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American Vanguard Corp. (AVD)

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to the American Vanguard 2019 Fourth Quarter and Full Year Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

I would now like to turn the conference over to our host, Bill Kuser, Director of Investor Relations. Thank you. You may begin.

William A. Kuser

Director-Investor Relations & Corporate Communications, American Vanguard Corp.

Thank you very much, Diego. Much appreciated. And welcome, everyone, to American Vanguard's 2019 fourth quarter and full year earnings review. Our speakers today will be Mr. Eric Wintemute, the Chairman and CEO of American Vanguard; Mr. David Johnson, the company's Chief Financial Officer. And also assisting in answering your questions, Mr. Bob Trogele, the company's Chief Operating Officer. American Vanguard will file our Form 10-K with the SEC tomorrow. That document provides additional detail to the results that we will be discussing in this call.

Before beginning, let's take a moment for our usual cautionary reminder. In today's call, the company may discuss forward-looking information. Such information and statements are based on estimates and assumptions by the company's management and are subject to various risks and uncertainties that may cause actual results to differ from management's current expectations. Such factors can include weather conditions, changes in regulatory policy, competitive pressures, and other risks that are detailed in the company's SEC reports and filings.

All forward-looking statements represent the company's best judgment as of the date of this call. Such information will not necessarily be updated by the company.

With that, we'll turn the call over to Eric.

Eric Glenn Wintemute

Chairman & Chief Executive Officer, American Vanguard Corp.

Thank you, Bill. Good afternoon, everyone, and thank you for your continued support of American Vanguard. Before speaking on our 2019 fiscal year, I think it's appropriate to pause for a moment and reflect on today's extreme overall market mentality. As you may know, led primarily by energy and bank stocks, the Dow dropped over 2,000 points today. An early selloff actually triggered a 15-minute trading halt. The selloff was driven primarily by a drop in oil prices triggered by Saudi Arabia's price war with Russia. In addition, the coronavirus has investors worried about supply chain disruption in various sectors.

The impact of energy companies has in turn put pressure on their lenders. While Dow stocks were trading at about 2 times normal volume, American Vanguard traded slightly under its normal daily volume. Our shares dropped about 6.25% over the course of the day. Generally speaking, most of our competitors experience share price declines in high-single-digit to low-double-digit range. This is in contrast with energy stocks which in some cases were down 20%.

Obviously, our stock is not immune to overall stock market trends. However, we have seen relative stability in both corn and soybean prices and have observed that farm economy tends to have its own cycles in spite of energy and other sectors.

With respect to COVID-19, to-date we have not experienced any material interruptions in supply or services from affected regions, including China. On the one hand, we are seeing indications such as more normalize inter-country transportation that would suggest the virus is beginning to show contraction within China. However, the virus has spread into multiple countries with over 100,000 cases and over 3,000 fatalities worldwide. Accordingly, we are following the matter closely and are keeping our workforce apprised of travel and hygiene recommendations published by the Center for Disease Control.

Turning our focus to American Vanguard, I would like to give a recap of 2019 followed by our 2020 outlook. I will then turn the call over to David for more detail on our financial performance. Following David, I will give you an update on our new product launches and our SIMPAS precision application technology.

The headline story in our industry during 2019 was weather. In the US, we saw unprecedented rainfall and cold in multiple regions including the Midwest and South that kept many growers out of the field during the first and most of the second quarters. In fact, prevent plant acres which are normally 2 to 3 million acres per year reached nearly 20 million acres in 2019, 11 million of which were in corn alone.

Consequently, demand for many of our higher-margin products, those destined for corn, sugar beets, fruits, and vegetables diminished. Even after the first half of the year, the domestic weather saga continued. Wet and cold gave way to record-setting heat and drought in the southern region. This had a twofold effect of obviating the need for both burned down herbicides for multiple crops post-harvest and cotton defoliant products such as our Folex.

In spite of this, we still generated a 3% increase in overall sales. With the addition of Brazil and our Assure II sales into Canada, international sales rose by 21% for the year, while domestic sales declined by 6% which was consistent with the performance of our larger peers.

Domestically, I believe that we performed as well as we possibly could have. Our sales team had positioned our products strategically, particularly in the Midwest, where channel inventory levels were low at the start of the season. Further, despite reduced corn acres, sales of our leading corn insecticide, AZTEC, and our herbicide, Impact, increased year-over-year.

Moving forward in 2020, we expect to see increased demand for our products on many fronts, particularly in the United States markets, which consume many of our higher-margin products. By some estimates, corn acres are forecasted to grow by as many as 10 million acres in the coming season, and the level of our domestic channel inventory at the start of 2020 is even lower than it was at the start of 2019.

Further, we expect that our LATAM businesses will grow – will continue to a strong international performance as they continue to grow and mature. For the year 2020 then, assuming no material acquisitions, we are targeting net sales in the range of $505 million to $515 million, a gross margin of 38%, operating expenses in the range of $160 million to $165 million, interest expense of $5 million to $6 million, and a tax rate of 27% to 28%.

With that, I'll turn the call over to David. David?

David T. Johnson

Chief Financial Officer, American Vanguard Corp.

Thank you, Eric. Good afternoon, everybody. As Bill mentioned, we will be filing our Form 10-K for the 12-months ended December 31, 2019 tomorrow. With regard to the quarterly financial results, the company's sales for the fourth quarters of both 2019 and 2018 were approximately flat at $131 million. Our fourth quarter 2019 gross margin was 36%, as compared to 40% for the same period of 2018.

There were two factors driving this change. First, our sales mix included higher sales of lower-margin products from both our Brazilian and Central American businesses. And second, our manufacturing output was down approximately 28%. And we incurred a corresponding decrease in factory cost recovery as we managed inventory for the year-end and the start of the new year.

Our operating expenses improved to 31% of net sales for the fourth quarter of 2019 as compared to 32% of net sales for the same period of 2018. Additional expenses associated with businesses and products acquired in 2019 and late 2018 were offset by reduced legal costs, accruals for incentive compensation, and expenses for both regulatory and product development.

In the fourth quarter of 2019, interest expense was higher than the prior year, primarily because of the acquisitions completed in the last 12 months and at the end of 2018. On the plus side, we incurred a loss in 2018 related to the settlement of derivative instruments that was not repeated in 2019. We closed the quarter with net income of $3.4 million or $0.12 per share which was in-line with the analyst consensus.

When considering our 2019 full year financial performance, the key financial matters remain consistent with last year. First, sales were up 3% to $468 million, as compared to $454 million in 2018. This improvement was driven primarily from businesses and products acquired in 2019 and 2018, offset by a drop of about 6% in our domestic business which reflects the type of reduction that many industry participants have been reporting.

In addition, international sales represented 40% of total sales in 2019, as compared to 34% in 2018. The change was driven by the addition of the Brazilian businesses that we acquired in January of 2019 and by a 14% year-on-year increase in our Central American business.

Second, in 2019, our factory costs were up about 4%. In addition, we took tough decisions during the year to slow factory output in response to the challenging domestic market. As a result, factory cost recovery was not as strong as last year. Inventory levels increased to $163 million at the end of 2019, as compared to $160 million this time last year.

However, this included approximately $13 million associated with new businesses or products. The underlying inventory of our pre-existing business ended the year at approximately $150 million which given the challenging marketplace in 2019 compares reasonably well with the target of $140 million that we set at the start of the year.

Third, gross margin ended 2019 on forecast at 38% which was in-line with our performance reported for the first three quarters of the year.

Fourth, during 2019, we continue to exercise tight control over our operating expenses which remain flat as a percentage of net sales at 32%.

At the start of 2019, we gave the markets an indication that we thought operating expenses could end as high as $155 million. As we saw the challenging domestic marketplace unfold during the year, we tightened up controls on expenses and most recently indicated the level close to $152 million. As we close the books for the year, we were pleased to come in slightly under that most recent forecast ending at $151 million.

Fifth, our effective tax rate remained flat year-on-year at 27.4% for 2019 as compared to 27.2% for 2018. Earlier in 2019, we anticipated that our effective rate could end between 28% and 29%. On reflection, that proved a conservative estimate. Looking at the bottom line, 2019 net income ended at $13.6 million or $0.46 per share.

Finally, with regard to cash generation, at the time of our third quarter conference call, we indicated that our target was to generate $40 million of cash from operating activities during the final quarter of the year. In fact, we ended up generating cash of $31 million. The shortfall primarily resulted from our estimates of domestic accounts receivable collections which are largely timing-related.

During 2019, we considered a number of acquisition opportunities and utilized our credit facility to make three small acquisitions including one that closed in December 2019. This continual investment in the future of our business resulted in borrowings totaling $149 million at December 31, 2019, as compared to $97 million this time last year.

In summary, when looking at the year just closed, we see that we have grown our sales in a very challenging year in the agricultural chemical space. This performance has demonstrated the robust nature of the company's more diversified business, especially when compared to prior years. We took tough decisions to hold down a manufacturing output and recorded higher levels of under recovered factory costs in comparison to 2018 in order to carefully manage inventories.

Finally, we have again had a very exciting year and closed on three acquisitions that we expect will power the company's growth rate in 2020 and beyond. For 2020, assuming we have no acquisitions, we are targeting inventory to reduce to approximately $150 million and we'll aim at a year-end debt level of $100 million.

With that, I will hand back to Eric.

Eric Glenn Wintemute

Chairman & Chief Executive Officer, American Vanguard Corp.

Thank you, David. A key component to our growth in 2020 and beyond will be our introduction of new products and technology innovations. At the Commodity Classic, the agricultural trade show that was held just last month, we highlighted our new product development pipeline, citing an accelerated process that we call innovation with speed and discipline. Through a combination of internal formulation skills and selective product acquisitions, in 2020, AMVAC will add 10 new offerings to our existing strong product portfolio.

These include the four herbicides that we recently acquired from Corteva; namely a Classic, First Rate, Hornet, and Python. In addition, as we commercialize SIMPAS, we are offering three high-concentration product formulations of AZTEC, COUNTER and zinc packaged in smart cartridges.

Further, we'll be expanding our herbicide portfolio with Impact CORE, [indiscernible] (00:16:33), both used on corn, and Surepyc IQ for use on turf.

Our plans over the next three years involve the introduction of more than a dozen additional formulations in herbicides, insecticides, and fungicides for use on corn, soybeans, canola, peanuts, rice, cotton, and turf applications.

Many of these products will be tailored formulations, specifically designed to have differentiated applications that provide excellent financial profitability. We expect that taken together, these new products could contribute incremental revenue of more than $10 million this year, $25 million in 2021, and $65 million by 2022 with gross margins in the 50% range.

Now let us turn to technology innovation. Before getting into this subject, I think it's useful to reflect upon the fact that unlike start-up companies, we have been generating profitable results for decades through the manufacture, distribution, and sale of multiple products. Our stockholder's equity now stands at $344 million. In short, we fund and commercialize our own innovative technologies while running a growing business.

Consequently, it is very exciting when we develop a cutting-edge technology like SIMPAS. My thinking, SIMPAS sets the standard for prescriptive application of crop inputs through low variable rate application of multiple products with traceability from factory to field and back. This spring, multiple SIMPAS systems will be operating on thousands of acres under the control of many of the largest distributor retailers in the United States, including Nutrien, Helena, Simplot, and WinField, who collectively represent the vast majority of the US agricultural inputs market. This will be accomplished with strong hands on support from our SIMPAS team and a platform that has been enhanced by Trimble. After 10 years from concept to market, SIMPAS is now receiving the kind of support that it deserves and we are excited to be earning our first dollar in its commercialization this year.

In addition, a number of our larger peers in the crop protection sector will be involved with internal demonstrations of SIMPAS to ensure that their products are compatible with the system. As this technology penetrates the market, we want to provide growers and agronomists with a broad portfolio of crop inputs from AMVAC and others. As you can see then, we continue to build for the future through innovation.

With that, let me turn to my closing comments. I find that running a business is a bit of a balancing act. You want to be resilient, efficient, diversified, and innovative while still growing and generating profits.

Looking back to 2019 and forward to 2020, I believe that we are striking the right balance. We showed resiliency in 2019, thanks in part to our diversification in foreign markets. We showed a commitment to efficiency in 2019, which we plan to carry forward into 2020. We continue to develop innovative solutions for the future such as

SIMPAS and new products in both up cycles and down cycles. Finally, we're poised to grow and to improve profitability in 2020.

And now we'll field any questions that you may have. Diego?

QUESTION AND ANSWER SECTION

Operator: Thank you. At this time, we'll be conducting a question-and-answer session. [Operator Instructions] Our first question comes from Jim Sheehan with SunTrust Robinson Humphrey. Please state your question.

Peter Osterland
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Good afternoon. This is Pete Osterland on for Jim. On your 2020 guidance for sales growth, could you break out what you're expecting for US versus non-US sales? And kind of along the same lines, do you expect that product mix will be a tailwind for margins this year as volumes in the US recover?

Eric Glenn Wintemute
Chairman & Chief Executive Officer, American Vanguard Corp.

A

Yeah, I mean, we're forecasting the 38% which you could paint a picture and say, well, if we do more US, which we intend to, those sales are profitable although we do have some lower-margin products for the US that we acquired in the Syngenta deal.

But I think we will see a rebound for US while at the same time – so I would expect – and I don't know, David or Bob can weigh in – that we'll probably do a little more than 60% domestically. But I think the 60/40 split – I think both are poised to grow, so it may stay similar along those lines.

Peter Osterland
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Great. Thanks. And then at your current debt levels, are you willing to continue pursuing additional bolt-on M&A opportunities near term if you identify something accretive?

Eric Glenn Wintemute
Chairman & Chief Executive Officer, American Vanguard Corp.

A

We are. Obviously we look at the deals that are there and if they're attractive bolt-ons that we think we've got accretive from day one, then yes, we definitely want to continue that process.

Peter Osterland
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Thank you.

Operator: Our next question comes from Joseph Reagor with ROTH Capital Partners. Please state your question.

Joseph Reagor
Analyst, ROTH Capital Partners LLC
Q

Good afternoon, guys, and thanks for taking the questions.

Eric Glenn Wintemute
Chairman & Chief Executive Officer, American Vanguard Corp.
A

Sure.

Joseph Reagor
Analyst, ROTH Capital Partners LLC
Q

So you guys mentioned that you haven't had any supply interruptions yet related to the coronavirus. Are there any key ingredients that you guys are stockpiling extra large supply of just in case there is future supply interruptions? Are you giving any thought to that?

Eric Glenn Wintemute
Chairman & Chief Executive Officer, American Vanguard Corp.
A

No. Again, I think we've got some more [indiscernible] (00:23:44), commoditized-type products that we've got inventory that is greater than what we'd like to see. We're hopeful that these interruptions will actually give us a better window for profitable sales with those inventories this year. But at the current time we're not getting any feedback that we're not going to be able to continue with the plan and budget that we've laid out.

Joseph Reagor
Analyst, ROTH Capital Partners LLC
Q

Okay. And then considering both the coronavirus situation and the oil price, are there any key areas you see there benefits or risks in the event of continued overall stock market pullback and potential global recession?

Eric Glenn Wintemute
Chairman & Chief Executive Officer, American Vanguard Corp.
A

I was looking today to see what happened to the commodity price of corns and soybeans and seeing that they were relatively unaffected by this. I know in the 2008 year, we in the industry in the Ag sector looked out and said, gosh, we're recession-free. But then 2009, factories got put back on in China and there was a flood of cheap prices that caused people that were sitting on high inventory levels, particularly with products like glyphosate took a real hit. So I can't say that this industry is void of that. But on the other hand people do have to eat, and so from that standpoint of a financial hit, I think our industry is poised better than some.

Joseph Reagor
Analyst, ROTH Capital Partners LLC
Q

Okay. Fair enough. And then just kind of seasonality this year, we expect to return to normal seasonality of call it a lower Q1 with a buildup to a stronger H2?

Eric Glenn Wintemute
Chairman & Chief Executive Officer, American Vanguard Corp.
A

Yes, that's correct. I think we're seeing good orders right now for our Midwest products on a daily basis which gives some optimism that we are seeing a rebound from 2019.

Joseph Reagor
Analyst, ROTH Capital Partners LLC

Q

Okay. Thanks. I'll turn it over.

Operator: Thank you. Our next question comes from Chris Kapsch with Loop Capital Markets. Please state your question.

Chris Kapsch
Analyst, Loop Capital Markets LLC

Q

Yeah. Hey. Good afternoon. So, curious about the – in terms of the guidance for 2020, with that sales growth, presumably you're going to have some better factory overhead absorption variances. So I'm wondering how that influences your flat gross margin guidance for the year.

Eric Glenn Wintemute
Chairman & Chief Executive Officer, American Vanguard Corp.

A

Actually, I mean, what we've got down currently is fairly similar to 2019. Again, keep in mind that we're looking to move inventory levels down further in this year.

Chris Kapsch
Analyst, Loop Capital Markets LLC

Q

Okay. So, I mean, you mentioned that I think you look – you're looking to reduce inventory levels by around $13 million. So are you suggesting that based on that and the [audio gap] (00:27:28) the utilization rates at the factories can be comparable than 2019?

Eric Glenn Wintemute
Chairman & Chief Executive Officer, American Vanguard Corp.

A

That's correct. So keep in mind that we don't make all of our products, right?

Chris Kapsch
Analyst, Loop Capital Markets LLC

Q

Right. Okay. And then so curious about the new product introduction that you mentioned and the new formulation. I'm just wondering just in terms of commercializing those products, have you – just the nature was it more of a market poll or is it something you felt like there's a need for the sort of formulations and you wanted to push them into the market?

Just wondering what's kind of behind the plan to see those growth. I think it was $65 million over a couple of years. And are those products – you mentioned the gross margin profile is pretty attractive. Are those cannibalizing existing products or is this kind of expanding the opportunities the market opportunity that you addressed?

Eric Glenn Wintemute
Chairman & Chief Executive Officer, American Vanguard Corp.

A

Yeah. So the first of the 10 for this year, we mentioned was for herbicides that we purchased from Corteva. And we feel – I mean, so we're – these are existing sales we think that there – and certainly we're in a focus for Corteva. And our people are excited about being able to rebuild them into the higher volume. So that's a start of it.

Then the other three that we mentioned, the COUNTER, the AZTEC and the zinc formulations will be for SIMPAS. And that we'll have minimal sales this year as far as the season, but we'll start making fourth quarter sales of those products.

And then the last three, one is – and I'll say these three and they are a result of what we call our idea review committee which we bring in what we think are kind of expansions or needs that we don't currently have in our portfolio that we think are good leverage points for us. And the idea is that we would be adding to the existing fees and filling holes in our portfolio. And then for those, they're given kind of a six-year window or whatever time we think it'll take to get to maturity. And so there's a game plan for each year from introduction through those six years.

So, I don't think we're cannibalizing in that and at least what we've laid out here. These are kind of making improvements. I know we added Impact atrazine to our regular – and we call it ImpactZ – to our current Impact, and we've seen kind of an expansion of our position there. I think if you stay flat and don't differentiate, sooner or later you're going to lose market share from what you currently have. So it's an effect to kind of build, build upon what we have and kind of offer new innovative solutions to our customers.

Chris Kapsch
Analyst, Loop Capital Markets LLC

Q

I appreciate the color. And then hey, Eric, you mentioned the competitive dynamic back in, I guess, 2009 over the course of the financial crisis. Just wondering and I totally appreciate Ag has its own cycle and we're coming off a very difficult year at least in North America given the weather disruptions. And there's some anecdotal evidence that different crop chemical companies have different channel inventories I guess maybe even by region, but can you just comment on given that as we're going into the growing season in North America this year, just the competitive dynamic. Any sense for any change in behavior in terms of discounting or motivation to move product through the channel as it relates to your visibility around your sales and your products? Thanks.

Eric Glenn Wintemute
Chairman & Chief Executive Officer, American Vanguard Corp.

A

Yeah. So I don't know that we saw anything extraordinary or unusual, Bob, from our competitors, and I'll let you comment on that after. But I think there certainly is a fair amount of pre-herbicides, emergent herbicides left in the channel from last year. And probably seed may be a bit of an issue too, so some of the seed carryover from that. But for our products, again, we didn't force or try to push people which is why we're pleased to report that we're starting this year with lower inventories than what we started for the 2019 growing season.

So I don't know, Bob, any color you've got on any unusual activity out there?

Ulrich Trogele
Chief Operating Officer & Executive Vice President, AMVAC Chemical Corporation, American Vanguard Corp.

A

I mean, most of the channel last year lowered inventory. So the market was at the retail farm gate level at about flat to maybe up 1%. That means they lower channel inventories. That was the general trend. I would say with the exception of one company, most companies are entering the year with low channel inventory.

Chris Kapsch
Analyst, Loop Capital Markets LLC

Q

Got it. All right. I appreciate it.

Operator: Thank you. [Operator Instructions] Our next question comes from [ph] Bruce Winter with – Bruce Winter (00:33:58), please go ahead.

Q

Yes. Thank you. The involvement of Helena, Simplot, Nutrien, and WinField seems to me a very positive development for SIMPAS. Can you detail more of their involvement this spring in terms of delivering the system to the farm, telling the system what to do, delivering the chemicals, taking away the chemicals? Go through that in a little more detail, please.

Eric Glenn Wintemute
Chairman & Chief Executive Officer, American Vanguard Corp.

A

Sure. So, yeah, you're right, we do think it's significant. It's part of – if we're going to get buy-in on SIMPAS, obviously we want our peers and our customer base to be excited by it and that's what we've seen. So Simplot, as you may know, this is the third year of them working with the system. They did everything last year as far as using three products prescriptively and felt very good about that.

Nutrien tested the system just with AZTEC, and did a single product. And we're pleased that Helena and WinField will be joining this year as well. And so with what we expect them all three to be using the three products prescriptively. We've got the excitement also that our RFID tag system is working. This last week, we started filling in the smart cartridges with our refill setup that we have put together, and that seems to be going very well.

And so when these get used and we will have the containers read and have them set up for refill for this next year. So I think for each one of them, a different geographic area, so they will have four different regions that are – or at least states that are having use of this, and we expect with this to make sure that we don't have any glitches with the system, so that when we go off to really commercialize this kind of probably starting a little bit in fourth quarter.

That growers and retailers will have a very rewarding experience with the product. We're also working – we've got individuals that have been writing prescriptions for SIMPAS that are working with those four customers and with their agronomists to make sure they understand how to go ahead and write the prescription that will that will incorporate into the SIMPAS system. So I think right now everything is looking on target.

Q

So it sounds like each of the distributors had numerous local sites and they're going to start doing a few this year and then maybe hopefully more next year, and then we'll roll it out to the whole system. Is that the plan?

Eric Glenn Wintemute
Chairman & Chief Executive Officer, American Vanguard Corp.

A

Yeah. I think we're hopeful that it will also be a much broader use starting in 2021. Assuming – we've been reluctant to take orders for systems until we're sure that this is going to do everything that we say it's going to do and we don't need to make any corrections. But when we get to April, I think we'll be able to understand if there's any change to the final production that occurs or where – when to start taking orders and going out there full speed and trying to encourage as many people as possible.

Q

Great. Good luck. Thank you very much.

Operator: Ladies and gentlemen, there are no further questions at this time. I'll turn it back to management for closing remarks. Thank you.

Eric Glenn Wintemute

Chairman & Chief Executive Officer, American Vanguard Corp.

Okay. Well, again, thank you, everybody, for the session. I guess we'll be back to you within two months.

William A. Kuser

Director-Investor Relations & Corporate Communications, American Vanguard Corp.

Six weeks?

Eric Glenn Wintemute

Chairman & Chief Executive Officer, American Vanguard Corp.

Right. Yeah. So, again thank you for your participation and talking to you soon. Bye.

Operator: Thank you. This concludes today's conference. All parties may disconnect. Have a good day.