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Conference Call Transcript

SPAR - Q3 2010 Spartan Motors Earnings Conference Call

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PRESENTATION

Operator

Good morning and welcome to Spartan Motors third quarter 2010 earnings conference call. All participants will be in a listen-only mode until the question-and-answer session of the conference. This call is being recorded at the request of Spartan Motors. Anyone has any objections, you may disconnect at this time. I would now like to introduce Ms. Paula Droste, Director of Investor Relations and Treasury for Spartan Motors. Ms. Droste, you may proceed.

Paula Droste - Spartan Motors, Inc. - Director of IR and Treasury

Good morning, everyone, and welcome to Spartan Motors' third quarter 2010 conference call. I am Paula Droste, Director of Investor Relations and Treasury for Spartan Motors. And Spartan's executives with me today are John Szykiel, President and CEO; and Joe Nowicki, CFO. I assume all of you saw the Company's earnings release on the newswire and Internet this morning. John and Joe will take a few minutes to discuss the results for the quarter.

However before we do, it is my responsibility to inform you that certain predictions and projections made in today's conference call regarding Spartan Motors and its operations may be considered forward-looking statements under the securities laws. As a result, I must caution you that as with any prediction or projection, there are a number of factors that could cause Spartan's results to differ materially. These risk factors are identified in our Form 10-K filed with the SEC.

With that, I would like to turn the call over to our CEO, John Szykiel.

John Szykiel - Spartan Motors, Inc. - CEO and Director

Paula, thank you very much and good morning to all of those listening in today's call and those on the Internet as well. Today, we will share our results for Q3, providing detail on the quarterly results; we will also provide an overview on our market's operations and strategic direction followed by a Q&A session. I will quickly cover some quick financials and then go over the markets, and then Joe Nowicki will get more into detail on the financials, and then we'll wrap it up from there and leave time for questions and answers afterwards.

In the third quarter, we continued to focus our efforts on four key areas, compelling products, growth in profitable market share, cost management and balance sheet management. Each day, we have the responsibility to strategically i.e. position the organization for the future and operationally

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focus the organization on short-term results. Well, the good news is we made solid progress on all fronts in the third quarter. Our financial metrics reflect our efforts to realign costs as we continued to invest in strategic growth initiatives. However, we remain guarded in our near-term outlook given the macroeconomic uncertainty in some of our markets.

Now, a quick recap of this quarter's financial results. Sales in the quarter increased 39.7% from last year's level, driven primarily by the addition of Utilimaster in December of 2009, along with increases in motorhome and defense sales. Excluding Utilimaster, sales in the quarter increased approximately 8% versus the same quarter of 2009. Net income from continuing operations is up 112% from the same quarter versus a year ago at \$3.5 million or \$0.11 per share.

As I stated in prior calls and stated a few moments ago, the foundation of our strategic and operating initiatives remain straightforward, fairly simple, but very, very focused. First, develop compelling products and services; second, growth in profitable market share; third, cost structure management; and fourth, balance sheet management.

As we look at compelling products through our market niches, we have three great brands in Spartan Chassis, Crimson Fire, Utilimaster and now the alliance with Isuzu. We are committed to leveraging those strengths through compelling products and growth in profitable market share and as time goes on, we will have more good days than bad ones.

We are committed to the emergency response marketplace, a marketplace of tremendous opportunity, as illustrated first by a completely redesigned cab and chassis, which conforms or provides new product offerings under more common architectures i.e. increased common bill of material sets. This redesign effort, while challenging, went extremely well but also provided the 2010 emissions compliant engines in the marketplace, a more streamlined look and what is nice is leaner from a manufacturing perspective for both Spartan and our respective OEM partners.

In addition, as we look at Spartan Chassis in the emergency response marketplace, not just this year but last year as well in 2008, significant engineering resources have been committed to the development testing and introduction of 2010 compliant emission engines. The offerings cover engines ranging from 340 horsepower to 600 horsepower.

What's amazing when people say, why do you have to have so many different engine offerings? There's over 35,000 fire departments in North America and each department is very, very unique as to how they look at their service. Very hilly, very flat, big city; very, very spread out and it is this customization, this focus of being very customer centric, that has been one of our foundations in the past and will be one of our foundations into the future as well.

In addition, there will be increased engine offerings as we look into the future, not in 2010, but as we go into 2011, offerings that will be driving us to be the number one spec as we look at emergency response chassis in the future. As it is imperative that we continue to support Spartan Chassis, which we will, and ensure that all that we do ensures that everything riding on it is a Spartan Chassis or desired to be a Spartan Chassis.

Crimson Fire's, Transformer, the Legend and First Response All Call vehicles, all offer improved maneuverability, shorter wheelbase, increased compartmentation, reduced price points and multi use. These re-engineered vehicles are gaining momentum in the marketplace. Orders are being placed and even in a very challenging market continue to drive opportunity for Crimson Fire.

We also expect to gain market share in 2011 with our investment in the Next-Generation Commercial Vehicle or the NGCV for short. This product launch remains on schedule; vehicle durability testing is in place; customer reviews and test drive runs are underway as well. I'll say this, the response from customers, that have driven the vehicle, that have done test drives, has been very, very positive. So we are moving the ball in the right direction, but we will do it right.

Again, this product will not roll into the marketplace till production of Q3, and when people say, why did it take so long, well, when you have some customers making 10 million package deliveries a day, it's imperative that the vehicles operate. And if the vehicles don't operate, packages don't get delivered and that's a pretty negative moment and does not drive long-term growth in shareholder or stakeholder value. We know we've got a great product, with a lot of compelling features around it from improved fuel economy, etcetera, but we also want to make sure that we bring it into market properly.

Our strategic alliance with Isuzu Commercial Truck of America provides growth opportunities again in 2011 but into the future as well. A simple amazing fact is Isuzu has 300 dealers in North America, and some of you have seen our PowerPoint slide showing 58 specialty vehicle markets in North America, and when you now add in the alliance with Isuzu, we now touch 47 of those markets through the brands of Spartan, Crimson Fire, Utilimaster and Isuzu. This doesn't mean it's going to be great things overnight; however, we have an opportunity, which we didn't have a

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year ago at this time, and now we're focused strategically and operationally on taking advantage of that. The N-Series gas is on track and as mentioned, production will start in the second quarter of 2011.

This commitment to compelling products and innovations will create opportunities for growth in profitable market share in even uncertain times. It's easy to say hard "to do", but we are very focused on making that happening. Earlier in the year, we also made significant changes in our cost structure, and Joe will get into that in greater detail, but the financial results reflect the hard work we've done. When you look at the drop in operating expenses from 15.8% in 2009 in Q3 to 11.9% in the same quarter of 2010, as a percentage of sales and I am not going to get in the math, it is very, very significant.

And again, it just gets back to our four tenets, compelling products, growth in profitable market share, cost management and balance sheet management. Each and every day, we are focused on those four strategic and operational initiatives. Our focus on balance sheet management continues to move in the right direction. I just want to compliment everybody involved in our exit from the ambulance business, in Road Rescue and how that was accomplished in such a timely manner and is really a positive, not just for Road Rescue but for Spartan as well.

On the motorhome side of life, and I am going to get a little bit more into the detail, into each market, again Joe is going to get into the financials, something that was very, very positive in Q3 was really just the stability in the motorhome market. Sales increasing by \$10.5 million or nearly 94% versus Q3 of 2009 but up 3% versus Q2 of this year. This stability reflects overall industry improvements compared to last year and earlier this year, which really is good news. A strong leading indicator of the RV industry is consumer confidence and as all of you know, while it's stabilized, it's still not been tested.

And this stability/uncertainty will likely dampen any significant market rebound and I did use the term market rebound but what I am trying to do is provide caution to you. Been in the business since 1985, consumer confidence is one of the biggest drivers of the RV industry and right now while it's up, it's still not where it was three years ago and while I believe that business will move in the right direction, I don't perceive it is going to take off like a rocket ship when I look at the Class A business. On a positive side, demographics are good, 11,000 people a day turn 50. That's also good for the emergency response industry. In addition, an RV vacation is still the lowest cost of a family vacation.

Let's switch gears to defense and specialty vehicle sales. Third quarter sales were up strong at \$8.3 million, up substantially from 2009, reflecting ILAV and SOCOM orders. Again, what's interesting there is a good article on the Wall Street Journal today talking about some of the changes going on in the military vehicle business but what's interesting is uncertainty actually works to our benefit.

Typically, larger markets become more micro market niche-oriented chains and creates opportunity for smaller companies like us, and what you're seeing that's reflected is in these ILAV and SOCOM orders which also move the ball in the right direction from an income perspective. What's also nice is the backlog was up to \$12.5 million from \$4.2 million a year ago. And so as we've said in the past, on the defense side of life, we are taking a strategic approach. The wins will probably be small, but the wins will be there and over time, we will grow the number of wins.

We are also very proud to achieve ISO 9001 certification this past quarter. This is integral and very, very key for us to be a long-term player in the defense marketplace. It also honestly increases how people look at us in a number of markets because what it validates is we are becoming a world manufacturer. And we are aligned with Isuzu today, the world's largest diesel engine manufacturer, one of the world's largest truck manufacturers and over time some of these process achievements not just help us in a specific market, but they validate the opportunity for other people to work with us in other markets.

The emergency response market continues to be very challenging, it continues to soften as a result of tight fiscal in state and really federal budgets. Emergency response chassis sales were down 17% for the third quarter of 2010 compared to the same quarter of 2009. Year-to-date sales were down about 2% versus the same period in 2009.

When we look at the body side of life representing Crimson Fire and Crimson Fire Aerials, sales were down 20% for the quarter compared to the same quarter of 2009. At Crimson Fire, the decrease was partially due to the timing of some shipments but the reality is it's very, very difficult from a local, state and federal perspective when it comes to budgets, and this will provide changes and challenges. Vehicles will change but there are significant challenges and as we look over the next 12 to 18 months, we expect the emergency response industry to be down. We've got some products, which hopefully will grow profitable market share, but as a whole that will be a very challenging market.

As we look to the future though, the reality is that there is a call for help every 1.25 seconds and another 54% of all fire trucks in service today are more than 15 years old. And that is a positive, which over time will drive the opportunity in the right direction.

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In closing, as we look at our markets, after-market parts and assembly saw year-over-year reduction in sales of 21% to approximately \$20 million. This was driven in large by MMPV contracts that were concluded in 2009, but also a reduction from a scope relative to the wars going on in Afghanistan and Iraq. The reality is, as the war is winding down, which is good news in a lot of respects, the defense side of life relative to aftermarket parts and assemblies is just not as strong as what it was a year ago.

However, on the other positive side, we had growth in emergency response, we had growth in delivery and service, and we had growth in recreation and specialty vehicle when we look at the aftermarket parts and assemblies area, because we have over 220,000 vehicles in operation today and we are focused on leveraging there.

Sales in our delivery and service segment, as I mentioned a few moments ago, increased \$5.2 million or 23% from the second quarter as orders from the previous quarter were filled. While Utilimaster's backlog declined from the second quarter, we remained highly optimistic about our investment in the NGCV, the next-generation vehicle which has significant improvement in fuel economy, and speed to enter and exit the vehicle, and again that will be introduced in the second half of 2011, but everything which we're seeing from the marketplace indicates that we have a product that will transform the delivery and service marketplace.

It's also important to note that Utilimaster generated a profit in the third quarter of 2010, as did Crimson Fire, as did Spartan Chassis. So all three brands run in the right side of the fence and I want to give thanks to all the Spartan associates. Joe.

Joe Nowicki - Spartan Motors, Inc. - CFO and Chief Compliance Officer

Thanks, John. Good morning, everyone. First, I'll cover a quick housekeeping item regarding the structure of the financials. Consistent with accounting guidelines and also the format presented in the second quarter, the Road Rescue has also been classified as discontinued operations. So all the sales, cost of sales, operating expenses, and other income and expense from Road Rescue have been pulled out, including historical comparisons, and put into one summarized line item.

Our third quarter results reflect the fulfillment of the commitments we made last quarter. As I mentioned in the last call, we expected a positive outlook for the second quarter of 2010, which we delivered on this quarter. Second, we quickly exited the Road Rescue business as we announced we would do last quarter to free up resources and focus on more profitable initiatives. The sale was closed on September 20th. The exit also improved our balance sheet as the sale of the business freed up capital and provided further liquidity.

The difficult decisions we made in the prior quarters to curtail cost and right size the organization in light of the current market conditions are paying dividends. No pun intended here with the current dividend announcement, which I will talk about later. While we're pleased with the results of the proactive approach, we intend to remain vigilant in the management of our cost structure given the trends in our backlog.

From a revenue perspective, third quarter net sales were up \$34 million or nearly 40% from the prior year. A majority of the sales increase was due to the addition of the service and delivery market, that we strategically acquired to intensely diversify our portfolio, although even excluding the service and delivery segment, sales were still up approximately 8%.

Motor home and defense vehicles contributed to the increase by \$10 million and \$7 million respectively. On a sequential basis, compared to the second quarter, sales were up almost \$5 million or 4%. Sales in the specialty vehicle segment were fairly flat from last quarter, reflecting approximately a \$7 million increase from the aftermarket parts and assembly business, offset by decreases in emergency response.

However, the delivery and service vehicles, a market that responds early to economic changes posted a sequential increase of \$5 million or 23%, which bodes well for their future. Our consolidated backlog was approximately \$173 million as of September 30, compared with approximately \$145 million a year earlier.

The backlog for 2009 did not include Utilimaster. Excluding Utilimaster, our backlog was down slightly to \$134 million or 8% from the prior year. The decrease year-over-year was driven by declines in fire truck bodies and fire truck chassis as a result of the [pull ahead] of orders received in 2009 before the 2010 emissions requirements. These were partially offset by motor home and aftermarket parts orders which were up year-over-year.

Sequentially, our consolidated backlog has eroded, as emergency response market experiences a cyclical weakening in response to the tightening municipal budgets and also the spike in orders we received to 2009 for the engine emissions change. Motorhome was flat compared to the second quarter, while service and delivery in aftermarket parts were down sequentially.

Gross margin in the quarter was 16.4%, down from 18.8% last year, due mainly to a shift in product mix, from defense and APA to motor homes and delivery and service vehicles. A lot of those margins will be here for a while due to our current sales mix. However, we remain committed to improve our margins in each of the end markets we serve.

Operating expenses increased by approximately \$0.8 million in the third quarter of 2010 compared to the same quarter of 2009, driven by the R&D expenditures, as John talked about, for the NGCV and the redesign of the cab and chassis for the 2010 emissions change. The R&D cost included \$1 million related to NGCV and that design changed cost in the 2010 emissions. R&D costs are elevated as we incurred the expense of prototyping and testing of these new products. We expect those costs to decapitate in 2011 with the conclusion of these programs.

Operating expenses in the prior year did not include the incremental spending from the acquisition of Utilimaster, which was approximately \$4 million in the third quarter of 2010. Excluding restructuring charges incurred in 2009, the expenses related to the recently acquired Utilimaster, our operating expenses in the quarter were actually reduced by \$2.3 million or nearly 18% compared to the same period in the prior year.

Sequentially, operating expenses decreased by \$2 million or 12%. Even more telling is the reduction in operating expenses as a percentage of sales, as John mentioned earlier, from 15.8% in the third quarter of last year to 11.9% in the current quarter. Sequentially, there is also the percentages down 230 basis points from 14.2% in the second quarter, all reflecting the momentum of our cost curtailment efforts. Keep in mind that some of the savings experienced in the quarter are one-time savings such as the impacts from furloughs taken and temporary salary reductions.

The increased sales, improved margins and the effective cost management have driven the positive operating income results of \$5.4 million for the quarter. This is up 105% from \$2.6 million in the same quarter of 2009. As shared in the last earnings call, we also achieved our goal of mid-single-digit operating income as a percentage of sales, which was 4.5% for the third quarter of 2010.

We're also proud to report net earnings from continuing operations of \$3.5 million or \$0.11 per diluted share. Other major accomplishments come from the balance sheet, with significantly reduced working capital resulting in a \$28.8 million operating cash flow in the first nine months of 2010.

Inventory has improved with a reduction of \$17.9 million since December of 2009, representing also a reduction of 17 days in inventory. Accounts receivable was slightly up due to the timing of some shipments to Utilimaster. While we've made great progress in reducing our working capital requirements, we see even more opportunity for improvement, particularly in inventory where we could see additional gains in the near future.

Our solid cash flow enabled us to continue paying down debt in the quarter. Our debt balance stood at \$15 million at September 30, down from \$46 million at the end of 2009 and even down from the \$20 million we had at the end of the second quarter.

Depreciation for the quarter was \$2.6 million. Capital expenditures for the first nine months of 2010 were \$3 million and we continue to forecast CapEx spending in the range of \$4 million to \$5 million in 2010.

With our strong financial position and positive long-term outlook, the Board has approved management's recommendation to pay its semi-annual dividend for the second half of 2010. A \$0.05 per share dividend was declared for payment on December 9, 2010 for shareholders of record on November 11, 2010. In addition, the Company's Board also re-authorized management to repurchase up to a million shares of common stock over the next year. Both of these items reflect the strength of our balance sheet and our confidence in Spartan's future.

We are pleased with the quarter's financial results, they affirm what I have said in the past regarded where we are headed as a company. A business model where we can maintain solid gross margins and operating income despite the volatile demand. We're also strengthening our balance sheet along the way.

I'll now turn the call back to John to share some closing thoughts on our outlook as we finish 2010.

John Szykiel - Spartan Motors, Inc. - CEO and Director

Joe, thank you very much. Again, as mentioned, the third quarter was another quarter of implementation as we completed the exit of Road Rescue and continued our business realignment, all driving improved financial results. The interesting thing is, if you look at 2009-2010, we've

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not only been profitable in some of the most difficult time periods since the Great Depression, we've diversified our business significantly. We have a major alliance with Isuzu, which we've never had before. We've generated cash, paying down debt relative to the acquisition. We've kept our dividend in place. We've just announced, as Joe mentioned, a stock buyback.

We're just seeing a company which is just following a pretty simple basic methodology, compelling products, growth in profitable market share, cost and balance sheet management. We just do those each and every day, all of us working together in a team and it doesn't mean that every day in the future is going to be easy, but we have made significant progress, as we transform this Company from an opportunistic enterprise to one that is strategically and operationally focused as we look to the future. And that bodes well for all stakeholders because there are significant challenges, not just within the US but throughout the world that are providing a lot of headwinds.

But as mentioned a few moments ago, the strength of our balance sheet demonstrated by the low debt, the sizable end use credit facilities, the reduction levels of the inventory complemented by strong cash generation, I mean that is a significant positive. We look at the effective cost management to focus on operations, short-term results, not just driving profitability but also helps long-term sustainability. We've resized our organization structure, tailoring to be reflex oriented within each one of our existing markets.

Cost management complemented by our strong balance sheet will not only position us for today, but will also position us for tomorrow, as we look at new markets but also on the M&A side of life. We will be wise in all that we do, but the integration of Utilimaster has gone extremely well, much better than the last M&As which we started in 1997, but a lot of that's because of Joe Nowicki, Tom Gorman, a variety of individuals within Utilimaster, the Spartan teams, etc., we're a group of people that are thinking and acting, first, from a [wide] perspective and executing together as a team.

As we look at our expanded market diversification, limiting our exposure to volatility in a single or narrowly defined market. We are in five markets today, most averaging about 20% of our sales mix. In essence, we have good diversification. When we look at growth in the future, where will it come from? Really four areas: organic, internal innovation, alliance, similar to what's going on with Isuzu, acquisition as replicated or demonstrated by Utilimaster and aftermarket parts and assemblies.

Bottom line, we are a significantly different organization, but stronger from a long-term shareholder value perspective than what we were three years ago.

Quickly, as we look at the catalyst within each market, I talked about the 2010 emissions, the improvements in efficiencies, we looked at Crimson Fire relative to the Transformer, the Legend, the First Response All Calls vehicle, and what's important I think for the group to know is the Crimson Fire brand is really a fairly new brand, it's really been in existence less than six years. Prior to that, it was Quality and Luverne: just some recent deliveries, Chicago, Dallas, Toronto, Buffalo, San Francisco.

So when people ask me, why am I excited about Crimson Fire, well, first, there is a call for help every 1.25 seconds. Second, it's a new brand. Third, operationally, they've done a lot to improve gross margins, reduce operating expenses. Fourth, they've moved into a new facility on the aerial side of life in Ephrata, Pennsylvania, which will not only reduce the cost of building an aerial, provide with some opportunities relative to refurbishment but also will enable us to enhance the compellingness of the products, yet produce it from a leaner perspective.

I talked about the NGCVs as it relates to delivery and service. I think something which is quick to note how we have changed dramatically over the last 12 to 18 months. When we look at innovation today relative to compelling products, lean is inherent within the innovation philosophy. It was not three years ago, five years ago, which means when we bring an innovative product to market, we are also very focused on lean. What's going on from a bill of materials, a process perspective, so that when we bring a product to market that is compelling, it is also lower in cost to produce and easier to service when it goes into the field.

That's nice when I look at Spartan Chassis, the new 2010 cabin chassis design, Crimson Fire's Transformer, the Legend, and its First Response All Calls vehicle, the FRAC. When I look at Utilimaster's NGCV, these are the first products reflecting this new thought process methodology. As time goes on, that number will grow but that's why you're also seeing some of the improvements in the margins. The Isuzu alliance and assembly agreement will leverage our capacity, provide us some opportunity, create jobs, but again we now touch 47 out of 58 markets.

If you look at the defense business, it's very, very challenging but also the opportunity will grow for small wins but we still have to execute. We've got some great data metrics in each one of our markets, call for help every 1.25 seconds. What's interesting is over 100,000 kidnappings a year and over 300 IEDs per month outside of Afghanistan. We've got an installed user vehicle base in North America of 225,000 vehicles and 11,000 people a day turn 50, which is good for recreational vehicles but also for emergency response [screen].

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When you look at the price per barrel of oil up over 224% since 2000, and this is key as people start to look at the next-generation commercial vehicle because the improvement in fuel economy is significant. So we are very focused on green, reducing the carbon footprint; emerging markets, taking advantage of global opportunities. We shipped 22 trucks to Beijing where they will become fire trucks for Beijing this past quarter, another first for Spartan Chassis. And again, less than 3% of our sales are export and we have got significant opportunity. The currency puts us in a great opportunity both from an alliance perspective and an export perspective. It's challenging.

And while I've just talked about a lot of positives, again we remain very guarded in our near-term outlook in many of our markets and the reality is there is tremendous global and North American uncertainty. We do have tightening municipal budgets. We have increased environmental and regulatory issues. But while we have these headwinds in front of us and challenges, our focus is sound and it's simple, compelling products, growth and profitable market share, strengthen the balance sheet and the appropriate cost structure. We've got challenges, very, very cautious; but I want to thank all the associates for their efforts and accomplishments this past quarter.

Now, it's time for questions.

QUESTION AND ANSWER

Operator

We will now begin the question-and-answer session. (Operator Instructions). Our first question comes from Joe Maxa from Dougherty & Company. Please go ahead with your question.

John Sztykiel - *Spartan Motors, Inc. - CEO and Director*

Hey, Joe, good morning.

Joe Maxa - *Dougherty & Company - Analyst*

Good morning. Appreciate the outlook and the color on the OpEx and trying to right-size the business. A couple of questions. Is there more to take out other than Road Rescue gone, it will be helpful a little bit? How much more should we be thinking about taking out of the model as well as, let's take a look at the backlog being down sequentially and given your cautious comments, should we be looking for backlog to decline a similar amount in the next quarter?

Joe Nowicki - *Spartan Motors, Inc. - CFO and Chief Compliance Officer*

I'll take the first one on the cost reduction part and then I'll hand over the backlog piece to John to talk about. On the cost piece, Joe, I think we've made a whole lot of progress in really realigning the cost structure across the Company as you've heard us say as we went through some of the numbers, just phenomenal efforts by all of the teams in really to say, we're a different-sized company than before and we need to align the cost structure, get into this mid single-digit operating income, kind of the goal and target we had in mind.

So to answer your question in a roundabout way so far, but to answer your question, there aren't a lot of significant changes that will be taking place from this point forward given the current revenue stream where we're at. We're always looking at other ways to improve our operations. John talked about lean and big initiatives we have going on. And will that help us to improve our margins and all our cost structure? Absolutely. I think we've done a lot of the heavy lifting and gotten most of that cost structure that we needed to resize ourselves already gotten in place. Now, on the backlog question?

John Sztykiel - *Spartan Motors, Inc. - CEO and Director*

Okay. So I just want to appreciate your directness because you are getting to the meat of the issues or the opportunities very, very quickly. As we look to 2011, we do expect the topline to be down slightly and let me just first give you the ups and the challenges as we look at each market. Recreation specialty vehicle, we would anticipate to be up slightly; delivery and service to be up; the alliance with Isuzu will also drive growth. When we look at the challenges, we have the emergency response market that should be down some. The defense markets should be down some.

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In aftermarket parts and assemblies, the defense portion should be down some. On the ER delivery and service in recreational specialty vehicle side, that should be up, but when you add it all up, we probably should be down slightly some in 2011 from a topline perspective versus 2010.

Joe Maxa - Dougherty & Company - Analyst

Very good. That's helpful. And I would assume you would look at the first half being weaker than the second half given Isuzu coming on in the back half and other products?

Joe Nowicki - Spartan Motors, Inc. - CFO and Chief Compliance Officer

We've got a little carryover in the first half of the year on the emergency response business and also the defense business and some of those programs are still continuing on a little bit into the first quarter. So, I think what you will see is in each of those markets a little different reaction, right. The emergency response business probably will tail off more in the second half of the year. We will pick up some of the work from Isuzu in the second half of the year, which should help to offset that.

Keep in mind, there's a ramp-up during that second half of the year as well too. We won't start right up with the full volumes but the new next-generation commercial van, it's pretty limited volume next year in the second half of the year. But I tend to think you'd probably see it still should be slowing down a little bit towards the second half of the year as well too and then maybe towards the end of the second half of the year, you will see some of that improvement as you mentioned from Isuzu.

John Sztykiel - Spartan Motors, Inc. - CEO and Director

I think as Joe mentioned, probably where you'd see the greatest opportunity or topline movement in the up direction is probably in Q4 going into 2012 just because that's where you will start to see this next-generation commercial van really come to marketplace in some significantly large volumes. As I mentioned earlier, you want to be very cautious in the ramp-up because you've got an education of the workforce, profits, developments, et cetera, but you want to make sure each and every vehicle going to the marketplace is absolutely correct from a performance perspective.

Joe Nowicki - Spartan Motors, Inc. - CFO and Chief Compliance Officer

Hey, Joe, the last piece I'll add on to is I'll close by circling back to the cost reduction question piece. Hopefully, what we've been able to demonstrate is our ability to flex the business with a revenue stream that comes across, right. Our intent is to try to get to a more variable cost structure and also manage the balance sheet. So regardless of what happens with the volumes, you will see us continue on that philosophy as we go forward.

John Sztykiel - Spartan Motors, Inc. - CEO and Director

And Joe, if I can just make one comment on the cost structure and the balance sheet management, I think what Joe is saying is that we will never lose our focus on improving our cost structure or balance sheet management. This process of continuously improving from a flexible cost structure perspective is something which is becoming really a daily part of our life.

Joe Nowicki - Spartan Motors, Inc. - CFO and Chief Compliance Officer

And that you're never done.

Joe Maxa - Dougherty & Company - Analyst

Okay. Thanks. A question on the gross margins, I mean certainly, they'll vary with the business mix and whatnot. But what are you -- how are commodity prices impacting you currently and what are your thoughts, I guess, on the commodities going forward?

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John Szykiel - Spartan Motors, Inc. - CEO and Director

Good question, Joe. That we watch and pay attention to daily. And actually to this point, all the commodity prices have been reasonably stable. We haven't seen a significant impact one way or another on the commodities. Also, the one advantage we have is we can price some of that into our product as well too which we do given the lead times with that.

Joe Maxa - Dougherty & Company - Analyst

Yes. Thanks a lot, guys.

John Szykiel - Spartan Motors, Inc. - CEO and Director

You bet. Appreciate, Joe.

Operator

Our next question comes from Ned Borland from Hudson Securities. Please go ahead with your question.

Ned Borland - Hudson Securities - Analyst

Good morning, guys. Good quarter.

John Szykiel - Spartan Motors, Inc. - CEO and Director

Thanks.

Ned Borland - Hudson Securities - Analyst

I guess, if we're looking at margins, what -- if you've done all this work on the cost structure and you're expecting the topline to decline slightly next year, I mean, are we looking at kind of a higher level of steady-state operating margins going forward? I mean are we looking at, say, instead of being kind of 1% operating margins, are we looking at maybe like 3% -- 3.5% if volume declines from here?

John Szykiel - Spartan Motors, Inc. - CEO and Director

Are you referring, Joe, to operating income when you talk about operating margins?

Ned Borland - Hudson Securities - Analyst

Yes. (inaudible).

Joe Nowicki - Spartan Motors, Inc. - CFO and Chief Compliance Officer

What we've described kind of long term going forward is this mid-single-digit operating income number, that goal hasn't changed, we haven't wavered from it at all. I think as John was talking about, we'll have some -- I think the short-term, because of some of the backlogs that we have for the defense vehicles and some of the fire trucks, fine in the short term. But long term, we're committed to that mid-single-digit operating income without question. In the mid-term is the part where, with the volume and some of those declines, it will be more [of a challenge], but we'll continue to focus on trying to visually manage that cost structure to get to that slot. It's going to be hard in that mid-term range though.

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Ned Borland - Hudson Securities - Analyst

Okay. By mid-term, you mean between now and sort of the second half of next year, when you have the new Van in place, right?

Joe Nowicki - Spartan Motors, Inc. - CFO and Chief Compliance Officer

Right, exactly.

Ned Borland - Hudson Securities - Analyst

Okay. And sort of segwaying to that, what are the sort of margin assumptions on the new product versus the legacy product of Utilimaster? I mean, is there a significant increase in margin on that, on a unit level?

John Szykiel - Spartan Motors, Inc. - CEO and Director

Yes, I think how I would address it is, it's definitely an improved margin from the current one, from a couple of regards. It's obviously the next step-up in the product in terms of capabilities, fuel efficiencies and economies to it. It's also designed for manufacturing in a much better way than the old product works as well too. And also the old product has gotten to be a little bit more of a commodity product where it is very price competitive on it. So we'll see a little bit improved margins, yes, on the new product versus the old, definitely.

Ned Borland - Hudson Securities - Analyst

Okay. And then, just sort of on the near-term outlook for Utilimaster, I mean, are you sort of forecasting kind of in the first half, you'll have a lot of your customers sort of waiting back for their new product or are there any kind of timing issues with regard to the launch? I mean, how are your customers (inaudible)?

Joe Nowicki - Spartan Motors, Inc. - CFO and Chief Compliance Officer

Yes, good question. And this is Joe speaking. I mean the good news is the delivery and the service business. Actually, the request for product holding even on the current product continues to improve each quarter. I think what you're starting to see is some of the improvements as noted by the trucking companies, the train carriers, etcetera, that the economy is slowly moving in the right direction.

So I mean you're still going to see demand for the current step van and truck body product. I will say this, in the current product, the pricing is probably more challenging and more competitive than what it was two years ago, but now as we look at Utilimaster and delivery service in Q1, Q2, we do expect the ball to move in the right direction and for them to continue their improvements. The next-generation commercial van will be an accelerator, but it's really not going to kick into high gear. While it will start in Q3, it's not really going to kick into a high-volume gear to really late 2011 Q4 and 2012.

Ned Borland - Hudson Securities - Analyst

Okay. So you would not view the next-generation van cannibalizing some of Utilimaster's legacy products?

John Szykiel - Spartan Motors, Inc. - CEO and Director

Long-term, yes. Short-term over the next, I would say, 12 to 18 months, no.

Joe Nowicki - Spartan Motors, Inc. - CFO and Chief Compliance Officer

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And I think also all for the matter of degree, Joe, certainly not cannibalize some of the existing product sales will be the old style commercial vans that they utilize, but not all. There still will be a need in the customer base that requires the size and capacity of the old style truck.

John Szykiel - Spartan Motors, Inc. - CEO and Director

I mean one of the things, and I am not sure if we've mentioned this in the past is the next-generation commercial van can carry about 12,000 pounds, where a large number of Utilimaster products, they carry not just 12,000 pounds but they carry 14,000; 16,000; 18,000; 20,000 pounds. So as Joe mentioned earlier, there is a variety of people in the delivery and service that either need the cube capacity. For example, like a Frito-Lay where they just need a lot of space or you've got people that need a lot of weight, for example, those in the clothing, et cetera or the tool part of life. So there will be some cannibalization, not very much, short-term, will be a little bit more long-term but the large GVW, large cube capacity, not that market. It's still going to be there.

Ned Borland - Hudson Securities - Analyst

Okay. Thanks.

John Szykiel - Spartan Motors, Inc. - CEO and Director

You bet, Ned.

Operator

Our next question comes -- (Operator Instructions). And our next question comes from Mike Ruggirello from Barrington Research.

Mike Ruggirello - Barrington Research - Analyst

Good morning, gentlemen. A nice quarter.

John Szykiel - Spartan Motors, Inc. - CEO and Director

Hey, Mike. Nice job on the name there.

Mike Ruggirello - Barrington Research - Analyst

Yes, it was a good effort. So, we saw some good improvement in the SG&A this quarter sequentially. And I guess I wanted to wonder how should we look at that going forward as a percentage of sales?

Joe Nowicki - Spartan Motors, Inc. - CFO and Chief Compliance Officer

Yes. On the SG&A side, as we talked about, we continue to have a lot of efforts in improving the operating expense part of our equation, right. And the volume helped this quarter as a percentage of sales to help it decline, but even in the dollar as we made great strides in reducing the dollars too.

John Szykiel - Spartan Motors, Inc. - CEO and Director

Yes.

Joe Nowicki - Spartan Motors, Inc. - CFO and Chief Compliance Officer

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When we take out the Utilimaster kind of acquisition or incremental cost and try to get to the same-store operating expense numbers, they're down about 20% from year-over-year where they were at. So we've really gotten that to the right level where we wanted to. Long-term goal on operating expenses is as we've talked about getting in that 11% range, right. Because our goals as we've talked about mid-single digits on the operating income, trying to getting us to the gross margins in that 17-ish range and operating expenses in that 11% to 12% range. We are there at that point right now and feeling good about our operating expense structure at this level of volumes, definitely.

Mike Ruggirello - Barrington Research - Analyst

That's helpful. Thank you. We saw a nice bump-up in Utilimaster sales this quarter. Should we think about that as a good run rate going forward or how should we look at that sequential improvement in Utilimaster sales?

Joe Nowicki - Spartan Motors, Inc. - CFO and Chief Compliance Officer

Yes. You're right. You saw a nice increase in the volume and that also helped to, as you saw in the bottom line, drive some profitability as well too. We've talked about with them that \$100 million you are pacing, so then gets them to kind of that breakeven point and when they cross over like they did this quarter, it turns them into profit, which is good even with the additional funding they're doing for the next-generation commercial vans (inaudible). I think based on their backlog and what we've seen in the order rates that pacing seems like it is going to be here for a while.

Mike Ruggirello - Barrington Research - Analyst

Okay. Perfect. A question on the RVs, are you guys seeing -- is it still mostly just dealers or are we seeing some consumer pull-through? I know you mentioned that consumer confidence is a good indicator. I was just wondering what specifically you guys are seeing?

John Sztykiel - Spartan Motors, Inc. - CEO and Director

No, actually, Michael, I would say it's dramatically or by far the majority consumer pull through and you're not just seeing it in RVs. I mean there is a number of articles and postings, whether it be cars, purses, clothing, etcetera that while the market finds it smaller, the luxury goods part of the marketplace has definitely rebounded. One dealer, I think said it best to me; he said, John, the high end of the motorhome marketplace, the large end of the motorhome marketplace is definitely smaller. But the fact is the financial markets have stabilized and actually gone up some, that the people who have the wealth, okay, now feel more comfortable about the future because there is stability, so they are buying.

Mike Ruggirello - Barrington Research - Analyst

Yes.

John Sztykiel - Spartan Motors, Inc. - CEO and Director

That methodology applies, whether it be a luxury motorhome, luxury car, anything that's defined within the luxury. The markets are small and nobody is arguing that, but those people within that market feel more comfortable about the future, primarily because they see stability in the financial market. So they already have the wealth, they just want stability. Some, they have wealth, they see stability, they are going out to buy which is good. We would just like to see more of them.

Mike Ruggirello - Barrington Research - Analyst

Yes. And I guess, finally, then my question is just in the capital structure, kind of what's your plan on that? Obviously, you guys paid down a lot of debt. What are you looking for going forward?

Joe Nowicki - Spartan Motors, Inc. - CFO and Chief Compliance Officer

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Sure. If you look at our capital structure, in fact we just had a great review with the Board last week, kind of [talking to some tenants] around capital structure and where we are headed. Probably the next big item, two items that as part of our capital structure tenants you saw and we talked about today, one was the dividend. We continue to believe that the dividend is providing a great return for the investors. So we plan to continue down that dividend track as we have.

Second is around the authorization for repurchase of stock. You will see us continue to make some strides to buy back some stock as well too. We do believe that our intent is to minimize any of the impacted dilution that you get from any of the benefit programs. So the Board authorizes the million share stock repurchase. So that's the second vehicle that was used.

Third, if you look at the debt elements of our balance sheet, we have about \$15 million in debt remaining out there. \$10 million of it comes due next month. So that will be coming due during this quarter. Given the high cash balance that we have currently and our ability to continue to generate cash as we've seen in the last few quarters, it's probably expected to pay it off and pay off that debt and get out of it altogether. So I would expect that we will be ending the year with about a \$5 million debt balance out there that give you a sense of kind of where we are going, Mike.

Mike Ruggirello - Barrington Research - Analyst

Absolutely, that was just what I was looking for and that's all my questions. Thanks, guys.

Joe Nowicki - Spartan Motors, Inc. - CFO and Chief Compliance Officer

Okay.

John Szykiel - Spartan Motors, Inc. - CEO and Director

And I would just like to make a comment about the debt reduction and all of you can figure this out yourself from a mass perspective, when you start to get into the Q, et cetera, but year-over-year, our inventory days outstanding was reduced by 30%. And when we look at our cash conversion cycle, that number was improved or reduced by 38%.

So, again, part of what you are seeing which you didn't see three, four, five years ago, is the very disciplined thought process to compelling products, growth in profitable market share, cost management, and balance sheet management, which is one of the reasons why since being with the Company in 1985, do we have significant challenges? Absolutely, but I have never seen more opportunity, but stronger financially to take advantage than in the 25-plus years I've been in the specialty vehicle business.

Mike Ruggirello - Barrington Research - Analyst

Okay. Good quarter, guys.

John Szykiel - Spartan Motors, Inc. - CEO and Director

Okay.

Operator

At this time, I am showing no additional questions. I would like to turn the conference back over to management for any closing remarks.

John Szykiel - Spartan Motors, Inc. - CEO and Director

Well, actually, this is John Szykiel, I sort of made a closing remark just a few moments ago, but really from a shareholder perspective, a stakeholder perspective, I do want to thank the shareholders for your interest but also your support and also the wisdom. It's amazing what we

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learned by interacting with very, very wise people. Second, all of our stakeholders, suppliers, dealers, OEMs, our associates, the communities which we serve in, want to thank them for their partnership and support. We had a very solid quarter.

As I noted in my Board report, this is a glimpse as to some of the performance metrics we can demonstrate now. As a Company, we've got three great brands, we've got markets with challenges, all with opportunity. The good news is we're positioned very, very strong financially which gives us the opportunity, whether it be a stock buyback, whether it be an alliance, whether it be an acquisition, an innovation. I think, we've got very good methodologies to make the right decisions and last just want to compliment the Board for their wisdom and their support.

So in closing, got a lot of work to do, we've got some severe challenges -- significant challenges, but we also have great opportunity and after this call, we just get back to the work. Thank you very much.

Operator

We thank you for attending today's conference call, has now concluded. You may now disconnect your telephone lines.

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