Hamilton Beach Brands Holding Company

2017 Third Quarter Earnings

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CORPORATE PARTICIPANTS

Greg Trepp, *President, Chief Executive Officer*

Jim Taylor, *Vice President, Chief Financial Officer, Treasurer*

Christina Kmetko, *Investor Relations*

CONFERENCE CALL PARTICIPANTS

Peter Benedict, *Robert W. Baird*

Mike Fisherman, *Zuckerman Investment Group*

PRESENTATION

Operator:

Good morning. My name is Virgil 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 Third Quarter 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. If you would like to ask a question during this time, simply press star then the number one on your telephone keypad. If you would like to withdraw your question, press the pound key. Thank you.

Christina Kmetko, you may begin your conference.

Christina Kmetko:

Thank you. Good morning everyone and welcome to our 2017 third quarter earnings call and our first earnings call as an independent public company. 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. Also joining us today for this first earnings call is Al Rankin, Hamilton Beach Holdings' Executive Chairman.

Yesterday, we published our third quarter 2017 results and filed our 10-Q. Copies of our earnings release and 10-Q are available on our public company website at www.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 For anyone who is not able to listen to today's entire call, an archived version of this webcast will be on our website later this afternoon and available for approximately 12 months.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-Q.

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.

As I mentioned, this is our first earnings call as an independent public company. At the close of business September 29, Hamilton Beach Brands Holding Company was successfully spun off from our former parent company, NACCO Industries. On October 2, our stock began trading on the New York Stock Exchange under the ticker symbol HBV.

Our business is made up of two operating segments: our Hamilton Beach Brands business, which designs, markets and distributes branded small electric household and specialty housewares appliances as well as commercial products in our Kitchen Collection retail business. I will provide a brief overview of our consolidated third quarter results and then I will discuss the third quarter results and fourth quarter 2017 and full-year 2018 outlook for each business. While we are providing a high level first look at 2018, I'd like to note that we are still going through our detailed annual planning process and we will provide more color on 2018 with our year-end earnings once the annual operating plan has been finalized.

Hamilton Beach Holdings' consolidated revenues for the third quarter of 2017 were $181.7 million compared with consolidated revenues of $188.4 million in last year's third quarter, and our consolidated net income was $4.3 million or $0.31 per diluted share this quarter compared with consolidated net income of $8.7 million or $0.64 per diluted share last year. Our consolidated operating profit decreased $7.4 million from $13.5 million in 2016, and our current quarter consolidated EBITDA was $8.6 million. A discussion of each segment will provide more detail on the largest drivers that led to a decline in the consolidated results.

At Hamilton Beach, revenues decreased $3.7 million compared with the prior year. A strong increase in international sales and a modest increase in commercial sales during the quarter were more than offset by lower than anticipated U.S. consumer sales which occurred when orders that were anticipated to ship in the third quarter of 2017 did not ship until early in the fourth quarter. We do not believe this change will result in a shortfall in the back half of the year.

While revenues were down, gross profit was comparable between years as benefits from reduced product costs and a favorable shift in sales mix to higher margin and higher prices products offset the impact from lower sales volume. Nonetheless, Hamilton Beach's operating profit and net income decreased compared with the prior year primarily because of $2.5 million of one-time non-tax deductible costs incurred to affect the spin-off, as well as an increase in employee-related expenses. Despite the decline in third quarter results, we still expect Hamilton Beach to have a solid year in 2017.

Looking forward, we believe changing consumer buying patterns continue to create uncertainty about the overall growth prospects for the U.S. retail market for small appliances. In this environment, we expect 2017 fourth quarter U.S. and Canadian consumer markets for small kitchen appliances to be comparable to the prior year, while other international consumer and commercial markets are expected to continue to grow moderately. Sales are also expected to continue to shift from in-store channels to internet sales channels.

We expect sales volumes and revenues in the Hamilton Beach segment to increase in the fourth quarter of 2017 compared with the prior year due to new product introductions and anticipated upgrades or enhancements in our other product lines, as well as increased placements and promotions in our core small kitchen appliance business for the fourth quarter holiday selling season, and the additional revenue from the delayed third quarter shipments. We expect the fourth quarter revenue increase to more than offset the revenue declines for the first nine months of 2017. As a result, we continue to expect an overall modest increase in Hamilton Beach's full-year 2017 revenues over 2016 provided consumer spending is at expected fourth quarter levels.

Fourth quarter 2017 net income is expected to increase substantially compared with the fourth quarter of '16 with anticipated benefits from increased revenues and reduced product costs expected to be partially offset by incremental costs associated with being a standalone public company. Higher employee related expenses, and increased costs to implement our strategic initiatives. We expect the anticipated increase in fourth quarter net income to result in a modest increase in full-year 2017 net income compared with last year despite the additional costs incurred related to the spin-off and the incremental costs to be incurred going forward as a standalone.

Other than the $2.5 million of spin-off expenses recognized in the third quarter, our year-to-date reported financial results do not include any of the normal and customary expenses associated with being a standalone public company. Going forward, we expect to incur up to $3 million pre-tax annually of incremental expenses associated with being public. We expect Hamilton Beach's full year 2017 cash flow before financing activities to be substantial but significantly lower than full-year 2016.

In 2018, the consumer retail market for small kitchen appliances is expected to grow modestly compared to 2017 and the international and commercial markets are expected to continue to grow moderately. Overall, we expect Hamilton Beach's revenues to increase in 2018 compared with 2017 due to enhanced distribution and increased higher price, higher margin product placements resulting from the execution of our strategic initiatives. Net income in 2018 is expected to increase modestly compared with this year as the benefits of the increase in revenues are expected to be mostly offset by the costs to implement these initiatives and the incremental public company costs, as well as the anticipated increases in advertising expense and product costs. In 2018, cash flow before financing is expected to be higher than 2017.

Moving to our Kitchen Collection business. The retail business reported a net loss of $1.2 million this quarter compared with a loss of $700,000 last year on a revenue decrease attributable to both a decline in comparable store sales and closing underperforming stores over the past year. We expect the current challenging retail environment with lower foot traffic to physical retail locations 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 expects to close a total of 19 stores and open six for full-year 2017, the majority of which have already occurred. As a result of these actions, we anticipate Kitchen Collection's revenues and results to continue to decline in the fourth quarter and for the full year compared with the respective 2016 period. Cash flow before financing activities is expected to be positive this year but lower than 2016.

Over the past several years, the pace of new Kitchen Collection store openings has slowed, and the number of store closings has increased. Currently, approximately 75% of our Kitchen Collection store portfolio is in outlet mall locations and 25% is in enclosed malls. In 2018, we expect to continue to aggressively manage our store portfolio through natural lease expirations and ongoing renegotiations of rent commitments with a goal of having approximately two-thirds of stores with leases of one year or less by the end of 2018.

We are also focused on decreasing our store count to a smaller core group of profitable outlet stores in more favorable outlet mall locations. If we are unable to reach acceptable terms with our landlords as leases come up for renewal, the pace of store closings could increase. As a result of these initiatives, we expect Kitchen Collections 2018 revenues to decrease compared with 2017 as non-performing stores are prudently closed.

It is our goal to have Kitchen Collections deliver breakeven results in 2018; however, this objective could be challenged if the results of the fourth quarter 2017 holiday selling season are lower than expected, requiring adjustments to our 2018 expectations, if pending renegotiations of rent commitments are not as successful as we expect and if 2018 store traffic is not at expected levels. Due to forecasted working capital changes and capital expenditures, we expect Kitchen Collections cash flow before financing activities to be a modest use of cash in 2018.

Overall on a consolidated basis, we expect Hamilton Beach Holdings fourth quarter operating profit and net income to increase compared with the 2016 fourth quarter, resulting in full-year consolidated operating profit and net income comparable to last year, and we expect 2018 consolidated net income to improve modestly over 2017.

Finally, looking at our balance sheet, we had cash on hand of $3.1 million and debt of $80.5 million at the end of the quarter. Prior to the spin-off, we paid NACCO a $35 million cash dividend which was mostly an acceleration of a dividend that would have been paid at the end of 2017 if the spin-off had not happened. We borrowed on our revolver to pay the dividend and anticipate repayment of those funds from fourth quarter cash receipts.

Our current intention is to pay regular quarterly dividends. Our Board of Directors at its first regularly scheduled meeting in November is expected to evaluate and determine a dividend payout, taking into account our business needs and capital structure. We do not have any further information to provide on the dividend rate at this time.

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

Operator:

As a reminder, if you would like to ask a question, press star followed by the number one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster. Again, that's star followed by the number one on your telephone keypad to ask a question.

Your first question comes from Peter Benedict from Baird. Please go ahead.

Peter Benedict:

Hey guys, thanks. I've got a few. First, just kind of a bigger picture one. I mean, I know not a direct peer per se, but Newell was out speaking about weaker trends across the U.S. in their appliance and cookware businesses, and they talked about inventory de-stocking at retail. Just curious kind of what you guys are seeing on those fronts and how maybe it compares to past periods where you've had some inventory de-stocking going at major retailers. That's my first question.

Greg Trepp:

Okay. This is Greg, and I think there's been some de-stocking at retailers during the year, and I think right now we're seeing pockets of that and we're just having to just deal with it. I think in the end, the sell through to the consumer through the register is sort of hanging in there at plus or minus flat, so as we go through some of these de-stocking things, we just have to deal with it and work to accelerate the POS to make up for it.

Peter Benedict:

Okay, thanks Greg. The shift in timing of deliveries between 3Q and 4Q, any way you can give us a sense of the magnitude of what that was, how much maybe that depressed the third quarter and then we can obviously roll that into 4Q?

Greg Trepp:

You know, we're not in a position to spell the exact number out, but I think earlier on we had given an outlook that said we think we'll be up for the back half of the year enough to make the whole year up slightly, and I think that's kind of what we have in this current outlook, so I think we'll hold onto that, incremental shipments into the fourth quarter, and that will help us deliver that outlook that we've been talking about now for the past couple quarters.

Peter Benedict:

Sure, okay. Then shifting gears a little bit, could you talk a little bit about the product cost environment at this point? I think for 2018, your release said you do expect some increases there, but I think you think may be able to offset it, so just curious what's driving kind of the higher product cost view, understanding you haven't completed your plans for 2018. What's kind of driving that, and then how do you expect to offset that?

Jim Taylor:

Yes Peter, this is Jim Taylor.

Peter Benedict:

Hey Jim.

Jim Taylor:

Good morning. Yes, what we're really seeing is some increases in commodities that are happening and impacting our suppliers, so that's something that will have a little bit of pressure. We think that we have programs in place to offset that through actions that we'll be taking in the marketplace, and this is not something that we haven't experienced in the past and so we have a process that we'll go through to manage it, we think fairly effectively.

Peter Benedict:

Okay, that's helpful. Two more, one on the commercial business. You guys have been in the business for a while. Help us understand what you've been doing the last couple years and how that sets you up, maybe, to see that business hopefully accelerate in the next couple years. What's been going on behind the scenes there and how does that maybe change the trajectory of the business as we look out the next few years?

Greg Trepp:

This is Greg. Peter, what has happened, and the team has been doing a very nice job of it, is really expanding the portfolio in two ways. One is moving to higher priced, higher durability products that are able to handle the demands of a large chain, either a regional chain or a global chain as they implement their menu items, like a smoothie program. We've also been expanding our category breadth into new areas, and so what's happened is we've gone from a portfolio that for a long time was focused on smaller businesses, lighter duty abilities to this ability to really handle the needs of a global chain or a large regional chain. So as that product portfolio has expanded for the past couple years, it takes some time to get that customer to test the product, get comfortable with it, and then convert away from one of their current partners, and so as we've been working on this now for the past couple years. We're starting to make more progress on that front and we're seeing very good acceptance to our products, and the goal now is to convert those tests to wins and full roll-outs, which if we can get that pace to accelerate, that will help drive some incremental sales.

Peter Benedict:

Okay, that makes sense, thanks. Then just lastly on the Kitchen Collection business, it looks like comps probably down high single digits there, or in that range, here in the third quarter. Help us think through maybe what turns that around or bends that curve in 4Q or even into next year, and then the breakeven comment in '18 on that segment, was that operating income or net income for that segment? Thank you very much.

Greg Trepp:

Sure. Really what we continue to try to do as the foot traffic trends unfold, we're doing a few things. One is, as we mentioned, if the stores can't provide a return, then we'll close them as leases come up, but we're also doing things for folks that do enter the mall. We're working with the landlords to be sure we're participating in marketing programs to make sure folks are aware of our stores, and then once they come in the store, we're spending a lot of time motivating, educating our sales personnel to maximize the sales to the folks that come in. If we can get the average sale up or the closure rate up, it helps offset some of the foot traffic softness; but it is a challenge and if the malls can--again, an outlet mall, which is where we're focused, has a little bit stronger place in the retail environment, so I know they're very focused on keeping that foot traffic up. If they can be a little bit more successful with that and we can continue to drive incremental sales to those folks that do walk in the door, that will help mitigate the pressure on the foot traffic, but it is—you know, there is pressure now and that's something that we're just going to have to work on quarter by quarter.

The breakeven comment is on an operating profit basis.

Peter Benedict:

Okay, great. Thanks very much.

Greg Trepp:

Thank you.

Jim Taylor:

Thanks Peter.

Operator:

As a reminder, if you would like to ask a question, press star followed by the number one on your telephone keypad. Your next question comes from the line of Mike Fisherman from Zuckerman.

Mike Fisherman:

Good morning guys. It sounds like you're not going to quantify the timing of the shipments in the third quarter, but have you already shipped those into Q4 and that gives you the confidence for the revenue growth in Q4?

Greg Trepp:

What I'll tell you is as we stand here now, we still feel good about the outlook we're providing, so we're a few weeks smarter than we were before the quarter closed, so it still seems to be on track. There's really three elements that drive the big holiday season performance, and one is do we do well on placements, and then the second is do we do well on promotional support, winning a fair share of promotions, and the last is the consumer showing up in the appropriate amount and buying the category. I think we continue to feel good about the first two and that's driving our estimates, our outlook.

The last part is we're assuming an average consumer shopping habits. If they were to be a little stronger holiday season, we might do a little better; and if it's softer, we might pull back a little bit. But really, if we just get a normal consumer support at the store level, I think we'll feel good about our back half outlook.

Mike Fisherman:

Okay. What about specifically the timing of the shipment that you didn't get in 3Q? Did you ship that already in Q4, or that's still to come?

Jim Taylor:

That's largely shipped.

Mike Fisherman:

Okay. Then can you talk about the free cash flow guidance? What exactly was your free cash flow for the holding company, for Hamilton Beach Holding Company last fourth quarter?

Christina Kmetko:

I believe that's in our S-1.

Jim Taylor:

Yes.

Mike Fisherman:

I'm just trying to understand, with one quarter to go, given that your use of cash of, I think $12 million year-to-date, could you give more color or quantify what you expect the fourth quarter free cash flow before financing activities is going to be?

Jim Taylor:

We don't really provide the projection. What I will say is that we feel comfortable with a strong fourth quarter from a cash flow perspective, and that for the full year we'll come in with, as we've indicated in the earnings release, with a strong year from a cash flow perspective, probably more in the normalized versus 2016, which was an extraordinary year from a cash flow (inaudible).

Mike Fisherman:

What's your definition of a normalized free cash flow?

Jim Taylor:

I'm not going to provide that projection, but you can look back at the numbers historically and I think you can get that information.

Mike Fisherman:

Okay, thank you guys. Good luck in the fourth quarter.

Jim Taylor:

Sure, thanks.

Operator:

There are no further questions at this time. I will turn the call back over to the presenters.

Christina Kmetko:

I do not have any wrap-up comments, Greg. Do you have anything you would like to add?

Greg Trepp:

No, I think we're good. Thank you everybody.

Jim Taylor:

Thanks.

Christina Kmetko:

All right, thank you. If there are follow-up questions, I can be reached at 440-229-5130. Thanks, and have a great day.

Operator:

Thank you. As a reminder, today's call will be available for encore replay after 2:00 pm Eastern time and will be available under November 9 at 11:59 pm. Please dial in on 800-585-8367 or 855-859-2056, or internationally on 404-537-3406 and enter the ID 4296097 to listen.

Thank you. This concludes today's conference call and you may now disconnect.