if that's going to be a very important part of us getting to those goals.

Michael Fisherman
Analyst, Zuckerman Investment Group LLC

Q

Can you put a timeframe around hitting those goals?

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

A

Well, what we said during the road show was that we can't put a timeframe on it, but we can say that even with a 4% to 5% growth rate per year, you get to a low end of that range in just a few years. So, I think really what our view is that if some of these come into fruition faster, we'll hit the range in a shorter time period, and if they take a little longer, we'll get there a few more years later. Acquisitions could push us into that range faster. If we can't find one that's a strategic fit, it'll take a little longer. So, it's hard to put an exact timeframe on it, but we are focused on being sure we get into that range here in a not too distant future, but you won't see it in 2018 as an example.

Michael Fisherman
Analyst, Zuckerman Investment Group LLC

Q

But when you look at your valuation versus what these companies are being acquired for, how do you compare what the market is willing to pay for your company now versus the time and the risk it's going to take to getting to your long-term targets, like are you comparing your strategy versus what you could be able to sell the company for now?

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

A

Yeah. We look at everything. First of all, we've got to remember that in the short-term here, this was in the S-1 and we talked about this quite a bit, which was we've got to be careful in the first two years after the spin. We don't want to jeopardize the tax-free nature of that spin. That's an important thing for shareholders. But our view is we've got a really strong board of directors. The management team is very focused on building shareholder value. So, if we do it organically, that's great. And if sometime down the road, there was something that was better for shareholders and the board would consider that and make a decision.

Michael Fisherman
Analyst, Zuckerman Investment Group LLC

Q

Great. Thank you.

Operator: [Operator Instructions] And there are no further questions coming into the queue at this time. I will turn the call back over to Ms. Christina Kmetko for closing remarks.

[01RX2S-M Christina Kmetko]

Thank you, everyone. We appreciate your interest and thank you for joining us today. If you do have any follow-up questions, you can reach me at 440-229-5130. Thanks and have a great day.

Operator: And ladies and gentlemen, thank you for participating in today's Hamilton Beach Brands conference call. This call will be available for replay beginning today, March 8 at 12:00 PM, Eastern Time through midnight on March 15. The conference ID number for the replay is 8796786 and the number to dial for the replay is 855-859-2056. Thank you very much. This concludes today's conference call, and you may now disconnect.