

Flux Power First Quarter 2022 Financial Results and Company Update

Presenters: Ron Dutt, CEO & Chuck Scheiwe, CFO

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OPERATOR: This is Conference # 2915539

Operator: Good day and thank you for standing by. Welcome to the Flux Power First Quarter 2022 Financial Results and Company Update conference call. At this time, all participants are in a listen-only mode. After the speaker's presentation, there will be a question-and-answer session. To ask a question during this session, you will need to press star one on your telephone.

Please be advised that today's conference is being recorded. If you require any further assistance, please press star zero. I would now like to hand the conference over to Justin Forbes. Thank you, please go ahead.

Justin Forbes: Good afternoon, and welcome to Flux Power's financial results call. This is Justin Forbes, Director of Marketing and Investor Relations for Flux Power. I'm joined by Ron Dutt, CEO; and Chuck Scheiwe, CFO, who will present results of operations for our fiscal year 2022 quarter one ended September 30, 2021.

Following, I'd like to read our safe harbor statement. Our discussions may include predictions, estimates or other information that might be considered forward-looking. While these forward-looking statements represent our current judgment on what the future holds, they are subject to risks and uncertainties that could cause actual results to differ materially.

You're cautioned not to place undue reliance on these forward-looking statements, which reflect our opinions only as of the date of this presentation. Please keep in mind, we are not obligating ourselves to revise or publicly release the results of any revision to these forward-looking statements in light of new information or future events.

Throughout today's discussion, we will attempt to present some important factors relating to our business that may affect our predictions. You should also review our most recent Form 10-K and Form 10-Q for a more complete discussion of these factors and other risks, particularly under the heading

Risk Factors. A copy of our press release and financial tables can be viewed and downloaded on the Flux Power Investor Relations website at fluxpower.com/investors.

And with that, I'll now turn it over to Ron Dutt.

Ron Dutt: Good afternoon, and thanks, Justin, for the introduction. Our headline story this quarter is continued revenue growth yet again and along with a \$28 million current order backlog. And that's more than all of last year's total revenue for the year, which ended June 30. So, this \$28 million backlog is as of November 10th, and it's about \$2 million -- it's less than \$2 million due to the supply chain disruption that's been affecting everybody.

The backlog reflects orders principally in material handling sector, which is a multibillion-dollar addressable market, and then along with the remainder primarily from the airport GSE market, which is now back in gear. This represents our 13th consecutive quarter of year-over-year growth.

We're growing current customers, and we added new customers in the quarter in material handling, and material handling industry, while it has typically a single-digit growth, the adoption of lithium and our lithium is double digit and increasing its pace.

As I mentioned, there's a renewal of the airport GSE activity in our packs for them, particularly to our key customer who is one of the largest global carriers in the world. They are so pleased with our packs, they are also purchasing our packs for their warehouses.

We're expanding our relationship with Beam Global. We're an exclusive provider. And they have the mobile charging station platform for vehicles. For all this growth, we do have production capability for over \$100 million in revenue annually, and we will be ready to add a second shift in this coming spring with multiple assembly lines.

And then our service, our service capability is expanding with server partners, a new call center, added training, videos, all of which to ensure maximum uptime for customers.

Turning to profitability, we have begun a new broad-based initiative to develop a more efficient platform for our packs. We're targeting cost reductions, fewer parts, driving lower inventory, faster assembly, easier service and more flexibility to introduce other new related products. We will

begin rolling this out later on next year, and that will be rolled out in phases going well into 2023.

A big element of our cost is the battery cells that we source from China. We continue to look at suppliers on a regular basis, their costs, their reliability, their quality, their risk. China is producing a lot higher vendor sourcing than in the past.

We, in the process of this past year, adding a new supplier. We do not want a single source something that ranges from 30% to 50% of the BOM of our pack. All of this is driving towards building scale in this business. Our target market, the Fortune 500 companies, and being a vendor that can play at their level as they have many requirements to meet.

Not only building scale, but we've also got to get profitability. We're targeting margins over 30% in the near term. In fact, we have a path with some of the things that I mentioned, along with some other projects, to target over 40%. We believe we've got to target that to ensure that we have healthy profitability in the near future.

We now are beginning to see operating leverage with our infrastructure. We've built it for a number of years now, and the infrastructure of production, service ISO 9000, other elements to ensure that we cannot only sell packs to these Fortune 500 companies, but we can be their vendor of choice as they order packs each year and every year.

We also want to leverage technology for the benefit of our customers. We want to be a leader in this. Our recently rolled out product last year of SkyBMS, which is the telemetry product, offers real-time reports. We understand from our customers, they advise that ours is better than anybody else's, although there's a lot of telemetry out there. We see this as a platform for the future and being able to offer a new or more -- one or more new features each year. It's based in the cloud and serve many interests for the customer to help them manage their business.

We're also engaged in building high-voltage capability. Packs that -- line-up that we've had, they range from 24 to 80 volts and cover the industry sector we're in. There are also applications where -- that require a higher voltage. So, we have developed a 400-volt battery pack, and we're now beginning deliveries to an electric autonomous shuttle provider. These high-voltage products will open the door to many other opportunities as we build scale.

As part of building scale, we've got to have the quality. We have ISO 9001 certification, had that for several years, and we're now aggressively implementing lean manufacturing to achieve these efficiencies for scale and back to the customers for timely deliveries to them.

The other item I want to talk about is how we're doing building our brand and reputation. Our target audience, the Fortune 500 companies, really do their due diligence on who they're going to have as a vendor because they're committing millions of dollars of business to managing these very large fleets, and they have just regular cadence of ordering new packs, packs for new forklifts and also replacement, and our packs do just drop in for replacement.

We've won business with Fortune 50 and other Fortune 500 companies who are very disciplined and the demands from vendors and want to migrate to lithium. Most of the new customers we talk with are convinced that the value of lithium over other sources and are planning to convert their fleet on an ongoing basis into the future.

Another element that we deal with is ESG. We've all heard a lot about it. It's in the news, environmental, social and governance related to sustainability, green, environmental. This is a hot topic and a high priority for groups like SEC, NASDAQ and many Fortune 500 companies and institutional investors and funds. Our products kind of hit the sweet spot of this concern and allows our customers to address many of the environmental concerns, specifically, we have a paradigm shift. That includes no required OSHA reporting for hazardous acid spillage, a much higher efficiency of packs, drawing power from the grid, which saves tons of carbon dioxide for our customers. And this is often at a life cycle cost -- hard cost savings, and we do not rely on government incentives.

Finally, another element that's extremely important to our brand and reputation because that drives our ability to continue to add these large customers, and it's building very seriously a culture of trust, not only with ourselves, but this really is offered to the customers as the value that we provide: product quality, service, ease of doing business for the complex requirements from large fleets, including their timeliness.

With that, I will now turn it over to Chuck Scheiwe, our CFO, who will provide some more color on the numbers.

Chuck Scheiwe: Yes. Thank you, Ron. As Ron mentioned, we achieved another quarter of year-over-year growth. We did \$4.5 million a year ago in Q1 2021, and we just closed on that \$6.3 million in Q1 of 2022.

As we have increased the sales of our larger battery packs, some packs are seeing higher per unit pricing, adding revenue from our recently launched larger battery packs, which are for Class I and II forklifts and airport ground support equipment. And our customer base continues to increase, along with new customers added each quarter.

As Ron mentioned, our order backlog is \$28 million, both very well to support our sales trajectory. And as you guys know, our focus is on large fleets that order new forklifts throughout the year, and we're seeing success in continuing ordering each year from them.

Our gross margins increased from 19.4% in Q1 of 2021 to 21.3% in Q1 of 2022, and our ongoing cost reduction actions that include the larger battery packs for higher margin, we've got design cost reductions and vendor volume pricing, those were largely offset by the supply chain disruption we're seeing, which, as you may know, higher cost on steel, electronic parts and these common off-the-shelf parts as well as inbound shipping costs.

In response to that, we've increased prices in early October, but we -- it's going to take a number of months before we see that more than limited benefits as we work through our backlog.

Our selling and administrative costs increased from \$2.9 million in Q1 of 2021 to \$3.5 million in Q1 of 2022. That was primarily reflecting higher outbound shipping costs, which really nearly doubled over the past year. And we've had some significant increases in insurance costs for D&O and others.

R&D expense increased from \$1.5 million last year to \$2 million this year due to new product development efforts, including our UL certification expense on the packs as we're working with second source battery sales. Our anticipated improvement in net loss was offset by the supply chain-related price increases we mentioned earlier.

As some of you know, we executed a registered direct capital raise of \$14.1 million in net proceeds in September. That raise is an important element to support our business plan and to reach cash flow breakeven, and it also protects us from any unknown supply chain issues that might come up.

Also, our Silicon Valley Bank line, we went ahead and increase that from \$4 million to \$6 million. That will be our backlog for resources to support working capital needs. But at this point, we have not drawn anything on that facility. In addition, we continue to have availability on our ATM line of \$5.7 million.

Now I'll turn it back to Ron.

Ron Dutt: Thanks, Chuck. While we continue to track on our business plan, the leadership and the adoption of lithium-ion battery packs in our market sectors, the pressures from COVID-19 and supply chain disruptions that are so widespread, we all know about them, we read and hear about them every day, have been challenging for us as well.

They've served to make us perform better. Our supply processes and vendor selections have been improved to keep pace with our growth, along with a number of other elements of our operations.

And in this current very competitive market for good people, again, which seems to be another widespread impact across the country, we've been affected by it, but we've also taken steps to ensure Flux Power is a great place to work with an exciting future in a culture valuing competence, high engagement and trust.

We continue to expand our reputation in the marketplace, building scale, exploring partnerships, building partnerships and leveraging relationships with the OEMs and our customers. We're very optimistic. Flux is on track to yet another record year of growth. Our \$28 million order backlog speaks pretty loudly with that regard. We're pushing for even more.

While material handling is a multibillion-dollar addressable market, remember, material handling, the single-digit growth sector. But this has double-digit adoption of lithium, which is increasing each year. And not only that, we have a growing presence in adjacent high growth markets, including the vehicle charging, which I mentioned, and autonomous shuttles. And we continue to study adjacent markets.

And that concludes our prepared remarks. Now I'll turn it over to questions.

Operator: As a reminder to ask a question, you would need to press star one on your telephone. To withdraw your question, press the pound key. Please stand by while we compile the Q&A roster.

Your first question comes from the line of Chip Moore with EF Hutton.

Chip Moore: Hi good evening, thanks for taking the question.

Male Speaker: Hi, Chip.

Chip Moore: Hey, so great to see the record backlog. Can you talk a bit about how fast do you think you can get through those orders just given some of the supply chain constraints currently and then maybe you can give us some insight as to composition of the backlog because it's a release that tax size and margins.

Male Speaker: Yes. No, good question. We mentioned that during Q1, it didn't affect our numbers dramatically from what we were expecting. But the whole supply chain disruption is something that is impacting us. It's the 60 ships at Long Beach. I'm just stating, I think what you all know, trying to find electronic components, paying \$50 for a \$5 component that is difficult to find, and also by the way, I don't think we mentioned that in migrating to a new sales supplier, we've had to run a number of the models through a certain limited number of UL certification exercises. So, all that's come when everybody, the UL people, our vendors, us, are being impacted by the supply chain. So, it's like everything is slowing down.

Two of our major forklift manufacturers have lead times, one has 80 weeks, the other has 60 weeks. So, everything is kind of moving at a slower pace, and so are we. So, the backlog that we now have, of course, is a record. It represents delivery to occur this month, next month through March, and I think a couple of months beyond that. So that's based on the orders we have in hand. And we continue to get new orders each day.

The bulk of that backlog is in the bigger packs. Those GSE packs, which are 80 volts and our Class I and II packs as well. We have a new customer that's put in an order on that for material handling Class I. And we have our other installed base customers who are continuing to order as well.

So, the margin should be helped by that. We put out pricing to offset as much as we could, hopefully temporary doubling of steel, doubling of shipping costs and other components. So, you got a lot to stir in that pot. But we will start shipping that backlog this month and then on and the exact timing of that for this quarter, I'm glad we don't give forward guidance because I think it's tough for anybody to give a high certainty number of

how much we're going to be able to put in this quarter. It's principally again dependent on getting parts in here. We have the production capability.

Male Speaker: Yes. And I think that backlog will definitely be done, and the target is FY '22 for sure. It's just going to be in the latter part most likely. We do have quite a few cells coming in right now. We're getting ahead of the supply chain fairly well at this point. So, it's looking better.

Chip Moore: Got it. Makes sense, and that's helpful. Appreciate the color. And maybe just if I could sneak in one more. You talked about adding a second shift in the spring and some of the initiatives you're doing in terms of more modular platform. How should we think about any sort of OpEx ramp for some of those initiatives as we move forward?

Male Speaker: No, not at all. I mean your second shift is using the same equipment we've got on site here. There really isn't anything we need to add CapEx or OpEx other than just production bodies, which are going to hit costs through that process. So, we don't see a lot that we need to add to any of our areas.

Chip Moore: Okay, great. Thanks very much.

Male Speaker: Yeah, thanks, Chip. Thanks for the question.

Operator: Your next question comes from the line of Amit Dayal with HC Wainwright.

Amit Dayal: Thank you. Hi, good afternoon, everyone. Thank you for taking my question. Ron, in the pipeline, aside from the airlines, are there any other end markets that you are seeing decent traction in?

Ron Dutt: Well, I just remind everybody, material handling has been our primary focus because it's so big and there's a lot of low-hanging fruit there and we're making hay there of our assembly line, the GSE, the vehicle charging stations, the shuttles, the one that we talked about before and that we're continuing to look at and I think there's a real future there is robotics as well. Robotics is really starting to catch on.

Part of the issue there is making sure that the business case in terms of how that's going to market. The margins, we've got to be very -- we want to be very attentive to margin. We're not just going to buy revenue because we can get into robotics. So, I think it's the right applications that we need

to select, but there is so much on the scene. We say more, say no probably 10x more things than we say yes to, but that's all part of our strategy.

So, to me, everybody here is really jazzed about what's going on in the market because a number of opportunities continue to turn up, and there's some -- it's too early to talk about, and that's what makes this exciting. So that's all part of our strategy.

Amit Dayal: Okay, thank you. And then the relationship with Beam, has that translated into revenues yet? Or is that something that you might see come through this fiscal year or starting this fiscal year.

Ron Dutt: Yes. We've been shipping packs to them for about a year and a half, Chuck, about 1.5 years. And it's been a steady flow of number of packs each month, but not huge. They're very good on press releases announcing contracts. They're getting with municipalities and cities and government all over the country. We have a great relationship with Desmond Wheatley, the CEO over there. And part of their -- it just takes a little time to get a lot of these government entities, a spun up and growing in revenue.

But we ship to them, we've been shipping every single month for 18 months. And as they start their real instalment work, we will see our packs to them increase because we are the exclusive provider for them.

Amit Dayal: Okay. Okay. Understood. With respect to sort of the supply chain-related pressures right now that everybody is going through, I mean, would it be fair to maybe assume lower margins over the next few quarters? Will potentially then margins recovering towards the later half of the fiscal year?

Male Speaker: Yes. That's exactly what we're forecasting. This quarter we're in right now is going to be tough, but we think that we'll see some traction with steel coming back in the line. People stop [unintelligible] and everybody's doing the part out there. So, I think we'll start to see that come back in the two last quarters of our fiscal year.

Male Speaker: Amit, a lot of different pockets. It's like expedited shipping, okay? We don't get a certain type of cell module on time, we've got to ship it by plane. And it just goes on and on like that. So -- but yes, Chuck's spot on here.

Amit Dayal: Okay, that's all I have guys. Thank you so much, I appreciate your time.

Male Speaker: Thanks, Amit. Thanks for the question.

Operator: Your next question comes from the line of Allen Klee with Maxim Group.

Allen Klee: Good afternoon. Following up on the margin question. You mentioned that your charging margins over 30% now, and you have a path to over 40%. When you say you're charging over 30% now, does that mean on a couple of things you do or overall? And how do you think about the timing to that over 40% comment?

Ron Dutt: No, Allen, thanks for the question. Yes. Just -- I'm glad you mentioned that because I don't want anybody to take that the wrong way. We're not at 30% margins now. We're like anybody with a small to large line-up of product, a smaller product, the margins are well, well below 30%. And then as we build up, we have some of our products above 30%. But the average, as you've seen from our reported results, particularly once we include all the costs is well below that.

As I mentioned, we have a redesign of our platform, which we're really looking to provide a very impactful increase to our margins. We've got some other projects that are in the queue. And Chuck in his forecast is we're certainly putting in plans that would get us to 40% over time. Now we don't want to get into giving guidance on the timing of that, but it's before your kids -- it's before -- in the near future. Chuck, can you add some color to that?

Chuck Scheiwe: I think to add to that is even in this last quarter, had it not been for steel increases -- it's not that this would have happened with the supply chain issues, we were back to our normal pricing from six months, a year ago, we would certainly be closer to that 30% today.

But we can't control that. So if -- there are a lot of out of our hands as well on the supply chain, steel growing through the roof, that type of stuff. So, I don't think it's a huge leap for us to get to 30% if things would kind of level back out on the supply chain side with what we've got out there today, if that makes sense.

Allen Klee: Okay. Thank you very much.

Operator: And your next question comes from the line of Allen Klee with Maxim Group.

Allen Klee: I asked my question. I'm not sure why I got asked again.

Male Speaker: You can ask a second question, Allen.

Allen Klee: All right. Well, you know what, I did -- one thing that stood out when I heard you talking, which you just mentioned was the new initiatives of more efficient platforms for packs and lower inventory and all that. Could you maybe just go into a little more detail explaining that because that seems pretty important?

Ron Dutt: It's very important to us. And I don't want to get carried away and say it's transformational, but that's kind of -- it's the excitement we have around it. And recall, we've been doing this since 2013, first one to put packs out there. But honestly, we didn't know much about what we're really doing because we were the first pioneer. And we've learned a lot of lessons over the years, had a lot of experience from packs in the field. We've got over 10,000 packs in the field with different customers. And believe me, you get all kinds of feedback.

And also, our UL certification exercises are very expensive. Each one has cost over \$100,000. So, it involves so much assessment and very detailed understanding of what's going on with the packs. So, our engineers, I mean, we've got, I don't know, 25 engineers, Chuck, some number like that. And we've developed the expertise over the years. And we believe that it's time to take some of these things and make that, at Ford we'd call it an all-new product. It wasn't just freshening, making some cost reduction changes and get that quantum jump.

So, it involves designing the packs based on an experience because we've got to satisfy durability and safety. So, we got to be careful what we do. We've got to have packs that are going to work for the customers. But there are ways to have fewer bends in the steel. It lowers the steel costs. How we do our harnesses?

First of all, we want to outsource harnesses to people that have high efficiency processes for that. But how that's done? The components on our boards, electronic components get cheaper every year. We get smarter on how we can design different modules for different types of packs with that as well.

So, we put all that together and particularly with an eye to have fewer parts. We hate complexity. Fewer parts mean lower inventory, gain less working capital, also the design to make it more serviceable. It's popular in this

industry. So, while there's no maintenance with -- while there's no water maintenance, and they really are, but they still need -- there's still some things that could go wrong, that can happen. And there's nothing that I know of in the world that doesn't need some level of service. So, we want to make these packs -- and there's accidents that happen too when the packs need to be fixed. And so, they can be serviced easily and timely. And this is really for the benefit of the customer.

Our customers do not want any downtime associated with our packs. So, our job is to consider all these elements. And we think this new platform is really going to take a huge step up with that, and we're going to have a much more attractive cost profile as well.

Chuck Scheiwe: Yes. We're talking about inventory and stuff like that. This is big enough that it would probably -- we think we could get rid of 60% of our current items out there, inventory items and reduce the number of parts we have by that significant amount, which is huge. And that also translates into rather than having multiple lines down there where you need to focus more on the single line of similar module, packs that can go into multiple battery packs. So, it's a pretty substantial change there from what we currently do.

Ron Dutt: And the assembly time will be very significantly reduced, which translates to faster throughput. And as we grow -- I mean we're growing 50%, 60% each year. And we think our momentum is still there. So, we are consciously preparing for that continual greater throughput.

Allen Klee: That's great. And I did think of one other thing. Last quarter, you mentioned how you had some issues of -- you have finished inventory. It's just trying to find that one part, and you've increased your people to try to do more sourcing. How do you think about that issue today?

Chuck Scheiwe: We've got, I think, three buyers on hand now. We're catching up. We've learned a lot as to who's the people that are reliable to go get the stuff. A lot of times, we just talk to somebody, oh yes, we got those and go back and have later [inaudible]. We learned about -- to work with, so we've got a lot of knowledge now. It's getting much better.

So, I think the only thing -- we've got some finished goods sitting there right now that are wrapped up and ready to go just waiting on a couple of things from UL. We're just holding out at this point, which is happening next week. So, it starts to free stuff up.

Ron Dutt: But as a footnote to that, note the obvious here, our inventory levels are much higher because of the supply chain disruption. And we have internal targets on inventory turns and working capital turns. And we're doing a lot of work now to get there.

Allen Klee: Great, thank you so much.

Ron Dutt: Thanks. Allen.

Operator: And again, that is star one if you would like to ask a question at this time. Your next question comes from the line of Scott Billeadeau with Walrus Partners.

Scott Billeadeau: Hi, guys. Most of my questions have been answered. I was just going to kind of dig in a little bit on the supply chain issue. Is there a particular module piece of the BOM that you're having trouble with? Is it one, two or three things? Or is it, gee, just shipping on four things and can't get another thing? Maybe if you could give us a little idea on that, that would be great.

Ron Dutt: Well, let me start off and Chuck can probably give you the real answer. We got three or four parts typically on these packs. But it's 5 or 10 that really occupied most of the spotlight. And of course, getting cells from China, the electronic components are the ones that are more recently or like everybody else, shifts.

Capacitors, isolators, these parts, getting those, and there's -- everybody noticed that toilet paper runs on those components. So the board -- the vendor that manufactures the board, if they're missing a part, we don't have a board. We don't ship a pack. So those are probably some of the more exasperating ones. We're working hard with them.

We've actually moved beyond some of our suppliers from several years ago because we've outgrown them. And so we've stepped up. This is normal. This is what happens with companies. And believe me, we've been doing it as well.

Chuck Scheiwe: Yes. I think, Ron, hit most of them. It appears a lot of the electronic stuff, but we've had to spend a lot of time with our buyers actually buying parts for our vendors for the board. So, the vendor might come back in, and we can't find it. There's a lot buyers that need to get on the funnel and find parts to keep these boards going. So, we've got a lot of that going. We're actually helping vendors to provide stuff in building boards.

And I think the other thing, you've got to get creative. So, we had some cliffs, for example, that we couldn't find. We've got a 3D printer here, so we printed our own. So, you got to get creative sometimes, too. So, kind of interesting.

Ron Dutt: Yes. And just as a further example, we've had a buyer and one of our electrical engineers spend enormous amount of time together trying to find parts as we need both their disciplines to make that happen.

Scott Billeadeau: Alright. Great guys.

Ron Dutt: Thanks, Scott.

Operator: And there are no further questions at this time. I'll turn the call back over to management for closing remarks.

Ron Dutt: Okay. Well, thanks, everybody, for listening to us. Thank you for your time. We -- everybody here at Flux is just very jazzed about what's going despite all the headaches on the supply chain. It's a great time to be in this sector.

We're fortunate to be -- as I said, probably too many times people hear me trying to say it, we're at the right place at the right time, and in a growth sector like this, absolutely a pleasure for us to be here.

So, thanks for your support. Chuck and I are always available if you want to have any follow-up questions. So, with that, thank you.

Chuck Scheiwe: Yes. Thank you.

Operator: And this concludes today's conference call. Thank you for participating. You may now disconnect.