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Horizon Global Corp. (HZN)

Q1 2016 Earnings Call

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen. Welcome to the Horizon Global First Quarter 2016 Earnings Conference Call. My name is Lori, and I'll be your operator for today's call. As a reminder, today's conference is being recorded for replay purposes.

I will now turn the call over to the Vice President of Investor Relations, Maria Duey. Maria, you may begin.

Maria C. Bringer Duey

Thank you, Lori, and good morning everyone and welcome to Horizon Global's first quarter 2016 earnings conference call and webcast. Hopefully, everyone has had a chance to review the news release issued yesterday. Our first quarter earnings release and the presentation slides that we will refer to during the call are available on the Investor Relations portion of our website.

Turning to slide two, I'd like to remind you that statements in today's presentation will include our views about Horizon Global's future performance, which constitute forward-looking statements. These statements are subject to risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements. We've described these risks and uncertainties in our risk factors and other disclosures in the company's most recent annual report on Form 10-K, quarterly report on Form 10-Q and other reports that we filed with the Securities and Exchange Commission.

Today's presentation also includes non-GAAP financial measures. Any references to operating profit, earnings per share or cash flow on today's call will be as adjusted, unless otherwise noted, with the reconciliation of these adjusted measurements to GAAP in our quarterly press release and presentation slides available on the Investor Relations section of our website at www.horizonglobal.com.

Joining me on our call today are Mark Zeffiro, President and CEO of Horizon Global; and David Rice, our Chief Financial Officer.

Following our prepared remarks, the call will be opened for analyst questions. If we are unable to take your question during the call, please feel free to call me directly at 248-593-8810.

With that, I'll now turn the call over to our President, and Chief Executive Officer, Mark Zeffiro. Mark?

A – . Mark Zeffiro

Thank you, Maria. Good morning to all and thank you for joining us today. We are off to a good start in 2016 with our team driving strong sales and profit gains in the quarter. Our business has performed well in nearly every channel, as the end markets for our products remain favorable. Our three key priorities remained directly in front of us, as we execute on our strategic initiatives.

If you would please flip to slide 4 in the deck, I would like to start this call by discussing some of the trends we are seeing both in our business and in our industry. End markets remain positive in the quarter with most of our channels performing as expected. Our market channels continue to evolve as distributor consolidation that we experienced in 2015 continues to stabilize, with our larger aftermarket distributors growing and gaining share. Auto OEs continued to build more global vehicles, increasing the content for our types of pro ducts and providing an opportunity for growth.

Global currencies continue to remain weak against the U.S. dollar which affected this quarter's results as compared to last year. On a positive note though, currencies have remained stable in comparison to th e fourth quarter of 2015. We are seeing some early signs of commodity inflation most notably upward pressure on fuel prices.

Against that backdrop, Horizon Global had a good start to the year. Our team continues to focus on the execution of our three priorities. EPS in the quarter was $0.15, a 50% increase over 2015, deconstructing that EPS performance, operating profit more than doubled in the quarter, mitigating the impact of incremental interest cost on our bottom line. This is the third time consecutive quarter of profit improvement and I'm proud of our efforts as a team to deliver this result.

Adjusted operating margin improved 280 basis points to 5.8%, as the benefits of our margin initiatives are taking hold. This margin expansion, even at historically lower quarters, provides further evidence that the actions we have taken and the plans we have in place are driving margin improvement. In addition, net sales increased 5.5% on a constant currency basis, supported by OE growth on a global basis, the strength of e-commerce and strong retail sales.

With that in mind, please look to slide 5. We remain focused on three financial priorities for value -creation: improved margins 10% and 10% at a segment and then enterprise level improved capital structure to less than two times lever and drive sales growth 3% to 5% organically. This page includes a few of the initiatives that we believe will deliver, enhance value to shareholders.

On slide 6, you'll see how we executed against these priorities in Q1. We deliv ered and adjusted segment operating profit margin of 9.1% and improvement of 300 basis points in the quarter. Productivity continues to improve in North America as our efforts to consolidate facilities and streamline our organization are nearly complete. The consolidation of our manufacturing facilities in Mexico is nearly complete and the production is ramping up. We are also finalizing the sourcing efforts for products being transitioned to our Chinese partners which we expect to provide margin growth late in the year.

The completion of these projects is expected to support a sustainable new level of profitability for the business. We are also focusing on improving the company's capital structure. We end the Q1 with leverage of 3.77 times, while preserving cash and borrowing availability for execution of our strategic plans. We still see leverage of approximately two times as our goal. Kudos to the team for efficiently managing our working capital and using less operating cash in the quarter.

We posted 5.5% sales growth on a constant currency basis in the first quarter. Our Horizon North American e-commerce and retail businesses continue to experience strong growth. E-commerce which represents less than 10% of sales experienced 16% growth in the quarter.

Regarding retail, you might recall in the fourth quarter of 2015, our retail partners reduced inventory in channel. We saw a bit of a bounce back in this quarter as retail channel began to fill for the spring selling season. While we're growing with our larger distributors and installer order patterns have normalized, the aftermarket channel is down. We're now more able to meet fulfillment demand in the season and therefore have discontinued the use of certain promotional programs.

Our Horizon International segment grew nearly 7% on a constant currency basis. In South Africa, we relocated the business to new larger facility and bought the assets of a competitor which added capacity and the opportunity for margin expansion in the region. We believe these actions are in an important step in growing our South Africa business at a regional level as well as establishing an additional low-cost manufacturing option for our global business. In the quarter, however, we experienced integration pains that caused rates to dip even in a face of great top-line performance.

Our Global OE business saw additional wins in the quarter. Our focused efforts to grow with and support our Global OE customers are paying off with eight new program wins in the first quarter alone which on a full run rate basis should represent nearly $5 million in new sales for the company. We are pleased with our continued progress on all three of our financial priorities with our results demonstrating that organizational focus and alignment results in business improvement.

Moving on to slide 7. This chart should be familiar to many of you. It highlights our progress on the programs we're executing to deliver margin improvement. This quarter, we removed the plant productivity program. It remained a focus for us as performance has been more sustainable in the past year. We have plans in place to drive productivity and production cost as part of our operational excellence efforts. We will add additional programs over time as completed programs come off the schedule and just become part of the normal operating culture of our business. We talked a little bit about South Africa earlier where we experienced some initial inefficiencies in our plant.

Our international businesses were impacted by slower demand in the UK and Brazil. Margins in these locations, while better than two years ago waned as our efforts to flex our cost structure in the quarter, were more than offset by the volume reductions.

You'll notice when we added new program at the bottom of the schedule, product innovation MGPP or Multi-Generational Product Planning. If you think about it, many of the efforts to improve margins that we've talked about to this point are backward-looking, fixing production, integrating businesses, closing facilities.

An important part of a sustainable business is our future, and in this case, the future of our products. This requires engaging our engineering and product leadership teams to think about our future not just our path. With many of those backward-looking projects, maturing or nearly complete, we have added more focus to building a robust MGPP that looks at new product introduction several years ahead.

We will update on you the progress in this important area over the course of the next several quarters and share how these efforts are adding margin to our business through better engineering and product leadership engagement. In total, we are on track with most of these efforts to deliver margin improvement in 2016 and beyond.

With that, please turn to slide 8, and I'll turn it over to Dave Rice, our CFO, who will go a little deeper into our review of our performance in the quarter, then I will be back to wrap up and share our outlook for the balance of 2016.

David G. Rice

Thanks, Mark. In the commentary to follow, I will be addressing our performance in the quarter on an excluding special items basis. Cash flow and balance sheet commentary will be on as reported basis. Before I begin, please note that we realigned our segment for 2016 our first calendar year as a standalone public company to reflect how we now manage our business. We will report results for the North America and international segments, the change being that our operations in Brazil previously included in our Cequent Americas segment will now be reported with the businesses that's formally called CAPEA collectively now referred to Horizon International.

With that, please turn to slide 9 for a summary of our Q1 results. As Mark noted in his business commentary, first quarter reflects our third consecutive quarter distinguished by a significant improvement in operating margins of the segment and enterprise level. Sales on a constant currency basis improves 5.5% as compared to Q1 of 2015. If rates stabilized at their current levels, we would expect currency translation to have a less significant impact on our reported results by Q3.

Segment operating profit margin improved to 9.1% a 50% improvement from 2015, the $13.3 million representing 300 basis points increased over the same period of 2015. This performance resulted from favorable input cost, the benefit of our margin improvement efforts and incremental volume.

At an enterprise level, operating profit margin improved 290 basis points 5.8% of net sales from 3% in the prior year. In the first quarter, we incurred positive support of our standalone corporate structure as compared to the previous year which represents an allocation from our former parent. Costs incurred under our transition services agreement were insignificant in the quarter, substantially relating to a financial statement – financial system conversion and the completion of our annual proxy statement. We do not expect to incur additional costs under that agreement.

Operating cash used in the first quarter declined from the prior year. It improved earnings in a lower investment and working capital more than offsetting the 4.2 million in interest cost incurred under the new capital structure not in place last year. Recognize that this incremental interest cost has a $0.15 headwind at an EPS level. Total debt at the end of the quarter was $211.8 million, an increase over the year-end level of $188.7 million, supporting our seasonal investment and working capital. Our net leverage after considering $11.7 million of domestic cash stands at 3.77 times. This result is reflective of the improved profitability and working capital management of the business. The entire Horizon team is energized by the impact of our actions, and our actions have had on the business remain focused on delivering our three key priorities.

On slide 10, I'll go through the performance of our Horizon North America segment. Q1 sales for our North America segment grew 5% from the 2015 level with the investments made in our automotive reorganization and a strong end market resulting in sales growth of $6.9 million in that channel. Eth retail channel continues to deliver with an increase of $2.8 million, mainly resulting from prior share gain. Our e-commerce activities grew by $1 million in the quarter on strong demand from our Internet partners.

While we face volume headwinds in the aftermarket channel, which was down $3.6 million, we are growing with our national distribution partners. We continue to modify our commercial prices to better align with our customers demand. The industrial channel continues to be challenged by toughness in the energy in agricultural end market and was down $2.1 million in Q1.

The North America segment delivered exceptional margin expansion in the period, achieving a 400-basis point imrprovement over the prior year to 9.9% of sales. This performance is comprised of favorable input cost of approximately $1.6 million, half of which is attributable to material cost. The balance sheet improvement is comprised of leverage on incremental sales growth, plant productivity and the benefit of t the integration of the Americas business started in late Q2 of last year.

The North America segment continues to focus on the winding down of the [indiscernible] (13:31) operations, the successful integration of our Horizon North American business. And continue investments in the structure supporting OE customers.

Performance in our international segment is highlighted on page 11. Q1 sales for international segment grew to $41.5 million on a constant currency basis, up 6.9% as compared to Q1 of 2015. As Mark mentioned in his comments, our team's execution of global OE strategy has continued to result in new program launches in the segment. Australia, Germany, and South Africa al experienced growth in OE volumes, driven both by new award launches and strong market conditions. OE growth was the main contributor of the $4.3 million increase across this group of business.

In the quarter, our South Africa business continue to ramp up of new OE programs, finished the quarter at sales level nearly 50% over 2015. Offsetting these improvements, Thailand continues to reflect a decline as compared to the prior year. While launches of new program have not yet fully offset the decline in the [indiscernible] (14:31) original program award. Operating profit for the international business was down 4.6% or about $100,000.

Productivity improvements in Australia and Thailand and volume leverage in Australia, Germany and South Africa were more than offset by the volume pressure in Thailand. And input cost headwinds in Australia on purchases denominated in U.S. dollars.

In international segment, we will continue to focus on OE program launches across the group while accelerating manufacturing productivity in integration activities. Commercial development in Europe, and managing growth in South Africa will also remain critical focus areas for the team. Now, on slide 12 is a view of our leverage and liquidity. As of the close of Q1, we had approximately $93 million in total liquidity made up of $18.7 million of cash on hand and $74 million of availability on our bank facilities.

The increase in our leverage ratio to approximately 3.8 times from 3.3 times at year-end is consistent with our seasons' working capital investment cycle. Since we typically generate cash after Q1, we believe we are on track to report quarter-over-quarter de-levering as compared to 2015 moving to the balance of the year. In addition, the health of our working capital position at quarter end has improved since Q1 of 2015. We improve the velocity of our inventory by 13 days which reflects more normalized customer demand patterns and distribution network efficiency. Accounts payable declined 11 days from Q1 of 2015, exhibiting a more normalized level at the end of the first quarter as compared to the prior year when we were preparing for our launches as stand-alone company. Improvement balance sheet was made possible by the hard work of our entire team executing our financial and strategic priorities.

In closing, I'd like to leave with three takeaways from our financial performance. First, the number one financial prior year of margin expansion continues to be a focus at every level of our organization, backed up by specific projects that are now reading through our results. Second, we continue to see commercial opportunities across the regions in which we operate and are dedicated to capitalizing in order to achieve our organic growth initiatives.

And finally cash generation driven through enhanced operating performance and consistent working capital management to provide us the flexibility to invest in our strategies ultimately improve our capital structure.

If you'll turn to slide 13, I'd like to turn it back to Mark who will cover our long-term goals, discuss our current year guidance and wrap up our prepared remarks. Mark?

A – . Mark Zeffiro

Thanks, Dave. Please turn to slide 14. Last quarter we introduced our long-term strategic goals to the investment community. The Horizon Global team is committed to building a best-in-class business that supports customers and uses our products – users of our products while providing employees with the opportunity to grow and develop.

While we focus on our three key priorities every day, we also have eye on the Horizon in our long-term strategic goals. We feel we are positioned to execute our long-term strategic goals resulting in a Horizon Global that is larger more profitable and best-in-class in each of the markets we serve.

We believe we have structured ourselves for differentiated growth and efficiency. The threshold set out on this page are an expression of our vision for the company: increased profit and substantial cash flow to support continued growth, all while growing faster than the market and being an employer of choice. We have work to do, but we feel the foundation is in place to meet our strategic goals, which would afford us the opportunity to grow beyond the markets and products that we provide today and expand our relevance to our market set through new technologies and adjacent opportunities.

So, with that in mind, let's turn to slide 15 for our guidance for the remainder of 2016. We're off to a good start in 2016, making real progress on many fronts. I am optimistic about the year, but one quarter does not make a year.

We expect to deliver more than 70% of our operating profit for the year in the coming two quarters and are confident in delivering on those original expectations. Our teams are aligned and working to meet or exceed those goals and our momentum is good. We will continue to update you as the year progresses.

With that said, we continue to expect to grow at approximately 3% to 5% on a constant currency basis, gaining share and winning programs along the way. We expect to increase segment operating profit by more than 100 basis points over 2015. This income growth will offset our full year level of interest cost and normalized tax expense for 2016.

We recognize the importance of cash flow on the capital structure and believe that we'll be able to divert our operating cash in excess of net income. We expect capital expenditures to be about 2.5% of sales supporting margin accretive investments in our business.

Our tax rate for planning purposes is 20%, but is expected to be lower in 2016 as certain unrecognized tax benefits favorably impact the rate. Our performance in the first quarter of 2016 demonstrates the progress on all three of our key financial priorities and value creation efforts in the company.

Wrapping up on slide 16, we delivered significant profit improvement in the first quarter of 2016. And while we're excited about the opportunities ahead. There is some uncertainty in this election year. We remain committed to increasing shareholder value as demonstrated by our first quarter results and our continued progress on our key financial priorities. Our team is aligned and engaged at all levels to deliver this performance. Our investment in this strategy and structure of our global OE organization is resulting the programmatic wins, and our retail and e-commerce strategies are driving real sales growth.

I would like to thank our dedicated teammates. Their outstanding efforts to satisfy customers and deliver on our margin initiatives have resulted in a promising start to the year. Thank you to our stakeholders for their support in making Horizon Global a better company. We're excited about the opportunities ahead.

At this point, we will gladly take your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Matt Koranda of ROTH Capital Partners.

Matthew Koranda

Q

Good morning, guys. Thanks for taking my question.

A

Good morning, Matt.

A

Hey Matt.

Matthew Koranda

Q

So, just wanted to start with guidance for the year. It looks like your sticking with your more than 100 basis points of year-over-year segment operating margin improvement which I think implied about 9.4% in 2016, but since you ran at about 9.1% in the quarter, and it does seem like you're tracking pretty close to the goal with also what looks like a benefit from [indiscernible] (21:11) later this year still to come, are there any headwinds or items that you guys worry about in the next three quarters that kind of level you out where you are and only cause an incremental improvement toward that 9.4% or is there some upside left there?

A

I would describe it this way, Matt, is that if you think about Q3 on a comp basis, we had a tremendous Q3 in 2015. So, I could see that getting tempered down a bit, as we get into that quarter just in terms of the realization that some of the benefits that we're kind of feel trapped in the balance sheet as they really came through in Q3. So I would just tell you that we're optimistic about exceeding our 100 basis points at a segment offering profit margin level. We're off to a really good start for the year. We've got to finish that Juarez move. We've got to finish the consolidation of those plants. We've got to finish on [indiscernible] (22:06), so there's a fair number of things that we have to execute well on, otherwise make sure that we either meet or exceed those expectations.

Matthew Koranda

Q

Got it. Okay. Thanks for that, Mark. And then I guess sticking with this theme, you did mention Juarez and that closure. Could you just give us an update on where things stand in Juarez and what's left to complete there? And will you guys be carrying some safety stock as a part of that or is that already reflected in the inventory from Q1 ?

A. Zeffiro

A

We had actually some heavier stock levels in Q4 going into Q1 as a result of that transition plan. So what you're seeing is our inventory days came down as a result of not only just the use of that inventory to fulfill customer needs but also that natural transition. So we're producing in Reynosa now most of the available products that otherwise needed to happen. The stuff that's getting sourced in China really will start to happen here in early Q3, late Q2, as we start to make that transition. So I would tell you that the stuff that's immediately within our control, they're learning and burning through that inventory that was already built. So with that said, I think we're in a good spot with respect to that working capital there. The HD stuff is moved. And therefore, I think we're in a good, relative spot as to what we expected. The move of China has, like I've talked about publicly, slid a little bit for us just in terms of on the back of tooling and tooling availability for us and launching those new products.

So, with that said, I see benefits coming from us late in the year. And by late in the year, let's not forget that you have to purchase the inventory that you've already built at the higher cost relative load and then we'll start to see some of that benefit here in Q4 as that inventory from China ends up being the normal fulfillment inventory to our customers.

Matthew Koranda

Q

Got it. Really helpful, Mark. And then, you did call out commodity inflation as a potential headwind. You're just setting in now, I guess. But when can you guys do to mitigate some of this deal and book cost that you have? And is there any hedging you can do in a rising steel environment? Maybe just talk a little bit about that.

A

Yeah. I would tell you this that the team has been buying steel for a long time, and they're pretty professional in that respect. And typically, we take a six-month out kind of position with purchases and feathered purchases accordingly. Where the operating team has to then take that is as we've anticipated those effects, we obviously are back out in the market with customers every day when they're asking for price reductions. This is part and parcel of the combative interface that you have to have to otherwise advise them of the fact that input costs have swing – have swung for us and are moving up.

So, to that end, it's typically not an easy conversation, and it's not something that you just get the following day. It ends up being something that you have to prove that there's material effect on like – on your cost structure to be able to otherwise substantiate the price increase. So, it's a matter of time under the curve in terms of when you can really recover that cost increase. But with that said, we obviously took care of ourselves in terms of on a downward side of this as well in terms of making sure that we were appropriately sharing those benefits with our customers.

< Q – Matthew Koranda>: Got it. Okay. And then last couple here from me, in the North American channel review, you guys did call it aftermarket is down a bit and mentioned pricing modified with customer demands. So, maybe you could just elaborate a little bit on that. And then also, I think everyone is interested to hear your take as always on sort of what you're seeing with distributor consolidation. I know you guys always have your ear to the ground with that. But what's the latest you're seeing on that front?

A

Yeah. Fantastic. When you think about – let's deal with the last one first, distributor consolidation and I'll talk about aftermarket more directly. What we're seeing is that distributor consolidation resulted in some of these larger guys as they took inventory out in the system in 2015 be as of a national course of events, be as a less warehouses, less DCs, less things of that nature, their order rate has returned to normalized levels in aggregate and a little bit better than that. So not only they're growing but I think that they're taking share along the way from some of the mom-and-pop's that are out there today. So, we're seeing and we're growing with those biggest guys and it feels like we're supporting them with the right kind of inventory and the right kind of commercial programs.

Now, the other thing – the other reference point that I made was in an effort to better align our ability to deliver when customers need the product, historically the business had been not able to, if you will, flex up and flex down its volumes nearly as efficiently as we can do today. So one of the things that we did was historically there were promotional programs that otherwise would load people up in Q1 because we would produce a lot of that in Q4 going into Q1, ship it in Q1. And as such, they would carry inventory for a longer period of time.

The outcome is that – and we would have to incentivize our customers to be able to do that because obviously they were taking the risk of that inventory. With our more efficient product in Reynosa, as well as more efficient overall supply chain management, the team clearly differentiated its ability to be able to have fulfillment rates well into the 90s that you don't need to do that anymore. You can fulfill when the customer needs the product. And as such, we were able to step away from those promotional programs because they've gotten larger and larger over time and now we just have things that are more targeted in terms of what we need for promotional activity.

So we've gotten more effective and efficient as a result of our ability to flex up production on all the hard work of John Aleva and team done in Reynosa as well as obviously others in the supply chain related world. So it's been a journey, but the journey has resulted in us being a more effective supplier to our customers and a more efficient manufacturer.

Q

Got it. Very helpful, Mark. And congrats on a great quarter, guys. I'll jump back in queue.

A. Zeffiro

A

Absolutely.

Operator: There appear to be no further questions at this time. I'll now return the call to Mark Zeffiro, President and CEO for any additional or closing remarks.

A – . Mark Zeffiro

Well, I appreciate everybody that's on the phone, taking the time to hear the outstanding results from Q1 for Horizon Global. This is the first quarter in our real standalone year as a company. We're excited about what it means to us, and I'm excited about the engagement and alignment of our organization on those priorities. We're going to be talking obviously with many of our significant investors over the next few days, and look forward to hearing their questions and look forward to hearing how they view the quarter as well.

So, with that said, we'll terminate the call and thank you for your support.

Operator: Thank you for participating in the Horizon Global first quarter 2016 earnings conference call. You may now disconnect.