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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Douglas Dynamics Fourth Quarter and Full Year 2019 Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to hand the conference over to your host, Ms. Sarah Lauber, CFO.

Sarah C. Lauber - *Douglas Dynamics, Inc. - CFO & Secretary*

Thank you. Welcome, everyone, and thank you for joining us on today's call. Before we begin, I'd like to remind you that some of the comments that will be made during this conference call, including answers to your questions, will constitute forward-looking statements. These forward-looking statements are subject to risks that could cause actual results to be materially different. Those risks include, among others, matters that we have described in yesterday's press release and in our filings with the SEC.

Joining me on the call today to discuss our results is Bob McCormick, our President and Chief Executive Officer. Bob?

Robert L. McCormick - *Douglas Dynamics, Inc. - President, CEO & Director*

Thanks, Sarah. Good morning, everyone. Thank you for joining us. For the full year ending 12/31/2019, Douglas Dynamics delivered tremendous results with record net sales of $572 million and record adjusted EPS of $2.42. This outstanding performance in 2019 is even more impressive considering the headwinds we experienced throughout the year, namely, below-average snowfall for the season ending in March 2019, continued long lead times on Class 8 chassis and uneven supply of Class 4 through 6 chassis. While mitigating the effects of these external challenges, we focused on factors within our control, providing high-quality product solutions to end users, which improve performance of their work trucks, driving productivity and margin improvements throughout our facilities and maintaining our focus on getting better every day.

I want to congratulate all Douglas employees for their first-class execution and dedication to serving our customers. It was quite a year. From a Work Truck Attachments perspective, we overcame the below-average snow season, delivering near record results. This outstanding performance is driven by a combination of the ongoing success of our new product launches for our non truck-mounted equipment such as Plus for skid-steers and ATVs, strong acceptance of a more robust parts and accessories offering, plus strong operational execution.

Moving on to the current snow season. We got off to a good start in October and November, but the months of December and January saw little snowfall and above-average temperatures across much of the snowbelt.

In total, through January, snowfall is below the 10-year average across the cities we track. More specifically, while the Midwest has seen reasonable snowfall so far, New England remains significantly below average. Having said all of that, there is still a lot of winter left. As we've seen in the past 2 winter seasons, there can be significant snowfall in March and even April. At the moment though, we are on pace to see a below-average snowfall season, which could impact our preseason ordering period. At Work Truck Solutions, our record top and bottom line performance were driven by a combination of increased volume and price and improved operational performance. Our order patterns remained strong during 2019. The teams at both Dejana and Henderson are seeing success in applying DDMS continuous improvement concepts in a custom upfit environment, resulting in both reduced lead times and margin improvement.

Of course, the chassis situation remains a challenge for both of these businesses. We expect supply of Class 8 chassis to start to improve in 2020. Demand for over-the-road chassis continues to fall as predicted, which should result in more production being allocated to the Class 8 chassis we need. At this stage, we believe most of the improvement in lead times will occur in the second half of 2020. For medium-duty Class 4 through 6 chassis, we are again experiencing chassis supply constraints due to tight supply lines and component shortages at many of the work truck OEMs. And while we did experience Class 4 through 6 chassis shortages during 2019, the early signals are that shortages in 2020 may be more severe and last longer. At this point, we expect these shortages will impact our business throughout the first half of 2020.

While we continue to monitor these situations closely, mitigating the impact where possible, we acknowledge that these external challenges will hinder our growth in the short term. But let me make 1 thing clear. We are very encouraged by the long-term prospects for the Solutions segment. As we approach the first anniversary of him taking on the role, John Siebert is doing a great job as President of Work Truck Solutions. He and his leadership teams are positioning both Dejana and Henderson for long-term profitable growth by expanding our competitive advantages and leveraging synergies across the businesses.

At this point, I'd like to speak to a new headwind that is starting to impact the global economy, and that's the coronavirus. As you may know, we have a global sourcing office in Beijing, a team of people dedicated to supporting our U.S. production and upfit facilities with high-quality products sourced throughout Asia. Their safety is of paramount importance to us. Through mid-February, we instructed this team to work from home, which was standard practice across most of Beijing during this time. We are pleased to announce that they have returned full-time to the office, resuming their normal duties.

From a business perspective, we believe there will be an impact, not only on the direct supply of components from Asia but also in the supply of components from our U.S. supply partners, many of whom also source components from China. As the situation remains fluid, we aren't yet able to predict the impact with any sense of accuracy

but expect supply chain shortages will begin to show themselves in the coming months. We are in constant contact with both our U.S. and China sourcing teams, and we'll provide updates as the situation unfolds. At Douglas Dynamics, one of the things we take great pride in is seeing around corners. One of the downsides of such a robust, long-running favorable economy is a tightening labor market, especially in manufacturing. While this is something that most U.S. companies have been experiencing in recent years, we have doubled down on our commitment to attract and retain talent by building high-performance organizational development capabilities to drive ongoing development of our most precious resource, our people.

As a follow-on to some of the items we discussed at our investor event in October 2019, I'd like to share some results regarding our organizational development program that we kicked into high gear almost 1.5 years ago. In 2019, we delivered 50 training and development sessions to more than 360 people, largely targeted to managers and supervisors at facilities around the country.

We believe this group is key to promoting development across the teams they manage. I'm happy to report that the feedback from this group was extremely positive. Over 90% of the people would recommend the courses to colleagues. That kind of rating is significantly higher than national averages for similar training programs. While we got off to a great start last year, there is still a lot more for us to do. Our main focus in 2020 is to reach more shop floor associates and to ensure that we are tailoring the program to support their continuous improvement DDMS initiatives.

Finally, in an organization like Douglas Dynamics, whose success is centered on creating hundreds of decision-makers at all levels in the organization, it is often the development of so-called soft skills that have the most impact. Our program focuses on those soft skills. I feel strongly that if you provide your people with the proper tools and training, put them in a collaborative, continuous improvement environment and ask them to focus on better serving our customers, good things will happen.

With that complete, I'd like to turn to our cash usage priorities. Yesterday, we announced an increase in our dividend that Sarah will speak to in more detail. This increase marks the 12th time that we've raised our dividend in the past 10 years, reinforcing the fact that our dividend remains our top priority. And we're firmly committed to protecting and growing it over the long term. Next, we continue to make new investments across our business in order to best position ourselves for sustained success. We believe these investments will translate into our organization, being able to deliver even higher-quality products and services to our customers in a more efficient manner and ensure we maintain our leading positions in the markets we serve.

Finally, we also want to ensure we have capital available to pursue strategic acquisitions which will add important products and services to our portfolio. To conclude, I am proud of our strong full year performance and the strides we've made across our organization. While external headwinds will always exist, it does seem as though 2020 will have at least its fair share. But that's okay. At Douglas, our business model is built around managing many factors outside of our control. I can promise you this: while navigating these challenges, our teams will be laser-focused on serving our customers and getting better every day.

So that when conditions improve, we would be better positioned to meet our long-term profitable growth goals. We will have expanded our market-leading positions and will be a more efficient company. We are encouraged by the many long-term trends across the truck equipment industry and look forward to addressing the challenges ahead.

With that, I'll hand the call to Sarah to discuss our financial results and guidance.

Sarah C. Lauber *- Douglas Dynamics, Inc. - CFO & Secretary*

Thanks, Bob. I'm just going to jump right into our full year and fourth quarter financial results and will then touch on our outlook for 2020.

Thanks to the hard work of all the Douglas teams, we were able to deliver a banner year in 2019. Full year net sales were a record $572 million, which is a 9% increase over last year. The increase was driven by multiple factors across both segments. As mentioned last quarter, Work Truck Attachments experienced a strong preseason order period. They also benefited from new product launches, strength in non-truck equipment and increased parts and accessory sales. In Work Truck Solutions, we experienced strong demand across all Class 4 through Class 8 truck markets in addition to pricing recovery on higher material costs and the benefits of generally improved Class 8 chassis supply predictability.

Gross profit for 2019 of $168.8 million or 29.5% of net sales compared to $154.9 million or 29.6% of net sales in 2018. Gross profit margin was in line with the prior year, and we are very pleased with the impact of improved operational efficiencies, particularly in our solutions business.

We were also successful on recovering price on material inflation within the year, but this dollar-for-dollar impact was dilutive to gross profit margins. In addition, we experienced higher labor and health care costs, which had a negative impact on margins.

On a GAAP basis, full year net income of $49.2 million or $2.11 per diluted share increased from $43.9 million or $1.89 in 2018. Our strong full year performance across all operations resulted in record adjusted EBITDA, record adjusted net income and record adjusted earnings per share. We produced full year adjusted EBITDA of $108.1 million compared to $96.4 million for 2018, and 2019 adjusted net income of $56.3 million or $2.42 adjusted earnings per diluted share increased from $47.4 million or $2.04 in 2018.

Now I'd like to briefly cover our fourth quarter results, which also displayed top-line strength compared to last year. For the fourth quarter of 2019, we recorded net sales of $160.3 million, an approximate 6% increase compared to net sales of $151.8 million in the same period last year.

Gross profit for the quarter was $46.3 million compared to $44.1 million in the fourth quarter last year.

As a percentage of net sales, gross profit was 28.9% compared to 29% in the same period last year. SG&A expenses for the quarter were $18.6 million, $1.9 million higher compared to $16.7 million recorded in the fourth quarter last year.

The increase was driven by higher variable compensation due to better performance and higher benefit and health care costs. We produced adjusted EBITDA of $29.9 million in the fourth quarter compared to $28.8 million for the same period last year. The increase in adjusted EBITDA is primarily related to continued strong momentum we're experiencing within our more profitable Work Truck Attachments segment. It's also worth noting that we completed the planned termination of our pension plans in the fourth quarter and recorded related onetime expenses of $5 million net of tax. This drove a decline to our GAAP basis fourth quarter net income of $11.6 million or $0.50 per diluted share compared to $14.7 million or $0.63 per diluted share for the fourth quarter of 2018.

However, on an adjusted basis, which excludes the onetime pension termination expenses, fourth quarter net income was $16.7 million or $0.72 per diluted share, an increase over the $14.4 million or $0.62 per diluted share for the corresponding period last year.

Now let's look at the segment results for the fourth quarter. Work Truck Attachments recorded revenue of $79.9 million and adjusted EBITDA of $21.3 million compared to revenue and adjusted EBITDA of $77.3 million and $20.2 million, respectively. The increases for both net sales and adjusted EBITDA can be attributed to the ongoing positive demand trends that we're seeing combined with pricing recovery on material costs.

The Work Truck Solutions segment recorded revenue of $80.4 million and adjusted EBITDA of $8.6 million. In Q4 last year, the segment's revenue and adjusted EBITDA were $74.5 million and $8.6 million, respectively. Net sales were higher based on continued strong demand, price recovery on higher material costs and ongoing improvements in Class 8 chassis supply predictability.

Adjusted EBITDA was flat on an absolute basis, but down 80 basis points as a percentage of sales due to increased labor and health care costs.

Turning to the balance sheet and liquidity figures for the full year 2019. Net cash provided in operating activities during 2019 was a record $77.3 million compared to $58.2 million in the prior year. Free cash flow of $65.8 million increased over last year by $17.3 million. The teams have been working diligently on inventory management and have successfully lowered inventory levels that were built up last year in anticipation of tariffs and rising prices. As a result, total liquidity was approximately $135.1 million at the end of 2019, which includes $35.7 million in cash and $99.4 million in borrowing capacity under our revolver compared to last year's liquidity of $122.4 million.

As I've said many times in the past, we prioritize our dividend and also remain committed to reducing our debt.

We paid a dividend of $0.2725 per share of our common stock at the end of December. In addition, we will increase the dividend for the 12th time in 10 years to $0.28 per share for the first quarter of 2020, which equates to a projected full year annual increase of $0.03.

Net debt of $245.8 million at year-end is down from $278.1 million at the end of 2018 due to the $30 million prepayment we made early in 2019 to reduce our borrowings. In addition, we just recently made an additional $20 million payment on our debt based on our strong financial and cash flow performance in 2019. As a result, our net debt leverage ratio has declined from 2.8x last year to 2.4x at the end of 2019 and 2.3x today, subsequent to the $20 million payment.

Capital expenditures for 2019 totaled $11.5 million, an increase of $1.8 million when compared to 2018 capital expenditures of $9.7 million.

The increase is driven by ongoing investments in the business focused on our long-term growth. Overall, we're very pleased with our 2019 performance. We continue to be encouraged by the progress we've made towards our long-term goals.

Turning to our 2020 guidance. We expect to deliver net sales between $530 million and $590 million, adjusted EBITDA in the range of $95 million to $120 million and adjusted earnings per share between $1.95 and $2.75. We also expect our effective tax rate to be between 23% and 25%. As we look at the year, it will be very difficult for the Attachments segment to achieve similar results in 2020 as they did in 2019 given the strength of the near record 2019 results, plus the likelihood that this will be the second winter in a row with below average snowfall and the multiplier effect that creates. It will also be a major challenge for the Solutions segment to repeat their record performance across the board again this year. We will continue to be impacted by chassis supply issues of various kinds from Class 4 through Class 8 for the foreseeable future, plus the supply of components and other attachments for our upfits are likely to be impacted by many external factors.

With that, as a reminder, we view our guidance at this time of the year to encompass most scenarios, except for the tail end of the bell curve, largely driven by seasonality of snowfall and dramatic changes around either supply chain or chassis availability. We view this guidance as a realistic view of 2020 given the strength of our performance in 2019, which will make for a tough comparison. While we made significant progress in 2019, we don't expect our results to show linear improvement every year. But as Bob discussed earlier, the teams at Douglas have experienced navigating through dynamic times. We will focus on what we can control while working through the impact of chassis supply changes and the unpredictable economic impact of the unfolding coronavirus crisis. We will remain laser-focused on talent and winning in a very tight labor market. We remain confident in the long-term goals we laid out at our investor event in October of 2019, and we are now fully focused on producing the best results possible in 2020.

With that said, I'll turn the call back over to Bob.

Robert L. McCormick - *Douglas Dynamics, Inc. - President, CEO & Director*

Thanks, Sarah. In summary, we are very pleased with our full year results for 2019. But we do not celebrate for long here at Douglas Dynamics. We continue to be encouraged that we're in a strong position to deliver on the long-term goals that we've set forth in our 5-year plan, but we are realistic regarding some of the short-term challenges we currently face. Nevertheless, the underlying fundamentals of both of our segments are strong, and we are well-positioned for long-term success.

Before I open up the floor for questions, I just wanted to thank our team for their ongoing dedication and tireless efforts on behalf of Douglas Dynamics and our brands and making my first year as CEO a very enjoyable one.

With that said, we would now like to open the call for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Tim Wojs from Baird.

Timothy Ronald Wojs - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Maybe just to start, how -- I know you guys typically walk into a year with a pretty wide guidance range. Any way just to frame how you're thinking what the -- I guess, any way to frame how the midpoint should kind of correspond in your eyes to kind of what you're seeing externally? So the midpoint, I think, implies revenues down a little bit. I think it does sound like you'll see revenue challenges in both businesses. And then how should we think about the drivers of just kind of EBITDA at the midpoint? What are kind of the offset -- kind of the positives and the negatives for each?

Sarah C. Lauber - *Douglas Dynamics, Inc. - CFO & Secretary*

Yes. No, great question, Tim. The way I'm thinking about the guidance overall, as you know, we always have a wide range going into the beginning of the year, just to cover from a snowfall perspective. And this year, sitting here, end of February, this looks like it could be another low snowfall year, which would compound the situation just from the standpoint that it would be 2 times in almost -- 2 years in a row of that.

But I mean, take a step back, our team knows how to manage through that. That's typical for us. But when we look at a broader view, there just seems to be more headwinds going into 2020 than we've had historically. We've got Class 4 through 6 that Bob mentioned, we expect could be more severe this year from just the volatility of supply.

Class 8 basically continues like it was in the fourth quarter, but we have an expectation that will improve but not until the back half of the year. We are starting to see some labor shortages, and that's starting to show. And then we have the wildcard of the coronavirus. So I think when you take all of that collectively and you look at the range, our midpoint does point directionally to being down year-over-year.

As I sit here today, that's probably -- that's where I land. So you take that and then translate that to the EBITDA guidance. So first, I'll start out by saying the fundamentals of the businesses are sound. And as Bob mentioned and I mentioned, we will focus on what we can control. When it comes to an earnings perspective, we had a lot of traction in DDMS in Solutions that we expect will continue into 2020.

We're going to continue to focus on growth. We laid out a lot of our plans at Investor Day -- that will be occurring in 2020: investing in our talent,

we're going to focus on our long-term decisions. But even having said all that, the volume that I just walked through could mask some of the favorability on the EBITDA side. So I think just from a midpoint perspective, that's a fair place, which shows just the challenges of not having year-over-year growth.

Robert L. McCormick - *Douglas Dynamics, Inc. - President, CEO & Director*

So I think, Tim, I would just add a couple things. I mean, you've been around us long enough to know that our guidance typically, as it gets adjusted throughout the year, is based upon the impact of snowfall and preseason orders and things tied to weather. In this particular case, you're likely to see more of our guidance adjustments throughout the year being made for things that we, quite frankly, don't yet understand the total impact of, coronavirus being one of them. And we're not alone there, certainly. And this Class 4 through 6 chassis supply challenge, while we've had them before, as I said earlier, the early indications are that it may be more severe and last longer. Last year was choppy: 30 days were good, 30 days were bad, 45 days were bad, 50 days were good. We are getting early signals that it's more sustainable -- I mean, from a timing standpoint, that we're not going to see swings up and down that we're going to see challenges at least throughout the first half. So I think keeping an eye on guidance this year is going to be probably one of the bigger challenges Sarah has, and there are just going to be a number of factors that will influence that in addition to the normal snowfall adjustments.

Timothy Ronald Wojs - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay, okay. No, that's helpful. No, I know you guys typically have a wide range. So I think it's just good to kind of get some color around kind of where you're thinking things fall out. I guess, kind of on that same kind of line of questioning or line of answering, Bob, do you expect -- are you embedding that the preseason period this year is going to be down relative to last year, just given the kind of 2 years of potentially below average snowfall?

Robert L. McCormick - *Douglas Dynamics, Inc. - President, CEO & Director*

It's too early yet for us to tell, Tim. I will tell you, one of the interesting things that we're seeing is that retail inventories are in pretty decent shape. I know you guys do some checks. The checks we did at the end of January show that retail inventories were better than we thought they might be.

And what that probably translates to is that the dealers had a more robust selling season when the landscapers are converting from summer to winter before the snowfall even showed itself. And that's likely driven by the continued strong economy and still the record pickup truck sales, right?

So from that standpoint, inventories should be okay. As Sarah indicated, when you get 2 years in a row of below average snowfall that, that has a multiplier effect. I would expect preseason orders to be lower, assuming that we don't see any wonderful terrific snowfall here over the next couple of months.

Timothy Ronald Wojs - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Yes, right. I guess you're like the only management team that loves snow. So and then on the medium-duty classes, what's changed?

Robert L. McCormick - *Douglas Dynamics, Inc. - President, CEO & Director*

I guess, I would say, nothing has changed in that when we hear about the supplier, our OEM supply chains, giving them fits, that was the same as last year. It was axles 1 month, and then it was transmissions 90 days later. We are hearing similar things. Again, it's got to be very frustrating for them. So we're not hearing anything new. The only new information that we're getting at this point is that they are sending a clear signal that this is going to be with us for a while. We still, just as a reminder, we are Ford's #1 full chassis recipient for 14 of last 16 years. And in 2019, that hasn't changed. So we still enjoy the most favorable position within the major OEMs of anybody in the market. So we know that when chassis become available, we'll get our fair share before the rest of the world. But this is like any other headwind, this is something we have to work through.

Timothy Ronald Wojs - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay, okay. And then just the last question I had. Can you just remind us when you put through the pricing increase in attachments and kind of when that anniversaries?

Sarah C. Lauber - *Douglas Dynamics, Inc. - CFO & Secretary*

Let's see. I mean, we look at it obviously every year prior going in -- prior to pre-season. The last increase anniversaries here, I think, April 1. So we'll have the year-over-year favorable impact in Q1. And then the teams will be looking at that right now on what they're going to do for 2020.

Operator

Your next question comes from the line of Ryan Sigdahl from Craig-Hallum Capital.

Ryan Ronald Sigdahl - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

Congrats on the quarter. So you mentioned supply chain disruptions for the Solutions segment due to coronavirus and other kind of global supply chain issues there. But do you expect any impact in the Attachments segment?

Robert L. McCormick - *Douglas Dynamics, Inc. - President, CEO & Director*

Oh, sure, sure. I mean, it's -- when you look at our global sourcing office we have in China, that office opened up a decade ago to serve at that point what was exclusively the commercial snow and ice control business. And still the lion's share of the dollars that we source through Asia are for the Attachments side. So I would expect it to impact both segments. We just don't understand how. I mean, we -- well, not how, but when and how much. Everybody carries 30 days of inventory on the ground if you source from China. We're no different. We've been in contact with our major manufacturing suppliers in China. 80% of those suppliers were up and running. Last week, the plants were up and running.

So that's all good news. But we also know that people aren't coming back to those factories from a full employment perspective right away. We know that that putting boats on the water and even people who want to air freight shipments aren't going to be able to because of the flight restrictions that have been in place. So it isn't a matter of if we're going to have some shortages, it is a matter of when and to what extent. Having said all that, we will catch up. We have -- luckily, this happens during the first quarter when we've got the balance of the year to get the supply chains full again. And I'm confident that our teams will be all over making sure that, that happens. But again, it falls in the category right now of we can't quantify it. We just know that logic tells us to be prepared for some shortages that will impact both segments.

Ryan Ronald Sigdahl - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

Got you. Makes sense. Then just -- you've talked quite a bit about guidance and kind of the year but you noted basically a below-average snowfall year thus far.

But in guidance, it assumes a normal snowfall year. So I guess, should we think that the year, as we speak today -- without kind of giving credit to what happens the rest of the winter. But that we're kind of trending maybe towards a lower end of that range or how do you think about kind of the high end, low end and midpoint of the guidance?

Sarah C. Lauber - *Douglas Dynamics, Inc. - CFO & Secretary*

Yes. I mean, the range is meant to encompass most of that variability of snowfall. So when we look at the midpoint, that's assuming average snowfall, and then there's going to be plus or minus depending on actual snowfall.

Robert L. McCormick - *Douglas Dynamics, Inc. - President, CEO & Director*

I think it's -- if we end up with our second below-average snowfall year, that's a logical conclusion to draw.

Sarah C. Lauber - *Douglas Dynamics, Inc. - CFO & Secretary*

Yes. Yes.

Operator

(Operator Instructions) I am showing no further questions at this time. And I would now like to turn the conference back to Mr. Bob McCormick, President and CEO.

Robert L. McCormick - *Douglas Dynamics, Inc. - President, CEO & Director*

Thank you for your ongoing interest in Douglas Dynamics. We look forward to seeing some of you soon at the NTA Work Truck Show in Indianapolis in early March and at the Sidoti Conference in New York at the end of March. Have a terrific day.

Operator

Ladies and gentlemen, this concludes today's conference, and thank you for your participation, and have a wonderful day. You may all disconnect.