Titan International, Inc. (TWI)
Transcript of Q3 2022 Earnings Call and Webcast
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Company Participants

Todd Shoot - Senior Vice President, Investor Relations and Treasurer
Paul G. Reitz - President and Chief Executive Officer
David A. Martin - Senior Vice President and Chief Financial Officer

Conference Call Participants

Steve Ferazani - Sidoti & Company
Kirk Ludtke - Imperial Capital

Presentation

Operator - Good morning, ladies and gentlemen and welcome to the Titan International Incorporated Third Quarter 2022 Earnings Conference Call. At this time, all participants have been placed on a listen-only mode, and we will open the floor for questions and comments after the presentation. [Operator Instructions].

It is now my pleasure to turn the floor over to Todd Shoot, Senior Vice President, Investor Relations and Treasurer for Titan. Mr. Shoot, the floor is yours.

Todd Shoot - Thank you, Matt. Good morning. I'd like to welcome everyone to Titan's third quarter 2022 earnings call. On the call with me today are Paul Reitz, Titan's President and CEO, and David Martin, Titan's Senior Vice President and CFO. I will begin with the reminder that the results we are about to review were presented in the earnings release issued yesterday, along with our Form 10-Q, which was also filed with the Securities and Exchange Commission yesterday. As a reminder, during this call, we will be discussing certain forward-looking information, including the company's plans and projections for the future that involve risk, uncertainties and assumptions that could cause our actual results to differ materially from the forward-looking information. Additional information concerning factors that either individually or in the aggregate could cause actual results to differ materially from these forward-looking statements can be found within the safe-harbor statement included in the earnings release attached to the company's Form 8-K filed earlier, as well as our latest Form 10-K and Forms 10-Q, all of which have been filed with the SEC.

In addition, today's remarks may refer to non-GAAP financial measures, which are intended to supplement, but not be a substitute for the most directly comparable GAAP measures. The earnings release, which accompanies today's call contains financial and other quantitative information to be discussed today, as well as the reconciliation of the non-GAAP measures to the most comparable GAAP measures. The Q3 earnings release is available on our website, a copy of the replay of this presentation will be available soon after the call within the Investor Relations section on Titan's website, and a copy of today's call transcript will also be made available. In addition, our latest quarterly investor presentation is now available on our website as well.

I would now like to turn the call over to Paul.

Paul Reitz

Thanks, Todd. Good morning. I get the pleasure of starting the call by saying this was another quarter where the Titan team has demonstrated our operational resilience and our determination to produce solid financial results, but most importantly, satisfy the needs of our customers. Our high level of execution was throughout all of our businesses as our global team continues to overcome challenges that they are presented. Our quarter third quarter results were led by a solid top line growth of 18% to $531 million that was supported with healthy volume gains. Our gross margins expanded to 16.5% that led to strong adjusted EBITDA of $61 million and EPS generation of [$0.68] per share. It's also good to see our financial performance translating into strong free cash flow, which was $40 million for this quarter and that puts us at $69 million year-to-date, that's a whopping $96 million year-over-year increase in free cash flow. It is truly impressive to compare the strength of our balance sheet today to where it was just a few years ago. We have confidence in our business, our end markets and, of course, the performance of our Titan team and see 2022 finishing at the top end of our previously communicated targets. Along with that, we expect free cash flow to exceed $100 million for the year. It's been really good to see our team overcome the challenges of the past few years and serve our customers as well as we have during this period of challenges. Our company has a solid foundation in place with our people, products and our production footprint. David will, of course, share more information on the financial side. But right now, I'm going to switch over to the market landscape.

It's reasonable to say that the business climate is a noisy place these days, but we do continue to believe that our end markets are still standing on firm ground, especially when you look at the large AG segment, and there really are a number of positive indicators that support the fundamentals in our end markets. Let's start with the farmers that are in a good financial position with their balance sheets and their income levels. The recent USDA report illustrates that corn and soybean supply demand factors along with the low stocks will bring good pricing levels into 2024 at a minimum. With good crop prices and income, farmers will continue to invest in upgraded new equipment and the latest technology in replacement tires. The strong farmer income for recent years, combined with pent up large equipment demand from supply chain and labor disruption to OEMs, along with the continuing low levels of available used equipment bodes very well for 2023 large AG demand. We believe that the bigger picture view is that large AG is in a solid position, and we expect this sector to work through the current supply chain challenges to a good future ahead. Looking at small AG, it appears that inventory is starting to normalize to pre-COVID levels. However, overall inventory is still below longer historical norms and there is a need to maintain current production levels in order to normalize their dealer operations. We at Titan have a strong customer base in small AG and we'll watch the inventory order levels closely as we prepare our 2023 plan.

Moving over to earthmoving and construction. We had a strong Q3 with sales growth of 19% with solid increases in demand. Our earthmoving construction segment continues to perform at a high level in meeting our customers' growing demand, especially during this quarter that is traditionally heavily impacted by the August holidays. The strong results were driven by solid OEM demand in all major geographies, and we had healthy growth in our aftermarket business

as well. We stated last quarter that our order book in EMC is good and that remains true. And this quarter, other companies have really started to make positive comments as well as they look towards the end of this year and to next. So we still believe that the outlook for the EMC segment looks promising for 2023. I have to say, over the last few weeks, I've met with quite a few customers, dealers and a peer group of some industrial CEOs. And I have to say the overall market landscape for heavy industrials, especially when you look at our primary end markets, agriculture and construction, remains in a solid healthy place.

So wrapping things up, our expectations for the fourth quarter remained strong for sales, adjusted EBITDA and free cash flow. And with our performance year-to-date and current visibility for the remainder of the year, we expect to finish the year at the top end of our previously communicated targets. Obviously, the business climate these days has a lot of moving pieces that require attention and ability to adjust rapidly. Titan has been consistently demonstrating our ability to navigate through these challenges and we have confidence in our team to take the appropriate timely actions as needed. Most importantly, I am confident, our team is confident, our customers are confident in the quality of products that we build around the world every day and really, the important role of these products play in meeting the evolving needs of not just our customers but the end users using that equipment. We continue to believe that the key elements are in place to drive continued positive momentum at Titan, and I really want to take a moment though to express appreciation to our Titan team for delivering tremendous results this quarter and really over the past couple of years. Our team is committed to taking care of our customers and we see healthy demand from them that will require us to continue to work very hard here.

With that, I would like to turn the call over to David.

David Martin

Thanks, Paul, and good morning to all of you joining us today. Our business continued to thrive during the third quarter as Paul said. We had strong results compared to the prior year. Let's not forget, the third quarter last year also was a strong result and we beat that by a nice margin this quarter.

Let's run through the key stats from this quarter's performance. We had net sales of $531 million in Q3, which represents the strongest Q3 in our history, and the first time it's exceeded $500 million in a third quarter. Net sales grew 18% from Q3 last year even with a 5% headwind on currency devaluation against the dollar. Also keep in mind, we sold the Australian business at the end of March, which also had an impact of lowering sales this quarter as compared to the prior year, and that was by another 2%. Excluding the impact of FX and the Australian divestiture, Q3 sales grew by 25%. Our gross profit grew by 45% from last year and our margin reached 16.5% versus 13.4% last year. Adjusted EBITDA for the quarter was $61 million, up 74% or $26 million from Q3 last year. And more importantly, our trailing 12 month adjusted EBITDA now stands at $236 million, more than doubling where it was at this time last year. Our earnings per share growth was also impressive on both reported and adjusted basis. On an adjusted basis, it went from $0.17 in Q3 last year to $0.54 this year in Q3. Our cash balances were also stable this quarter at $117 million and free cash flow for the quarter was $40 million, bringing year-to-date free cash flow to almost $70 million. As a result of further debt paydown this quarter, our net

debt dropped to $330 million, down from $368 million last quarter and our net debt leverage now stands at 1.4 times trailing 12 month adjusted EBITDA coming from the dramatically improved profitability and our continued focus on working capital management.

Before I get into the segment discussion, I want to clarify a few things about our business seasonality. The last couple of years have been exceptional because of the pandemic and then the market recovery. In Q3, we saw a return of traditional ordering patterns and plant maintenance by our customers and we had fewer production hours for our plants, that's what you see in the results when you compare it to first quarter and second quarters this year. At the same time, it's important to see that we had continued expansion of top and bottom line relative to last year in the third quarter, which is impressive given what I just said.

Now let's get into the performance at the segment level, starting with agriculture. Agricultural segment net sales were up about 50% of total sales this quarter and were at $289 million, an increase of $45 million or 18% from Q3 last year. This growth came from a healthy balance of volume increases and the impact of higher pricing, reflecting cost of raw materials and other inflationary costs, which includes logistics and energy. Currency devaluation impacted sales in the third quarter in the segment by 3% relative to Q3 last year. The agricultural segment gross profit for the third quarter was $46 million, up from $33 million in the prior year, representing a 38% improvement year-over-year and gross margins were strong for AG at 16% in Q3, up from 14% last year.

Our earthmoving and construction segment experienced a very solid quarter. Overall, net sales in the segment grew by $32 million or 19% from Q3 last year, a similar growth to what we achieved in Q2 this year. ITM, which represents the majority of the sales in the segment grew 24% within the segment from the third quarter last year. Similar to AG, growth for the segment was driven by increased pricing relative to raw materials and other cost inflation, as well as healthy volume increases. The strong dollar relative to the rest of the world was impactful in Q3 for this segment as sales were negatively impacted by currency devaluation of approximately 8% or $13 million. Gross profit within our EMC segment for the third quarter was $35 million, which represents an improvement of almost $14 million or 64% from gross profit last year. The gross profit margin in the segment was significantly better at 17% versus the prior year of 13%. Again, the largest driver of increased profitability came on the increase in sales within ITM while growth occurred across all our businesses and geographies from last year.

The consumer segment's Q3 net sales were up 10% relative to last year in Q3. Like last quarter, our specialty growth initiatives are taking off, most notably our custom mixing of rubber stock in the US, while we had some offset from slightly lower consumer sales across all regions due to normal seasonality this year, most notably our Latin American utility truck tire sales. This segment's gross profit for the third quarter was solid at $6.7 million or a 16% improvement year-over-year. Gross margins expanded to 16% compared to 15% last year in Q3, and this improvement in dollars and margins are primarily reflective of the positive mix of products that we sold.

SG&A and R&D expenses for Q3 were $34 million, which represents 6.4% of net sales for the quarter. This was down from last quarter's spend as well as the prior year, reflecting some

savings in legal fees and other variable expenses and the effect of the sale of the Australian wheel business earlier in 2022. For the first nine months, our SG&A and R&D costs, excluding royalties, were at 6.6% of net sales compared to 8.2% last year. We continue to have a very strong focus on managing our operating costs within our operations, and that has had even more of a positive effect on overall profitability.

During the third quarter, we recorded an additional $9.5 million related to indirect tax credits in Brazil. Our ITM Brazil operation prevailed in its legal action regarding non-income indirect taxes that have been previously charged and paid similar to what we had with our Titan Brazil operations in Q2. During the third quarter, we recorded $1.6 million in income taxes related to that recognition. On a year-to-date basis, we have recorded $32 million in total indirect taxes for Brazil in other income and $9.4 million in income taxes associated with that recognition of the tax credits. We expect to utilize the majority of these credits against future tax obligations over the next 12 months. The tax credit recognition was excluded from adjusted EBITDA for Q3 and the first nine months, as you see in the reconciliation in the earnings release.

Our reported taxes on income in the third quarter were $11.4 million, as I just stated, $1.6 million of the provision related to income from the indirect tax credits recorded during the quarter. As a percent of pre-tax profits, the overall effective tax rate was 21.1% in the third quarter, which was slightly less than what we saw in Q2. Cash taxes are expected to be around $25 million for the full year, reflecting the positive impact of the utilization of a portion of the Brazilian tax credits. This is higher than the guidance I gave last quarter as we've seen increased full year expectations of profitability in Europe and other countries.

Now cash flow continues to be a strong part of our performance this year. Our cash balances held steady this quarter at $117 million. Our operating cash flow was at $53 million in the quarter, which was driven by strong earnings and stable working capital. At the end of the third quarter, our liquid working capital as a percent of annualized sales based on the most recent quarter was at 21%, slightly up from Q2, while it improved from the prior year about 40 basis points. We are on track with our expectations, and I expect us to continue to improve our working capital management as we close the year out, while maintaining a strong view of setting up 2023 well from an inventory perspective.

Our capital spending in the third quarter was also within expectations of $13 million and the full year capital expenditure target continues to be at around $45 million to $50 million, which is the same as our original guidance for the year. We are already underway with our review of next year's capital expectations, and I believe we are near the sweet spot for spending with focus on ongoing maintenance in our various plants, along with investments to bring about increased efficiencies and selective capacity expansion. It is also important to note that with the continued technology innovations for our products, we are investing in the necessary tooling to manufacture the highest quality products for our customers.

When you put all this together, we expect free cash flow for the year to be at $100 million or more, the strongest yearly cash flow in our history. With the volatility that we are dealing with on an ongoing basis, this is tremendous performance from our team.

I mentioned it at the outset that our net debt leverage at the end of September improved to 1.4 times trailing 12 months adjusted EBITDA, down from 1.8 times at the end of the Q2 and 2.9 times at last year end. We made another nice improvement this quarter as we paid down debt by $35 million using our free cash flow generation. We have put ourselves in a very strong position as a company to have options on allocation of our capital.

As we discussed previously, we intend to manage our debt position across the business globally first and then when we look at the appropriate investments in the business to put us in a position to grow profitably on a sustained basis. We will also continue to evaluate the best opportunities to deliver the best returns for the company on a long term basis from acquisitions, to cash return, to shareholders.

Our financial performance this quarter was exceptional once again and it is reflective of the strong market that we're in and our ability to manage well through what has been an ever evolving environment. Our full year outlook has continued to improve throughout this year, and we expect to deliver growth and expanded margins in the fourth quarter relative to the prior year. As Paul discussed at the beginning today, we are driving towards the high end of the targets that we discussed last quarter in sales, profit and cash flow expectations.

Nothing is simple these days but our operating and management teams are bringing it all together to deliver very strong performance and the best in our history. That's our story for now, and it just keeps getting better.

Now I'd like to turn over the call back to Matt for any questions that you have today.

Question-and-Answer Session

Operator - We will now begin the question-and-answer session [Operator Instructions]. The first question comes from Steve Ferazani with Sidoti.

Steve Ferazani - Good morning, everyone. Appreciate all the detail on the call. I wanted to ask -- address some of Paul's early commentary, which seem to -- I know you're reporting a little bit later this quarter, so we've heard from your customers, and it seems to match up a lot with what we're hearing from the customers, which is order books on AG remains healthy but maybe not growing at this point after a very strong year, whereas heavy construction appears to be very, very strong, which would seem to be counterintuitive given global recessionary concerns. Can you sort of walk us through those two segments and how you're thinking about them as we're closing in on entering ‘23?

Paul Reitz - I'll start with earthmoving construction. You're right. That segment, for us, outperformed really in the third quarter, and we're seeing that the order books continue to remain healthy as we close out ‘22 and move towards ‘23. So to your point, that might be a little bit counterintuitive to what one would be thinking looking back six months ago, but certainly feel that's the position we're in and our Q3 results support that. So EMC looks good as we roll the calendar. When you look at AG, specifically looking at large AG, I think the fundamentals are where we thought they would be six months ago, three months ago and they continue right on

that pace. You get a little bit of noise going on with supply chains and labor at the OEMs as they get caught up on production. But all indications with the fundamentals from the farmer's perspective, from their balance sheet income, look at the inventory levels in the marketplace, I think the reports coming out of the supply demand economics for the crops look good for not just '23, but ‘24 into the future. So I look at large AG and feel really good about where things are positioned, and those have been consistent with the comments we've been saying really throughout most of this year. So that is something that we certainly see continuing in the trends as we move the calendar again into ‘23.

Small AG is something we'll keep an eye on. I think small AG gets misperceived in a way where you look at it as it's just a toy that everybody ran out and bought some land and they drive around and take the grandkids for rides now, because it's been induced heavily through pandemic spend and I just don't think that's the case. I think you got to really look at small AG closely from the commercial perspective and understand that some of the fundamental drivers that you see in large AG are also applicable for small AG, and there is definitely a strong commercial element to small AG. So I don't want to sit here and create a perception that, again, that was just pandemic induced hobbyist toy spending going on, it really is something that we see much different than that. Our customer base with small AG is very strong. We've spent a lot of time with them, kind of understanding where they see things going in the early parts of '23 and they see a marketplace where their dealers do need to continue to build their inventory levels. They do have some unmet retail demand. And clearly, the impact of inflation on small AG is going to have a bigger impact than it would on other parts of the business. So I think that's one thing you got to look at closely as inflation and interest costs go up, will that slow down some parts of small AG for next year. But at this point, again, there's unmet retail demand and inventory that needs to be replenished and they still got good healthy production levels as we move into '23.

Steve Ferazani - When we look at steel and rubber prices over the last six months plus, that seemed to be down pretty substantially. Can you talk about your aftermarket pricing and how that might impact margins over the next couple of quarters?

David Martin - Well, I think the way to think about this in terms of pricing versus cost, it's just maintaining alignment with that so that we protect dollars up and down when as things fluctuate over time. We've done a really good job of managing those expectations with our customers and it is managing through those kinds of cycles. And so we feel still very strongly, comfortably, that we've maintained that alignment, and we'll continue doing that going forward. Yes, you're right, the steel has had a lot more volatility to it up and down. But again, we've done a pretty good job managing that cycle. And specifically to aftermarket, we're very carefully aligned on both aftermarket and OEM with that regard.

Steve Ferazani - And last one for me in terms of maintaining your cash flow guidance for the year. So it's still -- I mean, if you exceed that number, it would be down a little bit, but still a significant number after two very strong free cash flow quarters. What's the focus now? I mean, it seems like you can still pay down some more debt here comfortably and get the balance sheet prepared for eventually, hopefully its two years out of cycle were to turn, would debt reduction still remain the priority?

David Martin - Yes, that still remains a priority, but we've paid a lot of our debt down. Our ABL facility in the US is at zero now, which was a priority for us to make that happen. We've taken the opportunities on some higher cost debt, particularly with respect to variable interest rates and we did that during the third quarter. And so put those things aside, we're in a very stable position. We may build cash a little bit in advance of 2023. We'll be very careful to align everything with respect to inventory on the working capital side during Q4 as well to protect production for next year and making sure that we have more level load everything that we need to. So overall, I think we're in a very healthy position to have options. Quarter-to-quarter, there will always be some fluctuations with that. But long term, we're building towards continued strong balance sheet and managing towards any cycle that's in front of us. And also, there will be opportunities in the future to do acquisitions and also do some, maybe even some larger investments in the business as well. And we'll obviously communicate those when we see those priorities come to fruition. So I think that's really the story.

Steve Ferazani - Would there be any increase in CapEx next year? I know it's early to start making budgetary announcements, but in terms of how you're thinking about CapEx, anything major you'd want to get done?

David Martin - Well, we have ongoing programs that we'll be carrying over to 2023 and beyond that, we have a multi-year kind of approach to some of our larger investments, and those continue. I've said it in my comments earlier, I think we're in a reasonable range of where we expect to spend from a capital perspective. Certainly, from a cash flow perspective, we're in a comfortable position there too. So I wouldn't expect it to be dramatically different.

Operator - The next question is from the line of Kirk Ludtke with Imperial Capital.

Kirk Ludtke - Thank you for the call, and congratulations on another great quarter. Just a couple of follow-ups. One is the split between large and small AG. My impression is you're pretty heavily weighted towards large AG, but I just wanted to -- are you sharing the split revenue wise?

Paul Reitz - No, it's not something we've shared publicly. But I think the market, obviously, with the prices on large AG are going to lead towards a split that's heavy towards large AG, and we certainly feel that our production capabilities are a strong attribute. When you talk about large AG, meaning we have the presses, both tires and wheels capable of servicing the large AG market and obviously, we got the LSW portfolio that is an excellent fit for large AG. So certainly, the dynamic is large AG and obviously the values with it are going to lead us to focus more on that. But I think at Titan, we're very proud of the small AG portfolio we've built through the years. And we've seen some customers in that space who've done a really good job building their own infrastructure around small AG. They've invested heavily in the market and they have built excellent resources internally for product development, their own footprints with their dealer networks. And so my comments about small AG and our customer base are really driven towards the fact we have some excellent customers in that space who do a great job servicing that portion of the market.

And so we have a tendency to look at it differently because those customers that really focus on small AG, they don't get into the large AG space as much, they go up to 150, 175 horsepower, and that's kind of where they cut off, but the majority of their portfolio is going to be 75 horsepower or less. And so again, it's a bifurcation that kind of just naturally happens within some of our customers. So that's where we direct the comments. And clearly, small AG has been on a tear for a number of years and again, our customers have done a great job helping really expand that market and building the strong base within it. I think those trends have been very positive for Titan as well. We believe really, really strongly in our capabilities, our portfolio in both small and large AG. But anyway what's your question? I'll stop talking and let you ask a question.

Kirk Ludtke - I was just wondering if there was anything you could share on the split. That's fine, I think I've got a good sense there. I appreciate it. Thank you. And then the returns that you've put up here are impressive and I'm sure they're getting the attention of others. I'm just curious, have you noticed any changes, any moves by competitors, or would-be competitors out there that would shift the competitive landscape potentially?

Paul Reitz - Well, I mean, I think our goal has been, through really the last few years, is to just keep continuing to take care of our customers' needs. And if you can stay one step ahead of the competition in doing that, that's how you win the race. And our team has done a great job doing that, the results clearly support that. And so we build products that meet the end users' needs better than any in the marketplace. We've done a great job connecting to the end users through our customers. And so our strength is really just to continue doing what we're doing. Any marketplace is competitive and you're going to see things change and go through different periods. And are we seeing anything dramatic change in our landscape at this point? No. But really, our focus is -- I mean, I think we have a competitive advantage and we need to continue keeping the foot on the pedal doing what we're doing.

Kirk Ludtke - And then last one for me, the comment about market fundamentals strong into 2024, caught my eye. I'm just curious -- how does that optimism impact your capital allocation? Do you have a net leverage target or any more clarity on that front?

Paul Reitz - I'll take the front part of that and let David jump in. I mean where I'm expressing that optimism is really on the farmer income side. When you look at the stock levels, they've really come down and so the supply demand economics in the grain space has really improved, I would say, in the last few months. So really, I think the indications are strong through '24 that farmer income based upon strong crop prices is going to be very healthy. And so with that, they're going to have the capital to continue to invest in new technology, new equipment. And along with that, there's the technology that we offer with our products, but also obviously the new equipment that will impact on our sales as well. So that's the front part of the question. David, why don't you take the rest.

David Martin - As we progress through this year, we haven't been in this era for very long, so we've been looking at all the alternatives and opportunities that are sitting in front of us with respect to how we allocate capital. We'll continue those discussions with the Board at the right times as we're going into 2023 planning. We're in the middle of it right now. We'll have the right

discussions at the right times with them, but just looking at whatever -- the landscape that's sitting in front of us. And as we look at this year and next year, we're going to be in a very strong position from a balance sheet perspective, either through further debt reduction or increased cash, both mean the same thing in that regard. So we believe we'll have multitude of options and we'll take advantage of those things to make sure that we deliver the right return for all shareholders and all constituents, all investors. So those decisions haven't been made at this point. We continue to evaluate all those things and we'll do those things and communicate appropriately at the right time. But right now, we're still in the middle of all that planning.

Kirk Ludtke - And then with respect to the capital structure, most of it is the fixed rate notes. I'm just curious, is the rest of the debt all floating rate?

David Martin - We have a couple of pieces of debt that are in Latin America that are fixed, but most of it is floating, yes…

Kirk Ludtke - You still have some debt that's floating rate that's pretty payable?

David Martin - Yes, it is pretty payable at various points, not exactly everything right now, but there are some opportunities there. But we did a little bit in Brazil this quarter, there were some higher rate pieces of debt that we paid off.

Operator - Thank you for your questions. This concludes our question-and-answer session. I would like to turn the conference back over to Mr. Reitz for any closing remarks.

Paul Reitz - I appreciate everybody's participation in Titan's Q3 call today, and look forward to bringing the year end results to you in 2023. So again, I appreciate everybody's participation. Thank you.

Operator - Thank you. Thank you for attending today's presentation. The conference call has now concluded.