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Hyster-Yale Materials Handling, Inc. (HY)

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MANAGEMENT DISCUSSION SECTION

Mig Dobre
Analyst, Robert W. Baird & Co., Inc. (Broker)

Hey, good afternoon, everyone. Thank you for being here. My name is Mig Dobre. I'm the Baird Analyst covering Machinery and Diversified Industrials. It's my pleasure to introduce to you Hyster-Yale. You might know Hyster-Yale as a leading global manufacturer of industrial lift trucks serving a wide range of end markets notably manufacturing, distribution and logistics, big box retail and food and beverage. We have with us today to brief us on the company, Al Rankin, the President; Colin Wilson, the CEO; and Ken Schilling, the CFO. So I'm going to turn it over to you for a formal presentation.

Alfred M. Rankin
Chairman, President & Chief Executive Officer, Hyster-Yale Materials Handling, Inc.

[Technical Difficulty] (00:57-01:16) what I'd like to do as the CEO of the parent company is to set the stage with few key perspectives. What we see around the world are global markets that are expected to be strong. We think that will endure over the next few years. I guess the caveat is that we hope that the markets are too exuberant, they'll fall back from that growth rates that we see recently because the slow, steady growth is a very solid platform to build our business on.

Secondly, we are raising our prices to offset the tariffs but the cost price differential lag will extend through the rest of this year and into the beginning of next year a little bit. And then of course, the whole tariff issue has created a considerable amount of uncertainty as that you hear from many other companies that are similar to ours. They're uncertain in their application and the ability to offset them through cost reduction activities and we don't know whether there will be more tariff as well.

So it is clearly an element of uncertainty and it's coupled with some additional uncertainty that emerged over the last few months or to some degree over the last year but more recently, more significantly. And that's in part shortages particularly at the heavier end of our line where our parts are being supplied by suppliers whose business with other customers is also at very high levels. So those are uncertainties, we're working through them. We deal with them, they do create some inefficiencies and cost of – near-term cost recovery for us but they are a part of the environment that we see [indiscernible] (03:16) now in the near term.

On the other hand, for the longer term, we have a set of core lift truck programs that we think can trigger in the medium term three-plus years significant organic growth and also cost reduction and that comes really through two major focuses on the forklift truck business. One is growth through intensified industry strategy activities coupled with much more effective support of our dealers in covering accounts where we have not been very successful before in the middle part of the market. We've been very successful in our national account program, in our smaller dealer accounts but there are a large number of very significant accounts where we think we can do better not only in the U.S. but around the world.

Also in our Bolzoni business which is relatively newly acquired, we've been expanding our product and solutions capability in the attachments business. And at the newly acquired Maximal China utility product producer, we're also expanding our product and solutions portfolio and adding a geographic end product set. In both of those cases we also see very significant opportunities are coming to pass that should come together over the next middle term period increasingly through three years or so.

And finally, there is our Nuvera business in fuel cells which remains a venture business but it's with a developed technology. We have a breakeven plan in place. We've said we've been aiming to reach a breakeven quarter the end of next year. We have some new opportunities and we're calibrating just exactly when we think that breakeven point will come. But over the next 18 months we see us moving toward that kind of a milestone.

We have had some significant new customers that are in different segments of the market for fuel cell engines than the forklift truck business. Those are in China at the main. And we have contracts in place. One is for range extenders in the bus market and the other as in another segment of the market where we see fuel cells being very applicable. Generally speaking, we're being paid for the development work that we're doing which will then lead to commercial volumes. Again, that's a program maturing in the middle term. What we see all of these programs doing is leading us to a point where we can reach our objective of 7% operating margin in the middle term, and our forklift truck business to have a significantly enhance profitability, certainly breakeven in our Nuvera Fuel Cell business, and enhanced volume and the leverage for improved profits in our Bolzoni attachments business, and then the contribution from Maximal over and above what it is doing today.

If you look at the company at a glance, about $3 billion in revenue in the Lift Truck business. Operating profit of $90 million, $150 million of EBITDA, return on capital of about 16%. So looking at the last 12 months on Bolzoni about $200 million, operating profit of $9 million, net income of $6 million, again, a substantial contributor, and Nuvera with the very significant losses in the short term which we expect to ameliorate over the next 18 months or so.

You can see geographically that we are significantly an Americas-oriented business but we have very substantial business in Europe, Middle East and Africa, an attachments business and a growing business in JAPIC, a part of which is not reported on balance sheet because it's a joint venture company and accounted for differently.

With that background, Colin Wilson the Chief Executive of our Hyster-Yale Group is going to give you an update on the programs that lie behind these. Colin?

Colin Wilson

President & Chief Executive Officer, Hyster-Yale Group, Inc.

Thanks, Al. A little bit about our company. We are a lift truck-centric organization. We have a range of products that goes across all five industrial classes of lift trucks, everything from a small Class 3 trucks selling for around about $225,000 all the way up to the largest container handling equipment selling around $600,000 to $700,000. So you can see at the bottom, over 290 different types of lift trucks which gives us the ability to be able to mix and match exactly what a customer needs in terms of their handling requirements with the lift truck out of our portfolio.

In terms of power sources, we're pretty agnostic. We will supply whatever power source a customer needs. We have invested in a fuel cell company. We are selling what we call BBR, our Battery Box Replacement instead of led acid batteries. Selling an increasing number of trucks powered by lithium ion. On the engine side, we do diesel, LP, CNG every which type of engine. Our acquisition of Bolzoni about three years ago gives us the ability to fit a wide range of attachments to lift trucks. To many customers, the most important thing they're buying is the attachment. This is what handles their goods. The lift truck just moves the attachment around.

On the bottom left, Solutions, we put a tremendous amount of investment into providing a wide range of customization of our trucks. Over 60% of all the products we build are customized in some way for a particular customer's needs. And then on the service side, development and a lot of IT infrastructure to be able to support our trucks. We call it Smart Connected Service, making sure that once we supply a truck to a customer, we have great technology backing up the serviceability of that truck in the field.

So a little bit about our market. The industry is at record levels. The top left-hand is global industry demand this year. It will be over 1.5 million lift trucks. On the bottom left, you see the U.S. market, the North American market going all the way back to 1972. This is a cyclical business. The middle black line is the trend line which is about a 5% accumulative growth over the period, and then the blue line and the red line of the upper and lower limit. You can see we actually broke through that upper limit in the back end of 2017 and we're back now to start a trend line. We expect to see that continuing.

I think the peak was largely driven by a lot of the price increases that we saw, that pull-forward demand as people were trying to accelerate purchases to beat the price increases that Hyster-Yale and all of its competitors were putting on the product in response to material inflation and power pressures.

Top right-hand side is a geographic disposition of the market. This isn't our volume. This is the total market volume. So we're in an Americas-centric organization. You can see that represents about a quarter of the market demand. The biggest market demand is in what we call the JAPIC region or Asia, the larger Asia-Pacific region. And that's the focus of one of our key specific strategies to become a stronger player in that territory.

On the bottom right is the product representation of the global demand. You can see the what's called the Class 3 which is the low range in terms of value products, warehousing products that typically work behind products. That's by and far the largest segment but if you look in the right hand side -the bottom right-hand side you can see it's only about 10% of the market by value.

What we say is the Class 5 segment of the market is the second largest in volume terms but represents over 50% of the market in terms of value and that is Hyster-Yale's strongest product in our portfolio and slightly decreasing over time but still represents more than half the market by value.

This is our results. We have a positive profitability trend despite strengthening headwinds. We have some near-term challenges as Al has already pointed out. But we are on an upward trajectory from a profitability perspective on a normalized basis.

Through a volume economies of scale business, we make money selling lift truck but we also get a lot of economics out of the parts business. In order to do that, we need a large park of machines in the field and around about I think the last number we looked at was 850,000 Hyster-Yale trucks currently operating in the field. So the more trucks we have in the field, the greater the opportunity to get that parts business.

We go to market through independent dealers. They make their money on parts but they also make their money on service and rental and supplying other equipment to our customers. So it's very important for them to have large populations of trucks in order to feed their economic engine. So the more we can sell, the bigger our park of trucks in the field, the greater the aftermarket opportunity which allows us to invest in designing new product, allows our dealer to invest in connect capabilities and so the six strategies that we have inside of this is economic engine, really all about driving volume and growth and margin enhancement over time.

I'll quickly go through these, I won't spend much time on any of them in the interest of time but our first strategy is leadership in delivering industry and customer-focused solutions. Well over 60% of all the trucks we produce are customized in some way. So let me just explain what's on this chart. We look at the market as in what we call industry verticals. There are eight industry verticals, seven that you see here plus the government.

The leaner segment, the more warehouse orientated it is so it's where we sell our warehouse products. The [indiscernible] (14:38) the segment, the more counter-balanced is the segment. And up until, I would say, about a year ago, we were going to market as a company that was selling counter-balanced trucks, warehouse trucks, and big bucks and we've realigned all of our sales and marketing organization into these industry verticals where we have a logistics team and marketing and we have a logistics sales team. Food and beverage team in marketing and food and beverage sales team, so really going to market the way the customers have organized the solutions to say this is why with the customer and the logistics industry, this is why we are the best value of proposition to meet your needs.

We've deployed a completely new sales team. If you look at the triangle on the left here, that represents the U.S. market, it's similar triangle in the other parts of the world. Like 200 customers represent 25% of demand. We have national accounts sales team that's around about 30people that tackle this segment of the market, we do very well. A little [indiscernible] (15:47) as we have very high share with those top buyers. The bottom end of the market, the 35% are the smaller accounts, around about 200,000 of those accounts in the Americas. It's where our dealers are very successful on a day-to-day basis. We have very high share there.

Where we've had weaker share is in the middle, the 40% that is represented by about 1,600 accounts that we haven't regarded as being large enough or don't want to be handled as a national account but are too big for our dealers to effectively compete. We put in a completely new sales team, around about 25 people dedicated to working with our dealers to tackle these accounts. And so far, we've seen a significant success. That's a big investment that we've made in 2018.

Secondly, delivering low cost of ownership and enhanced productivity for customers. This is about having the right truck whether it's a utility, a standard or a premium. And we have different trucks to meet those different segments. It also means automation. We're investing in internally developed automation as well as having partnership agreements with different automation partners.

It's about having the right power source and also we have a new range of products under development. The top right-hand side of this slide which is modular in nature which will give us the ability to mix and match different fleet components around the lift truck whether IC engine, whether it's electric, whether it's a broad battery box, the European market or whatever the configuration, the ability to mix and match components to exactly meet the needs or more precisely meet the need of customers.

Our attachments business as Al has already alluded is a growing business. We've seen very healthy growth rates over the period of time since we acquired it. The big opportunity here was in the United States market where we're very strong from a Hyster-Yale perspective. Bolzoni is a distant second in the market to Cascade. And we're putting in additional competencies to allow us to rapidly expand in the U.S. market as well as developing the core Bolzoni business around the world.

Our fuel cell business, around about I guess two years now, we split the Nuvera business. Nuvera focused on being a [ph] stock (18:23) and engine manufacturer of fuel cells; and then Hyster-Yale taking the responsibility for taking that engine produced by Nuvera and building it into a battery box replacement. This is a developed technology. We're developing the application in the – for the battery box replacements. So we're finding increasing markets for the fuel cells [indiscernible] (18:53) engines around the world most notably in China.

This is about the type of markets that the fuel cell is popular in. Heavy duty, continuous duty cycle trucks are the fuel cells can be the lowest cost of ownership for those customers.

Finally, but not finally, number five is growing emerging markets. This is really taken to a different level by our investment in Maximal. It's a very good Chinese company, significantly better than average Chinese company that we're making better through our investment, through our taking the technology and the expertise that we have in manufacturing, in engineering and raising up the Maximal capabilities to a higher level.

Then finally, leaders in independent distribution. We go to market to independent dealers that were exclusive to us. That means every dollar we spend developing our network, we get the benefit from. It allows us to devote our capital to [indiscernible] (20:05) development and to manufacturing and having our dealer partners investing their capital in facilities, in rental [indiscernible] (20:13) and rental fees. And we believe we have a very strong distribution network that's getting stronger over time.

So, with that, I'll hand back to Al.

Alfred M. Rankin

Chairman, President & Chief Executive Officer, Hyster-Yale Materials Handling, Inc.

So, in closing, let me just cover a few other slides. I think from the comments that Colin has made that our cash priorities are probably pretty clear and intuitive. First, we think of investment as not only being capital investment but also being investment in expensed activities that are leading to future growth.

We've been doing a lot of that. Both of those in the forklift truck business and the attachment business as you've heard. We're building that sales capability. We're building the new product capability which has both the expense associated with it and capital. We're investing in the share gain programs which are particularly the industry focus and the sales support activities that Colin outlined. We have our fuel cell business. We're ensuring that we're going to bring that to maturity and profitability in an orderly and thoughtful way and a very high priority. We are investing in some complementary activities, particularly automation.

But in terms of new business activities or new acquisitions of real size and substance, pretty clear what we have to do is to execute on the activity that we've undertaken, Maximal, Bolzoni and Nuvera, and those are very much our priorities. Our plate is really pretty full. And then, of course, we expect to continue to return cash to our shareholders. We've had a significant strong and growing dividend record over time.

When we think about valuation of the businesses that we've described, we tend to think quite differently about our traditional, mature forklift truck business and the attachment business. These are mature and somewhat cyclical businesses. We have leading market positions and products. We think we have opportunities for a significant share gain, as we've indicated.

We have very strong operating cash generation, and we look at these businesses as rather traditional -with rather traditional methods of valuation, in terms of EBITDA multiples on a net debt basis. But we do think that the return on invested capital characteristics that we have suggests that we should be – that we're doing a better job for our shareholders in terms of investing their capital than perhaps some of our competitors are.

And of course, the fuel cell business, you really can't evaluate on that basis. It is by its nature, at this point, a venture business. We think it has very significant growth potential, not only in the forklift truck business but in heavy-duty applications and even in automotive applications over time, and that we have the technology that really gives us a leadership position in that industry, particularly for the kinds of applications that I mentioned.

And so we think of that as a traditional venture capital business that has to be thought about in terms of adding value to the some of the other businesses as opposed to detracting it because it has losses. Those losses are really investments. They are simply investments that accounting requires you to put on the P&L and the balance sheet.

In summary, we think we have a very compelling investment scenario over the next few years. We think we can grow by something on the order of a third through the programs that we've described, significant share growth, technology, accelerators through the business acquisitions we've made, filling our assembly lines up so that there are no cost associated with plant fences that we haven't covered and absorbed. We have the growth programs and share significant programs underway in Bolzoni and Nuvera to enhance their profitability, bring Nuvera to breakeven and then further, a profitability over time.

So against that background, we'd like to take a little time to answer any questions that you may have.

Mig Dobre

Analyst, Robert W. Baird & Co., Inc. (Broker)

We're going to have a break right outside. All right, please join me in thanking these gentlemen for the presentation.