Workhorse Group Inc.

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Special Call

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Call Participants

EXECUTIVES

Duane Hughes
COO & President

Stephen S. Burns
Co-Founder, CEO, Secretary, Treasurer & Director

ANALYSTS

Brian David Kinstlinger
Maxim Group LLC, Research Division

Christopher G. Malde
Hart Capital Management, Inc.

Jeffrey David Osborne
Cowen and Company, LLC, Research Division

SHAREHOLDERS

Unknown Shareholder

Presentation

Operator

Ladies and gentlemen, greetings, and welcome to the Workhorse Group's Business Update Conference Call. As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Mr. Duane Hughes, President and Chief Operating Officer. Thank you. Mr. Hughes, you may begin.

Duane Hughes
COO & President

Thank you, operator, and good afternoon, everyone. We appreciate you for taking the time to join us for the call today. In a few moments, our CEO, Steve Burns, is going to give you a brief review of 2017 as well as a view on key 2018 initiatives.

I want to call your attention to our safe harbor provision for forward-looking statements that is posted on our website and is part of our year-end update. The safe harbor provision identifies risk factors that may cause actual results to differ materially from the content of our forward-looking statements. Our 2016 Form 10-K and other periodic filings on file with the SEC provide further detail about the risk factors related to our business.

For today's call, Steve will start with a summary of our 2017 operational accomplishments. He'll follow that with a review of our recently announced SureFly spinout and will finish with a view on key initiatives for 2018. He will then open it up to questions.

With that, I would now like to turn the call over to Steve.

Stephen S. Burns
Co-Founder, CEO, Secretary, Treasurer & Director

Hi, Duane. And I want to start by thanking everybody that is listening and follows us and supports us.

As Duane said, I want to start off with what happened last quarter. We're very happy to announce that we had a record quarter. We built and delivered 121 trucks. This is significantly higher than any quarter we've ever had. It's higher than in our entire 10-year history. I think, for perspective, it's important to say that, to our knowledge, there is no OEM on the planet, literally, that's building that volume of trucks, electric trucks, of this size and category. So we're very excited. This is kind of further proof that we continue to refine our expertise in our craft of building vehicles, right? I think everybody's probably aware that the complex and regulatory nature of putting vehicles on American roads is not trivial, there are very few people doing it and very few of any smaller companies doing it. So we're excited about it. We continue to learn. We continue to get better at it every quarter.

Again, as perspective, I think it's important to say, the total 2017 revenue was 69% greater than 2016, right? So that's a year-over-year increase since we have started our first truck build in 2015. Those numbers are unaudited, but I think they're something we want to talk about. We expect this trend to continue year-over-year, where we just get much better, both in revenue and in margin.

The current backlog already for 2018 is about $9 million, with another $3 million expected to close this month. So we're already off to a pace that exceeded the entire year last year.

That's on the revenue side. We think it's important to renew our guidance that we've been giving the last few quarters, that we worked hard such that in 2018, we expect to be gross margin-positive on our vehicles, right? That is a big change from what we've been doing for the last 4 years as we learned our craft and as our customers began to build confidence in us and our vehicles, we had to build them at a loss and we're turning the corner on that in '18 as we predicted.

So how have we done that? I think it's important. It just doesn't magically happen. It's a couple of things. First of all, volume. Our volume is increasing, as I just discussed, and that floats all boats, of course, right? Automotive is a volume game. And as we continue and increase our volume, our margins follows suit.

Also, light-weighting. Starting with when we had to design from scratch the Post Office vehicle, we realize to hit those towards our volumes, and at the price point, we had to really lighten up the vehicle. And by lighting the vehicle, you get to put a smaller pack in it and a smaller generator and a smaller charger. And it all kind of dovetails into better margins. So traditionally, these trucks are very heavy, and we've been able to really add modern techniques, carbon fiber, for example, to lighten them up. So that's how we've done it, with engineering and volume, okay?

So that brings us to kind of the first new vehicle we're going to introduce. In this quarter, we're going to begin initial production of our electric cargo van, what we call the N-GEN, next-generation van. Now just to put in your mind what a cargo van is, we, to date, have been baking large step vans, and we will continue to make those. But the cargo vans are Sprinter class vehicles for transit, ProMaster vans. These are the worker vans that you see on our streets all across America. This market is at least tenfold the market of the step van market. So we are entering into a much higher volume marketplace. And we believe this to be the delivery van of the future, but it also can be used by telecoms and cable companies, all the folks that use these type of vans.

We expect to enjoy first-mover advantage here. To our knowledge, we're the first United States company to be able to build and sell these vehicles. An electric van of this nature is -- the duty cycle that most folks use these cargo vans for really fits well with electrification. And we believe that we've enjoyed the success we have on these vehicles by the fleet interest in them because they have a lower cost of ownership. So the total cost of ownership the fleet would own this van, let's say, over 5 to 8 years is less expensive than if they bought a gasoline-equivalent van. And that's a significant milestone. We don't know that, that's happened before. Gasoline was always the low-cost leader. But when you look at total cost of ownership, our van wins. So we are -- and I would think it's important to note, again, this isn't years away. This isn't billions of dollars. Literally, sometimes it takes billions of dollars to bring our new vehicle to market, in capital expenditures. We're very close to the end of the quarter when we expect the first ones to start coming down the line.

That leads us to the W-15 electric pickup truck. This is, of course, our most exciting product because it has the most potential for sales. I think most people are aware that in America at least, pickup truck is the #1 vehicle category. And we are coming to market with the first electric range extended pickup truck. This marketplace is almost 3 million vehicles per year. We have over $300 million worth of preorders already from fleets, the likes of Duke Energy. Folks like Duke Energy will start to get preproduction vehicles, summer time frame. We are excited about this. The fleets are going to see it. It will also be pretty meaningful to folks to start to see preproduction vehicles on the road. So this is -- this represents -- we hope to build -- now I'm going to say a number here. And we were a small company and we're in a new industry, so we've been hesitant to give kind of future forecast of revenue. So these are aspirational, but we believe that we're going to sell 10,000 of these vehicles next year. We expect to sell about 2,000 vehicles this year. Again, a few early pickup trucks towards the end of the year. Most of that 2,000 will be the cargo van that we just spoke about. So those are naturally, significantly more volume than anything we have traditionally built, and it just puts us into a new category.

I want to talk about the United States Post Office next-generation program. We are one of the 5 finalists, and we've discussed this before. The Post Office doesn't want any of us finalists to really speak too much about it publicly. But the vehicles are in test, and we are excited about the progress our vehicles are making during the testing. And again, a lot of our technology is spurned from what we've been doing for the last 2 or 3 years as we contemplated and built these vehicles, and that's how it's made its way into the pickup truck and to the cargo van. And we like to leverage, right? So a lot of the parts are leveraged across all the -- all of our vehicles, and again, that's how you increase your margins.

I want to talk a bit about the spin-off of our SureFly product. Now this one is a little technical, so I'm going to read it and then kind of discuss it. As you recall, the SureFly is our entry into the exciting new emerging vertical takeoff and landing market. The FAA granted the Workhorse aerospace team an experimental airworthiness certificate, registered as tail number N834LW for the aircraft on January 2, and after extensive design review and inspection of the aircraft, we were granted that certificate. We exhibited the SureFly along with the W-15 electric pickup truck and the N-GEN delivery van at the Workhorse booth at CES this year, a few weeks ago, and really delighted with the reception we had there.

As part of our ongoing efforts to enhance shareholder value and raise capital through alternative, non-dilutive methods, we initiated the process of spinning off our SureFly operations into a separate publicly traded company called SureFly, Inc. The initial steps of the spin-off, which we took in December of '17, provide for capital infusion of $5 million into Workhorse in the form of a note, which is expected to be exchanged in the equity of SureFly concurrent with the spin-off. The lead investors in the note have exchanged features that provide a $33 million pre-money valuation for SureFly, which ultimately will be led -- which will lead them to preferred stock and warrants of SureFly. At the spin-off date, Workhorse expects to retain a portion of SureFly's common stock and to distribute a portion as a dividend to existing Workhorse shareholders. After the spin-off, expected in 2018, we intend to evaluate all of our options relating to the SureFly equity we have retained. The spin-off transaction will be subject to the receipt of regulatory approvals, the execution of intercompany agreements, arrangement of adequate debt and equity financing, the effectiveness of a registration statement and final approval by Workhorse's Board of Directors and certain other customary conditions. The spin-off will not require a shareholder vote and is expected to be completed in 2018. But there are no assurances regarding the ultimate time frame of the spin-off or that the spin-off will ultimately occur.

So I think it's interesting that a $33 million pre-money valuation on a product, that's a significant part of Workhorse's overall evaluation. And we felt that it just -- it would better served our shareholders and SureFly to be its own entity. And I think it's going to be the first pure-play public entity in that vertical takeoff and landing space, and we're expecting great things there.

The last thing we want to say is that we continue to evaluate finance and opportunities, including strategic relationships as well as other alternative financing methods, similar to that we did with the SureFly transaction. So we continually -- this is -- we are focused on non-dilutive financing or strategic financing. Those are our goals. We can't be assured of exactly when finances will take place, but we are confident that we will meet the needs that we have to build our trucks and retain shareholder value.
With that, I think I'll open it up to questions.

Question and Answer

Operator

[Operator Instructions] Our first question is from Jeff Osborne, Cowen and Company.

Jeffrey David Osborne
Cowen and Company, LLC, Research Division

Just 3 quick ones on my end. Definitely, I enjoyed listening to the aspiration for next year, Steve, of the 10,000 units, certainly more than we are looking for. Can you just talk about what the -- what facilities improvements you need both on the battery side as well as the facility in Indiana and potentially how much that would cost [3] weeks ago? And then I have 2 follow-up questions.

Stephen S. Burns
Co-Founder, CEO, Secretary, Treasurer & Director

Good. Thanks for asking, Jeff. Basically, there's 2 big impediments to volume: automation and R&D. And we've tried to strike the right balance where we are automating and doing enough R&D to lower the cost and to make it easy to assemble and lower our assembly cost based on our projected volumes. So let's say we had -- let's say we were Tesla and we had 400,000 preorders. That might cause us to upfront do a lot of in it -- on more automation. What we're doing is deciding how much -- how many people to put at it, how many robots to put at it, how can we engineer it so that's easy to put together. And so we -- I think the short answer to your -- I'm dragging it out a little bit. But the short answer is very little CapEx. Most of our expenses between now and hitting that 10,000 run rate are further R&D, the regulatory issues, the crash testing, all that sort of thing. But with our existing factory, both our assembly factory in Indiana and we've put some good automation towards our battery factory here in Cincinnati, so really, very little CapEx.

Jeffrey David Osborne
Cowen and Company, LLC, Research Division

Perfect. Good to hear. And then on the N-GEN [indiscernible] so it's great. But as we think about that being a big piece of the mix, of the 2,000 units, as part of the aspiration for this year, I guess, two-part question, do you have commitments on those? Because, obviously, that's different than the W-15. So, I guess, do you have a line of sight to demand for 2,000 of those? And then the second part is, is there any element of deposits that we should be thinking about for that? And maybe just a third quickie on the N-GEN, is just what's the rough price of those? Is it in the low to mid-50, similar to the W-15, or a little bit higher?

Stephen S. Burns
Co-Founder, CEO, Secretary, Treasurer & Director

Right. Good. Well, first of all, the reason we're coming out with the N-GEN ahead of the pickup truck is that N-GEN is just being a cargo van, much easier to build and lower regulatory because there's only 1 driver and maybe 1 passenger. The other thing that's changed there is we are doing, as opposed to now, with all the trucks we've ever built, we just build the chassis, and the customer like FedEx or UPS, they have their own body makers that they -- that put on the body, which is why the trucks aren't -- don't have a distinctive Workhorse look because it's the look of the customer. And this is going to give us a chance of people being able to see these trucks now and point to them and know they are electric or at least different and know they're Workhorse. But that requires for us to enter into the body, building business as well, took a little bit of work and a lot of partners. So we feel that -- but the N-GEN itself, again, is much simpler of a vehicle than a pickup truck. So we have -- we didn't feel the need to take preorders. So when you asked, are we getting deposits? We didn't take preorders on that because we had orders, right? So we have enough orders that we felt comfortable just going ahead and starting production. So we're going to do it a little bit differently with the N-GEN than the pickup truck. We wanted to really test the waters and make sure before we really [indiscernible] that pickup truck, that there was an audience there. The other thing I would say is, underneath the engine cargo van and the pickup truck, I don't know the exact number, but I'm sure it's north of 95% common parts. So we get -- really get a two-for-one here. And again, that -- all the work we have done on the Post Office and then on the pickup truck enabled us to not have to put that much into getting the N-GEN out. So that, again, the need for -- didn't have to have a big look to say, our customers are going to buy this if we build it. So we have customers.

Jeffrey David Osborne
Cowen and Company, LLC, Research Division

Got it. And so I assume -- so it's a assumption that, that's part of the $6 million of backlog [with] $3 million [indiscernible] that you're talking about?

Stephen S. Burns
Co-Founder, CEO, Secretary, Treasurer & Director

Yes. Yes.

Jeffrey David Osborne
Cowen and Company, LLC, Research Division

Got it. And then what about the price? I think I've thrown in [indiscernible].

Stephen S. Burns
Co-Founder, CEO, Secretary, Treasurer & Director

Oh, I'm sorry. I forgot. Coincidently, it's a similar price, $50,000, $60,000 range of all our trucks.

Duane Hughes
COO & President

Per volume.

Stephen S. Burns
Co-Founder, CEO, Secretary, Treasurer & Director

In reasonable volume from the customer, yes.

Jeffrey David Osborne
Cowen and Company, LLC, Research Division

Okay. And last one for you, Steve, and I'll move on, is the -- any sense you could share on what the cost reduction initiatives that you were able to achieve in 2017? And then more importantly, as we look to produce vehicles at gross margin-positive, I guess, what's the cost reduction that's needed for 2018? Or maybe another way of answering that is, what's the N-GEN cost reduction versus the prior models?

Stephen S. Burns
Co-Founder, CEO, Secretary, Treasurer & Director

Right. All these vehicles are -- the extreme light-weighting that I talked about enables us to put a smaller pack in these and a smaller generator, if they have a generator. The N-GENs -- a lot of the N-GENs will just be all electric. But that's a huge part of it, just lower cost. The second part is just naturally the higher volume. But we've been able to attract, and I've talked about this a few times on other calls, Tier 1 vendors. And it turns out that the Tier 1 vendor parts are better and less expensive than the parts we've been buying because the type of folks that will sell you things of lots in 200, it's just a different category of folks. And really, the Post Office is what drove that. Because the Post Office is like 180,000 vehicles, that was able to attract these vendors to us. And then we said, "Okay, if we were going to use you for the Post Office, then also, when we buy 2,000 or 10,000 parts, we'd like to buy your part as well." So it's kind of a combination of engineering, volume and just the natural progression of moving up the food chain a little bit and being able to move into vendors that are making these parts in very high volume for other applications that we're able to now leverage that.

Operator

Our next question is from Brian Kinstlinger, Maxim Group.

Brian David Kinstlinger
Maxim Group LLC, Research Division

I have a few questions. The first is, I just want to make sure I understood, with the E-GEN, N-GEN and W-15, and especially with expecting 2,000 N-GEN this year, are you able to build all of these simultaneously at the same facility, especially if a handful of them are producing higher volumes?

Stephen S. Burns
Co-Founder, CEO, Secretary, Treasurer & Director

Yes. We took a great care or 2 since we only have 1 facility. Now that facility has a capacity of 60,000 vehicles a year. And I think its best year when [Amistar] had it was 17,000 as not nearly utilized at full capacity. So we've built everything we build. We say, "Okay, how are we going to build this on our existing line with the slightest amount of modifications? And again, since the underneath of the 15 and the N-GEN are 95% identical, in addition to leveraging the parts from the suppliers that are better priced for higher volume, it enables us to assemble them on the exact same line.

Brian David Kinstlinger
Maxim Group LLC, Research Division

Great. And then you talked clearly about gross margin-positive for vehicle sales in 2018. Can you give us a sense for, just to be more direct, what kind of gross margin should we assume? Will it start fairly low in the low single digits and build out through the next couple of years? Or what do you think maybe '18, even a broad range, might look like?

Stephen S. Burns
Co-Founder, CEO, Secretary, Treasurer & Director

Well, we haven't publicly said any of that. But I think it's fair to say that in '18, at the 2,000-vehicle run, they'll be gross margin-positive, but probably not by much. When we start to get into the 10,000 volume in '19, then it's going to get -- kind of a maximum you can get in this business, it seems like, is about 25%. And I don't think they will be there at 10,000. But we should be 18%, 19%, 20% in that 10,000 a year run.

Brian David Kinstlinger
Maxim Group LLC, Research Division

Okay. And then if I look at the -- last quarter, we talked about the UPS order and how many you've had left on that order. Based on your backlog, can we assume that you've received an additional order from UPS? And if so, can you provide any details?

Stephen S. Burns
Co-Founder, CEO, Secretary, Treasurer & Director

Well, I think you can assume that we did finish the last order. That's what that 121 finished up. And there is a $12 million backlog here, but we haven't announced who the customers are. It's across a couple of customers. But one big one. But we haven't announced it, Brian.

Duane Hughes
COO & President

But we do have lots of repeat orders from multiple customers.

Stephen S. Burns
Co-Founder, CEO, Secretary, Treasurer & Director

Yes, I think the other thing is almost all of our customers are repeat customers.

Brian David Kinstlinger
Maxim Group LLC, Research Division

So $12 million, the actual backlog number, can you, by any chance, break that down between some of the vehicles?

Stephen S. Burns
Co-Founder, CEO, Secretary, Treasurer & Director

Well, it's -- I want to be clear, it's $9 million signed, $3 million, we think, is going to close this month very [closely]. I don't think -- yes, I think there's still some leftover -- not leftover, but there's going to -- we're still going to build some E-GENs where we can build them profitably. So some of those are in there. But I think -- I don't know about the $12 million, the mix, but, of course, over the course of the year, I'd say it's going to be 90% N-GENs.

Brian David Kinstlinger
Maxim Group LLC, Research Division

Right. So E-GEN is going to be a on-demand, only it's not something you're actively going to be pushing [indiscernible].

Stephen S. Burns
Co-Founder, CEO, Secretary, Treasurer & Director

Correct. On demand and if they can afford the price. And Ryder, we've got Ryder up to speed for selling them. They're going to sell the N-GENs and the pickup truck as well, but they're just starting to hit their stride, so we don't want to...

Duane Hughes
COO & President

And we've got them focused on California and New York.

Stephen S. Burns
Co-Founder, CEO, Secretary, Treasurer & Director

Yes. Where there's proper motivations within states like California, I think that's where you'll see most of the legacy E-GENs go.

Brian David Kinstlinger
Maxim Group LLC, Research Division

Okay. My last question. I'm only bringing it because you guys bring it up. You brought up financing. How much capital do you think the company needs to build all these trucks over the next, say, 18 months? Clearly, some -- there are going to be different ways to generate that capital, dilutive, non-dilutive, working with your partners. But what is that number you foresee?

Stephen S. Burns
Co-Founder, CEO, Secretary, Treasurer & Director

Well, again, we haven't published it, so I don't know that we should say it. But it is -- we're extremely proud of how low it is based on, in some circles, you say a number and it makes people gasp; in car circles, you say a number and people tell us we're crazy, we'll never be able to do it for that little amount. But our main thing is, we're really trying not to go to the capital -- we are going to have to bring some money in, but we really don't want to go to the capital markets if we don't have to. We can't get surprised, anything can happen. But we're really after non-dilutive and strategic monies. The SureFly, going out at a $33 million value, that at the appropriate point, if we decide we should tap that to pay for trucks, we can. We may spin out another one if we have to, to -- we may have to spin out a few children to feed the others. But our core business is making trucks, and we will do what we got to do to bring it in and try to keep shareholder value.

Operator

Our next question comes from Chris Malde, Hart Capital Management.

Christopher G. Malde
Hart Capital Management, Inc.

So maybe to just to drill into the Ryder relationship a little bit more, especially now that the W-15 is potentially growing more retail. Overall, how much, say, do have or how much have you talked with them about how the product launches and shifts and strategy so that they can support these various products that you're bringing to market?

Stephen S. Burns
Co-Founder, CEO, Secretary, Treasurer & Director

I kind of cut on you a little bit, Brian (sic) [Chris]. But I think your question was, first, the Ryder relationship and why does it exist today?

Christopher G. Malde
Hart Capital Management, Inc.

Right, exactly. And if you shift from the E-GEN to the N-GEN, how much buy-in did you have to get from them to say [indiscernible] they can support that? And then also, as you shift the W-15 more into the retail sector, how do you expect Ryder to support that? Or will that be a whole different model altogether?

Duane Hughes
COO & President

Great. So from the E-GEN or E-100 perspective, of course, we've got a couple of hundred of their salespeople, I think, up to speed and beginning the process, so starting to prospect for and sell those products today. They will continue to sell them into future years. And we're already seeing positive results from that. We actually -- as part of our backlog today, we are building trucks that Ryder has either leased or sold themselves. In regards to the engine, because it's so exciting, it is the next generation, if you will, of delivery and cargo van. They are very excited about the opportunity to begin to have an opportunity to sell that. So we've got to bring them up to speed, we've got to bring a few of these products to market, demonstrate proof of performance and then get the equipped Ryder in that in a sales and leasing mode. Same is true on the W-15. The real key to that -- even though we've opened up, I think you're alluding to the fact that we quietly, I'll say, opened up to consumer preorders, that opening up without announcing that publicly was to really fulfill the consumer demand needs that we have. We've got several thousand consumers who have really pressured us into being responsive and giving them an opportunity to get into the production queue. But we do understand that our focus is still the commercial sector. So from Ryder's perspective and the W-15, they are very eager and excited for us to bring that to markets to these commercial sector businesses so that they will have an opportunity to reach down into that light-duty segment. And the pickup truck isn't something that is common in their current sales and marketing queue. Now with that said, from a maintenance perspective, all of these products will be supported, and we expect the same on -- even on the consumer version of W-15 across the 850 locations that Ryder has today.

Christopher G. Malde
Hart Capital Management, Inc.

Got it. Okay. That's very helpful. And one other question on the DOE loan. Can you comment on any progress that has -- that had been made on that one?

Duane Hughes
COO & President

I don't [indiscernible] since the last time we talked about it, but it's slow progress, and we were a little worried on how slow it might get with the government shutdown, but they seem to have recovered from that. But things are still, I'll say, plotting along, good conversations have been had. We may have mentioned this last time, but in our most recent on-site meeting with the DOE, we had participants with us that included Panasonic, and they were very supportive in helping the DOE understand why they have committed to a supply agreement with Workhorse and why they think we're going to have success in this commercial sector and so on. So it is still moving forward, but no real news to report in terms of the next phase.

Operator

Our next question is from [Jan Kastberg], private investor.

Unknown Shareholder

I am curious about the W-15 as a shareholder and as someone who's on the waiting list for the truck. How long do you expect it will take for you to fill the more than 5,300 orders for commercial trucks before individuals like myself can expect to get a pickup truck?

Stephen S. Burns
Co-Founder, CEO, Secretary, Treasurer & Director

Well, at the run rate of 10,000 a year, it's going to take about 6 months to get through that. So we've been telling folks -- and we can't be precise on it because there's going to be a lot more fleet orders in those 5,000. But we wanted to -- and thank you for ordering it and having an interest, and we had so many people who wanted to do that. And the product has turned out to be very robust. And we thought it was suitable for consumer use. So I think the rough calculation is we want to start to at least be doing it half fleet and half consumer by summer of '19, I'd say.

Unknown Shareholder

So it will be maybe 1.5 years before I can expect to see a vehicle?

Stephen S. Burns
Co-Founder, CEO, Secretary, Treasurer & Director

Before you could take delivery. We're going to have a lot of events. We're going to take it -- the fleets start to get their first ones this June, and we want to make that not secret events. And we'll have some at the factory here, and we're going to do shows. Like we expect to do it -- for example, we're thinking about the L.A. Auto Show in November.

Unknown Shareholder

Now 1 more question. What kind of warranty are you going to offer consumers?

Stephen S. Burns
Co-Founder, CEO, Secretary, Treasurer & Director

Well, we're going to give essentially the same one as we give the fleets. It's 8 years on the battery pack, 3 years on everything else. Kind of like a standard pickup truck.

Operator
Ladies and gentlemen, this does conclude our teleconference for today. You may disconnect your lines at this time. Thank you for your participation, and have a wonderful day.