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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to the Fox Factory Holding Corp. Second Quarter 2019 Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, David Haugen. Thank you. Please go ahead.

David Michael Haugen

Vice President, General Counsel & Secretary, Fox Factory Holding Corp.

Thank you. Good afternoon, and welcome to Fox Factory's fiscal second quarter 2019 earnings conference call. On the call today are Mike Dennison, Chief Executive Officer; Rich Winters, President, Powered Vehicles Group; Chris Tutton, President, Specialty Sports Group; and Zvi Glasman, Chief Financial Officer and Treasurer.

By now, everyone should have access to the earnings release, which went out today at approximately 4:05 PM Eastern Time. If you've not had a chance to review the release, it's available on the Investor Relations portion of our website at www.ridefox.com. Please note that throughout this call, we will refer to Fox Factory as FOX or the Company.

Before we begin, I'd like to remind everyone that the prepared remarks contain forward-looking statements and management may make additional forward-looking statements in response to your questions. Such statements involve a number of known and unknown uncertainties, many of which are outside the company's potential control and can cause future results, performance, or achievement to differ significantly from the results, performance, or achievements expressed or implied by such forward-looking statements.

Important factors and risks that could cause or contribute to such differences are detailed in the company's earnings release issued this afternoon and in the Annual Report on Form 10-K filed with the Securities and Exchange Commission. Except as required by law, the company undertakes no obligation to update any forward-looking or other statements herein, whether as a result of new information, future events, or otherwise.

In addition, within our earnings release and in today's prepared remarks, non-GAAP gross margins, non GAAP operating expenses, non-GAAP income tax, non-GAAP adjusted net income, non-GAAP adjusted earnings per diluted share, adjusted EBITDA and adjusted EBITDA margin are referenced. It is important to note that these are non-GAAP financial measures that we believe are useful metrics that better reflect the performance of our business on an ongoing basis.

A reconciliation of these non-GAAP financial measures to their most directly comparable GAAP financial measures are included in today's press release, which has also been posted on our website.

And with that, it is my pleasure to turn the call over to our CEO, Mike Dennison.

Michael Dennison

Chief Executive Officer & Director, Fox Factory Holding Corp.

Thanks, David, and good afternoon, everyone. We appreciate you joining us on today's call. It's a pleasure to be speaking with you on my first earnings call as the CEO of FOX. As we've previously announced, our CEO succession plan was completed on June 29. After eight incredibly successful years within FOX, Larry Enterline has assumed the role of Executive Chairman of the Board. I thank Larry for his leadership and our collaboration. It's an honor to succeed him, and I look forward to working with Larry on strategy and business development initiatives going forward. At the same time, Dudley Mendenhall transitioned from Chairman of the Board to Lead Independent Director. In addition, Rich Winters, our former Executive Vice President, has assumed the role of President, Powered Vehicles Group. Rich and I worked together for many years, and like me he joined FOX in 2018 from Flex where he was most recently Senior Vice President.

FOX is a unique company, and it's been exciting to work shoulder to shoulder with such high-performing team of people to deliver best-in-class, performance-defining products with an authentic brand experience. I am confident that in the quarters and years to come, we are going to build upon our existing accomplishment to generate sustainable growth and value for our shareholders.

Now on to our second quarter results, I will briefly discuss our business and financial highlights. Rich and Chris will then provide more detailed updates on their respective businesses. Zvi will review the second quarter financials and discuss our 2019 guidance. And after that we'll open the call for your questions.

We are very pleased with our continued broad-based strength, and for the second quarter we are reporting record sales and probability. We benefited from the continued strong growth in our Powered Vehicles Group and solid execution in our Specialty Sports Group. Our second quarter sales of $192 million increased approximately 23% on top of the already strong growth in the prior year period.

From a profitability perspective, we reported non-GAAP adjusted earnings per diluted share of $0.68 representing an increase of 21% and an adjusted EBITDA of $38 million or an increase of 18%. We are very pleased to have exceeded our quarterly expectations for these key metrics, and we believe the diverse end markets within the segments we serve will enable us to continue to grow in the future.

To provide a bit more granularity, in 2018, our sales mix for the full year was 46% Specialty Sports, 14% percent Powersports, and 40% Automotive products. For the first half of 2019, our sales mix was 40% Specialty Sports, 14% Powersports, and 46% Automotive products, and we are excited about our continued expansion into new markets and adjacencies across the business.

As a result of our strong first quarter results and our current view of the markets we serve, we're raising our outlook for the year which Zvi will outline for you in a few minutes. We're also pleased to have closed our previously announced acquisition of RideTech, a leading manufacturer of suspension systems that enhance the handling and ride quality of muscle cars, trucks, sports cars, and hot rods. We believe this strategic transaction will help us further expand and diversify our Powered Vehicles aftermarket business.

We look forward to executing on our opportunities for continued growth in 2019 and believe FOX's diversified product offerings will continue to resonate with our customers, demonstrating our commitment to product innovation and growth of FOX brands in both existing and new categories.

We appreciate the strong efforts of our team as we continue to deliver differentiated products to our passionate customer base which reinforces the value of our brand. Finally, we are very pleased with our year-to-date results in 2019 and the outlook for the balance of the year.

And with that, I'll turn the call over to Rich.

Richard Winters

President-Powered Vehicles Group, Fox Factory Holding Corp.

All right. Thank you, Mike. Good afternoon, everyone. I'm very honored and very excited to assume the role of President of the Powered Vehicles Group. In the second quarter of FY 2019, sales of the Powered Vehicle Group (sic) [Powered Vehicles Group] (07:30) products were up 40.1% compared to the second quarter of 2018. These strong sales results are due to continued high growth across our product lineup, particularly with our off-road and powersports products which exceeded our forecast.

In addition, the recent acquisition of RideTech got off to a great start. RideTech is part of our newly created street performance business based in Morrisville, North Carolina. This group focuses on developing performance-defining products that can successfully compete in race, aftermarket, and OEM street vehicle applications.

In Georgia, we continue to make good progress on our expansion efforts. We broke ground in early June and started developing the site for our future manufacturing facility in Hall County. This new facility positions us very well for future growth. The first phase of this expansion project is on track to be up and running in the late second quarter of 2020.

We are also in the process of readying a new state-of-the-art R&D facility near our current location in Brezhnev and Georgia. We anticipate the site will be up and running by the end of August. It's located at the iconic Road Atlanta, a racetrack FOX has sponsored since 2018 and where we've helped support the development of the track's off-road courses. The new facility will enable us to continue to expand our research and development for both on-road and off-road products.

We continue to focus on our off-road capable, on-road vehicle market as our OEM customers Ford, Toyota, and Jeep continue to market and sell their respective model year 2020 products featuring FOX shock. These OEM platforms which are being very well-received by the media and consumers raise our brand awareness and inspire passion in enthusiasts to upgrade their current vehicles to be off-road-capable with our aftermarket bolt-on suspension solutions.

We have also made progress with our commercial line of shocks that includes semis and RVs. We recently launched a catalog for products that will start to see volume production once the capacity is established in Georgia.

I will conclude with a couple of desert racing highlights as we continue our winning tradition. FOX driver Andy McMillin won his second straight SCORE International Baja 500 and his cousin Luke McMillin finished second. In total, FOX drivers are in 12 podiums across various Baja 500 classes. FOX drivers has also won four or five classes at the Ultra4 El Rey Baja race in May, and we won the Tatts Finke Desert Race in Australia.

With that, I'd like to turn it over to Chris.

Christopher J. Tutton

President-Specialty Sports Group, Fox Factory Holding Corp.

Thank you, Rich. Good afternoon, everyone. In the second quarter of 2019 sales of Specialty Sports Group products were up 3.1% compared to the same period in fiscal year 2018 and we continue to build on the strong performance we delivered in the first quarter. Awareness of our portfolio of brands remained strong and we've launched additional initiatives designed to strengthen our customer loyalty and engagement.

One of our key brand building and product development strengths is our tireless effort on the race track. Earlier this year we launched a new Web series, [ph] Styles (10:42), which gives a behind-the-scenes look at our race support efforts on the UCI Mountain Bike circuit worldwide and showcases that talent of our [indiscernible] (10:49) athletes.

Viewers can tune in to our series on our YouTube channel every race week to view a new episode. At our Vancouver offices, we have a new retail process stores which we call the 101. It's a multifunction retail space where consumers can learn about, service, and purchase FOX, Race Face, Easton Cycling, and Marzocchi products. The space also showcases our history and services venue where we can host consumer meetings, cycling community, and media events. I'd now like to share some product news.

We introduced the all new Easton EA90 AX DISC Wheelset in the spring and is being well-received by our customers and media. Also new for 2020 is the Race Face Turbine SL Wheelset and the Marzocchi Z2 Trail and Enduro front forks.

I also have some news about our expanded relationship with quality bicycle products, which services more than 5,000 bicycle retailers through its four U.S. distribution centers. QBP now offers FOX Performance, Performance Elite, Factory series, forks, shocks, dropper posts, and services parts in addition to selling Race Face, Easton, and Marzocchi products.

I'll conclude with a few race highlights. Brett Rheeder won the first of two, three stops in the Crankworx World Tour and is in contention to win the Triple Crown of Slopestyle in August. And to-date [ph] this season our athletes have (12:07) claimed 39 UCI Mountain Bike downhill and cross country podiums.

And now I'd like to turn the call over to Zvi to review our financial results.

Zvi Glasman

Chief Financial Officer & Treasurer, Fox Factory Holding Corp.

Thanks, Chris. Good afternoon, everyone. I'd like to focus on our second quarter results and then review our guidance. Sales in the second quarter of 2019 were $192.1 million, an increase of 22.5% versus sales of $156.8 million in the second quarter of 2018. Gross margin was 32.4% in the second quarter of 2019, a 100-basis-point decrease from 33.4% in the prior-year period, while our non-GAAP gross margin decreased 70 basis points to 32.7%. The decrease in non-GAAP gross margin was primarily due to a change in customer and products mix as our larger North American powered vehicle OEMs represented a higher proportion of sale.

In addition, as we anticipated, we continue to experience manufacturing and supply chain inefficiencies as a result of the increase in demand, which negatively impacted gross margin similar to the levels that we experienced in Q1. Our team continues to execute on improvement programs in our existing California facilities to mitigate the inefficiencies while we are developing our new platforms in Georgia.

Total operating expenses were $32.7 million or 17% of sales in the second quarter of 2019, compared to $28.1 million or 17.9% of sales in the second quarter last year. The increase in operating expenses on a dollar basis to support our growth is primarily due to higher personnel costs as the investment in product innovation, acquisition-related expenses, and operating costs from our newly acquired RideTech subsidiary, partially offset by lower patent litigation-related expenses. Non-GAAP operating expenses as a percentage of sales were 15.1%, consistent with Q2 of last year.

Focusing on expenses in more detail, sales and marketing increased $1.5 million due to personnel, promotional activity, and various other costs, as well as operating costs from our recently acquired subsidiary as we continue to invest in our brand. R&D was up approximately $1.7 million primarily due to increased personnel investments to support new product innovation.

As we've consistently stated, the timing of R&D and promotional expenses often changes between quarters and years depending on a number of factors including product launch cycle.

Our general and administrative expenses in the second quarter of 2019 were $12.2 million, compared to $10.8 million in the prior-year period. The change was primarily due to $1.1 million in personnel-related investment and $0.8 million of facility expenses we've incurred to enhance our infrastructure to support the top line growth and changes in our business, as well as higher professional fees and various other expenses, partially offset by a $1.5 million increase in litigation-related expenses.

For the second quarter of fiscal 2019, our effective tax rate was 16.2% as a result of higher stock-based compensation tax benefits compared to a tax rate of 20% in the second quarter of fiscal 2018. Adjusted EBITDA was $38.2 million for the second quarter of 2018, compared to $32.4 million in the same quarter last year. Adjusted EBITDA margin was 19.9%, compared to 20.7% in the prior-year quarter. The lower EBITDA margin is primarily due to the change in gross margin I highlighted in my earlier comments.

On a GAAP basis, net income attributable to FOX in the second quarter of 2019 was $22.9 million, or $0.59 per diluted share compared to net income of $18.4 million, or earnings of $0.47 per diluted share in the prior-year period.

Non-GAAP adjusted net income was $26.6 million, an increase of $4.7 million, compared to $21.9 million in the second quarter of the prior-year period. Non-GAAP adjusted earnings per diluted share for the second quarter of 2019 was $0.68, compared to $0.56 in the second quarter of 2018. As a reminder, we incurred approximately $500,000 in costs associated with our credit facility refinance, which was not contemplated during our Q1 guidance.

Now, focusing on our balance sheet, as of June 28, 2019, we had cash on hand of $39 million. Total debt outstanding was $77.6 million, compared to $59.4 million as of December 28, 2018. As a reminder, at the beginning of June, we entered into a new credit facility which includes a five-year $250 million senior secured revolving line of credit which matures in June of 2024. The new credit facility replaces our previously existing term loan and line of credit and increases borrowing capacity by approximately $100 million.

Going forward, we believe the new facility will support our capital requirements for future growth, enabling us to execute on our strategy. Inventory was $136 million, compared to $107.1 million at the end of 2018. Accounts receivable was $95.7 million, compared to $78.9 million as of December 28, 2018. And accounts payable was $70.6 million, compared to $55.1 million at the end of 2018. The changes in accounts receivable, inventory, and accounts payable are primarily attributed to the growth of our business and normal seasonality.

Additionally our net property, plant, and equipment increased to $95.1 million as of June 28, 2019, compared to $64.8 million at the end of 2018, which includes $17.7 million due to the impact of new lease accounting standards in the second quarter of 2019.

Now turning to our outlook. For the third quarter of 2019, we expect sales in the range of $200 million to $208 million, and non-GAAP adjusted earnings per diluted share in the range of $0.75 to $0.80. For fiscal 2019, we're raising our outlook and now expect sales in the range of $728 million to $743 million. We expect non-GAAP adjusted earnings per share in the range of $2.56 to $2.64 for fiscal year 2019.

We expect full year EBITDA margin of 19.5% to 20% which is slightly lower than our 2018 EBITDA margins primarily due to the impact of customer and product mix as we expect Powered Vehicles OEM to represent a higher proportion of sales versus our previous outlook. The update to our margin outlook is primarily due to the aforementioned change index. As a reminder, large OEMs can have lower gross margins than aftermarket customers and smaller OEMs. We continue to expect non-GAAP operating expenses to run at 15.5% to 16% of sales, consistent with our previous outlook.

I'd also like to point out that our guidance continues to include the impact of tariffs and higher input costs based on current conditions. We expect CapEx of 2019 to be in the range of 5.5% to 6.5% of sales, which reflects the impact of our previously announced operation expansion. Our long-term capital expenditure model remains at 3% to 4% of sales.

Our guidance assumes an annual non-GAAP tax rate of 15% to 18%, which is slightly lower than our previous guidance of 15% to 19%. We continue to expect some quarterly fluctuation in tax rates to occur during the year due to the timing of certain variables such as stock option exercise and stock prices that are difficult to predict.

I'd also like to note that we are not providing guidance on GAAP EPS as it cannot be provided without unreasonable efforts due to the difficulty of accurately predicting the elements necessary to provide such guidance and reconciliation.

With that, I'd like to turn the call back over to Mike.

Michael Dennison

Chief Executive Officer & Director, Fox Factory Holding Corp.

Thanks, Zvi. And with that, we'd like to open the call for questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now be conducting a question-and-answer session. [Operator Instructions] Thank you. Your first question comes from Mike Swartz, SunTrust Robinson Humphrey. Go ahead, please.

Michael Swartz
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Hey. Good afternoon, guys.

A

Good afternoon, Mike.

Michael Swartz
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Just a question on the Specialty Sports business. This was I think the first quarter and maybe it was a year and a half where you haven't posted double-digit gains, and I know you've stuck to your long-range targets for that business this year. But was there anything specific in the quarter as to why that business decelerate? I think you said it was up 3% in the quarter.

Michael Dennison
Chief Executive Officer & Director, Fox Factory Holding Corp.

A

Yeah, Mike, I'll start and I'll let Chris weigh in as well. We're really proud of the SSG business, Specialty Sports business, and we think that bike remains strong in a market that has been showing some weakness. As we've said in the prior quarter and we think in this quarter we're sticking to our current guidance range and we think we'll be right where we should be. But there wasn't anything significant in the quarter to change dramatically what we would have thought occurred. So there was no event, if you will. And, Chris, some thoughts?

Christopher J. Tutton
President-Specialty Sports Group, Fox Factory Holding Corp.

A

No, I mean, we've said mid-to-high single digits all along. We're confident that we're going to be able to handle that through the course of the year, and we're on target to hit our [ph] plan (23:07).

Zvi Glasman
Chief Financial Officer & Treasurer, Fox Factory Holding Corp.

A

Yeah. This is Zvi. I might add that in the beginning of the year, we indicated that the growth rate for this year would be mid- to high-single-digit targets, so we're well on track with that. Up year-to-date 7.3% and we're pleased with our results. We think our results are ahead of what the industry is doing.

Michael Swartz
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay, great. And sticking with the Specialty Sports and bike business, can you talk about the expanded relationship with QBP that you announced. I guess, when do you expect to start seeing the benefit of that? Is there any kind of inventory build around that? Any kind of quantification on what that might mean for the business?

Christopher J. Tutton
President-Specialty Sports Group, Fox Factory Holding Corp.

A

Hi, Mike, it's Chris. Yeah. We started shipping them last month. We've had two weeks of check out data with them and all indications so far are very positive. They sell all of our brands currently now. There was a bit of a gap there. They sold all of our brands with the exception of FOX, so we're really just bringing them up to speed with everything. They've been a strong customer for Race Face for over 20 years and now they're selling all four our brands. So we're very excited and we think long-term this is going to be a great win for us at retail in the U.S.

Zvi Glasman
Chief Financial Officer & Treasurer, Fox Factory Holding Corp.

A

And this is Zvi. Maybe I can add, we do believe this is part of the mid to high-single-digit algorithm. It's not additive.

Christopher J. Tutton
President-Specialty Sports Group, Fox Factory Holding Corp.

A

Yeah. This was a planned decision. This wasn't something new.

Michael Swartz
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay. Great. And just one final question, Zvi, on gross margin, I think some of the headwinds you had this quarter in terms of mix in some of the inefficiencies that you've talked about are very similar from the first quarter. Maybe give us a sense of how long should those inefficiencies be in the business? Is this something that will kind of ameliorate once that new Georgia facility is up in running, or I guess how should we think about timing around some of that?

Zvi Glasman
Chief Financial Officer & Treasurer, Fox Factory Holding Corp.

A

Yeah. I think that's right. It's not the day that the Georgia facility launches. Obviously when a facility launches, there's a period of time where you optimize its operation as well. But we've seen outsized demand, very good demand in the Powered Vehicle business over the last several years here and that has -- we think that the revenue and the relationship with the customers are very desirable relationships. And so we want to make sure that we meet customer expectations. And as a result of that, we run certain inefficiencies, frictional costs, things such as expedited freight over time, things of that nature. I would point out, as you said, the level of inefficiency is relatively unchanged. The larger portion of it relates to the mix.

Michael Swartz
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay. Great. Thank you.

Operator: Thank you. Your next question comes from Craig Kennison, Robert W. Baird & Co. Go ahead, please.

Craig Kennison
Analyst, Robert W. Baird & Co., Inc.

Q

Hey. Good afternoon. Thanks for taking my questions. It sounds like your business is able to sort of grow in excess of the industry pace, but could you comment on demand for your products and market demand for your products in North America and Europe?

Michael Dennison
Chief Executive Officer & Director, Fox Factory Holding Corp.

A

Yeah. Craig, this is Mike. Let me kind of start with kind of a global statement, and then I can let the guys weigh in. So one of the benefits we've got in North America and in Powered Vehicles, most of that demand is in North America. That the market has stayed strong and gotten stronger. So we continue to benefit from a very healthy economy here. And a huge amount of passion for the products that we're putting out in the market on a number of different vehicles. So that played out very positively for us. And most of the market in Powered Vehicles is North American [indiscernible] (26:52).

In the rest of our business, in SSG, it's much more balanced between Europe and the U.S. And Europe, although the market has some economic pressure, we've seen strong bike demand and strong bike product demand there, pretty consistently throughout the year. So we wouldn't say that we're recession-proof, but I would say you know we've been able to balance our business [indiscernible] (27:20) a softer market probably is better than the average in that space.

Craig Kennison
Analyst, Robert W. Baird & Co., Inc.

Q

That's helpful. And then I don't know to what extent you're able to deconstruct your growth in the Specialty Sport market, but clearly you've got the end market which seems to be slowing, but then you got your own drivers, whether it's e-bikes, Marzocchi, Rhythm, maybe some spec games, maybe some upside from QBP. Is there any way to rank order what those drivers might be to help you outperform the market?

Zvi Glasman
Chief Financial Officer & Treasurer, Fox Factory Holding Corp.

A

Yeah. Craig, this is Zvi. We don't typically break out – I mean, I think you hit some of the important points that have contributed to our growth but we don't typically quantify or rank order them. But some of those trends like e-bikes that you mentioned, they've been strong trends in the last couple of years. That's clearly an important trend. And I think you hit most of the major ones, I'm looking at Chris, and is there anything you want to add or things we might have missed?

Christopher J. Tutton
President-Specialty Sports Group, Fox Factory Holding Corp.

A

Craig, it's Chris here. You commented earlier on softness in Europe. I think we've sort of pointed out a number of times to the e-bike mature market in Europe, and I think that's certainly helped our growth in Europe. And so it's one thing to look at when we look at some of our markets that may be under pressure, we're growing in those areas still. So I think overall we're outstripping the market for sure.

Craig Kennison
Analyst, Robert W. Baird & Co., Inc.

Q

And lastly, it sounds like the channel is well-positioned here but sometimes when we see a slowdown in retail activity, some of the channel partners are unaware of it and need to reduce inventory. Is there any expectation or any concern that at the OEM level or at the dealer level inventory is not where it should be?

Christopher J. Tutton
President-Specialty Sports Group, Fox Factory Holding Corp.

A

No. We're not saying that at all, and actually the addition to QBP, we're saying -- that's actually an input of inventory into our U.S. market, so just the opposite actually.

Craig Kennison
Analyst, Robert W. Baird & Co., Inc.

Q

That's helpful. Thank you.

Christopher J. Tutton
President-Specialty Sports Group, Fox Factory Holding Corp.

A

Thanks, Craig.

Operator: Thank you. Your next question comes from Scott Stember, C.L. King. Go ahead please.

Scott L. Stember
Analyst, C.L. King & Associates, Inc.

Q

Good evening and thanks for taking my questions.

A

Thanks, Scott.

A

Hi. How are you?

Scott L. Stember
Analyst, C.L. King & Associates, Inc.

Q

Yeah. Good. Thanks. You guys talked about the mix shift towards OEM business. Obviously there is a big component of that in the Powered Vehicles segment. Can you maybe just talk about both Specialty bikes and Powered Vehicles, how the aftermarket is performing on a year-over-year basis?

A

Well, I think if you look at on a year-to-date basis, our OEM aftermarket business is 62% OEM, 38% aftermarket. So it's a little higher. I mean, it's actually significantly higher than last year. Last year at the same period of time it was 56% OEM aftermarket. We don't break out between bike and Powered Vehicles, but we would tell you that we think our aftermarket is also performing well. Just that we've had some really strong growth in the OEM. And our long-term strategy is to make sure, Scott, that we stay balanced between aftermarket and OEM business. We think it's very healthy to keep those fairly balanced within the overall business from both sides, the SSG and PVG side.

Scott L. Stember
Analyst, C.L. King & Associates, Inc.

Q

Got it. The commercial vehicle opportunity you talked about having some products ready to go relatively shortly, and you would expect to start, I guess, ramping up once you get into a new facility. Maybe just talk about size up that opportunity again, and this may be a little bit more granularity as to when we could possibly see that actually hitting the numbers?

A

Yeah. We're selling product now. So we don't want to suggest that we're not selling product. But selling product and volume is kind of a different conversation which is why Rich alluded to Georgia and really to do true scale in that space. We think [indiscernible] (31:15) significant, whether it's in commercial long-haul trucking or in the RV space. We think there's a great opportunity. We usually roll into these pretty slow starting with the aftermarket and going into OEM. That's typically the strategy that we would deploy. We'll do that here too.

And when you think about kind of the timing for volume do occur, it's really kind of the back half of next year. That's when we have the facility up and running. We can have the lines up in running. We can actually take orders that are significant in size and be able to meet that demand. And the last thing we want to do is take orders we can't sell. So our customers are patient with us, they appreciate the catalogs we've created. They're excited to get going and so are we.

Scott L. Stember
Analyst, C.L. King & Associates, Inc.

Q

Got it. Just last question going back to the bike market. In the past, when we've seen the overall market slowdown, typically you're at higher end or the rarefied area that you guys operated and usually remains relatively robust, and again I think you've kind of alluded to that before. But just let us know how your market is doing, so we get to basically tell how you guys are carrying within the space that you're in? Thanks.

Michael Dennison
Chief Executive Officer & Director, Fox Factory Holding Corp.

A

Yeah. I'll start and Chris or Zvi can jump in. We do believe that that premium product category is a very good product category to be in. We think those buyers tend to be strong or resilient to other changes in the economy. So we like that space. We think that's going to [drive (32:42) us well future and that's clearly where we're targeted.

So it's hard to say. You never know on a long-term basis whether one part of the market will profit you more or less than others, but so far it's been positive for us.

Christopher J. Tutton
President-Specialty Sports Group, Fox Factory Holding Corp.

A

Yeah. I think the thesis is still intact. We believe that the segments of the market that we serve tend to perform better. We haven't seen any evidence to the contrary. As you're aware, there's not a lot of great third-party data out there, but we have no reason to think our thesis has changed and how it's played out the last several years.

Scott L. Stember
Analyst, C.L. King & Associates, Inc.

Q

Great. That's all I have. Thanks again.

Operator: Thank you. Your next question comes from Larry Solow, CJS Securities. Go ahead, please.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Great. Good afternoon.

A

Hi, Larry.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Good afternoon, guys. Thank you. Just one more question on the bikes or the Specialty Sports, just in relation to the quarter. And it does sounds like it's timing and I realize from following you guys for a while, there's always some early volatility. But does the -- just remind me though, this Q2 is normally, I guess, the first quarter for, I guess, on the bike side for buy ins for the new model year. Does that have any -- should that be any more worrisome or noteworthy? With a little bit of a decline in year-over-year sales, does that mean anything or am I reading too much into it?

Christopher J. Tutton
President-Specialty Sports Group, Fox Factory Holding Corp.

A

Yeah. Larry, I think you're reading too much into it. We're pleased with the performance of the SSG group. It's not any different than we expected at the beginning of the year. There's always differences in what your customers timing is for taking the initial orders in the model year. We're very excited about the product lineup. We've gotten good reception from our customers, from our OEM customers, our end customers, from the media. So I think you're reading too much into it, and we're very pleased with the performance of the business. I think Chris's business continues to outperform the industry.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Okay. Great. Excellent. And on the gross margin issue, so it sounds like kind of a high-class problem I think with the mix piece. And then on the relocation of the build out of capacity, I assume there's impact just as you're building out capacity. But there's also probably a greater impact which could turn into an opportunity just because there's just too much demand for you to bite off, right, to chew right now. So maybe you know I don't know if you can have or project increases in gross margin like you saw with Taiwan and the bikes. But just looking out three to five years, and you would assume in growth slows because it can't continue this way on the Powered Vehicles side, but I would imagine there would be our offset to the cost and then even a bigger improvement once it's settled into that facility, is that fair to say?

Michael Dennison
Chief Executive Officer & Director, Fox Factory Holding Corp.

A

Yeah. Larry, it's Mike. I'll tell you, I think you're absolutely right, the high class problem to have we get more demand, we had more demand in last quarter than we expected going into the quarter. We fulfill that demand, kept our customers happy, obviously a bit more painful for us to do it because it's just not the most efficient way to do it in California with our current capacity and factories there.

So we do believe that as you create the new platform, the new campus here in Georgia that has you know all the right supply chain structures and vertical integration that is an improvement for our business. Now we're not going to categorize or try to character what those numbers look like, but we think that's actually a great long term step for us and give us the capacity continue to grow.

So I think you're thinking about it right. We will continue to work on it. And I think as we get that factory up and running and some of the expansion moved over the Georgia, we'll continue to see improvement.

Zvi Glasman
Chief Financial Officer & Treasurer, Fox Factory Holding Corp.

A

Yeah. The only thing maybe I could add to that Larry is we like to focus more on EBITDA margins than gross margins. And I think in my comments I noted that we would run more like 19.5% to 20% this year versus the 20.1% we've had last year. We think that as we get Georgia up and running, and it's operating at volume and at efficiency, then we can be over that 20% long-term target on a sustainable basis. How far over, we've never really put an exact number on it. It kind of depends to some degree on the mix of business we get. The 20% is our number. We're not dogmatic about it. If we had a good piece of business at 19.5%, we're not going to walk away from it. But having said that, we're confident in that number over the long term.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Right. And just last question is just not an exact timing, but it sounds like you probably have some of these inefficiencies for the next few quarters. I guess you're not going live with that facility for about another 12 months. Sorry.

<A – MAY SIPON>

Yeah. We're planning to open that facility in the second quarter of next year, kind of the tail end of the second quarter. So you're going to see some of the efficiencies as we go from here to there and we'll actually – [indiscernible] (38:04) not a digital one day it's off, one day it's on event. There'll be some kind of -- go past that, but you're going to see improvements along the way as well. And I think Zvi commented in his prepared remarks that we are doing work right now in California to improve, so we are seeing traction in some of the areas that help be more efficient. We will continue to do that. We're not going to just wait for Georgia. We will absolutely continue to push everything that we can in California to reduce those inefficiencies.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Got it. Okay. Great. Thanks again.

A

Thanks, Larry.

Operator: Thank you. Your next question comes from Rafe Jadrosich, Bank of America Merrill Lynch. Go ahead please.

Zvi Glasman
Chief Financial Officer & Treasurer, Fox Factory Holding Corp.

A

Hi, Rafe, how are you?

Rafe Jadrosich
Analyst, Bank of America Merrill Lynch

Q

Hi. Thank you for taking my question. Hi, Zvi. So just the first question is in the tariff increases that were announced in May, was there any incremental pressure to your margins from that?

Zvi Glasman
Chief Financial Officer & Treasurer, Fox Factory Holding Corp.

A

It's not material. There's some impact. It's not material. It's not part of the reason for any of the margin decline. It has been very manageable for FOX. We have managed it over the last -- since they initially got announced at their initial level and not a meaningful impact.

A

Yeah. And I would add if there's much of an impact at all, it's really indirect, and the supply chain in the U.S. and North America, I would say, gets a little bit of pressure and gives them the opportunity to try to raise prices. So you get it in that indirect pressure, but since we buy so little that comes out of China and most of that goes to Taiwan, it's really negligible for us.

Rafe Jadrosich
Analyst, Bank of America Merrill Lynch

Q

Okay. It's very helpful. And then in your prepared remarks, you spoke about the increase in the credit facility. Can you just talk about a little more about the reasoning for that? And then can you also discuss or update us on the M&A strategy? Have you seen any changes there? Are the multiples out there changing at all? And then just remind us sort of what the parameters are in terms of size of company you're looking for, what leverage you're willing to take on, and just what type of company that you're looking at.

A

Yeah, a couple of things. So we entered into the new credit facility for a couple of reasons. Number one, we increased our capacity from $150 million to $250 million. So, we have the ability now to do deals without necessarily going to refinancing it. The second thing we did is structurally we had part of our facility was line of credit and part of it was term loan. This is a 100% revolver. And the advantage of that is in the past I was reluctant to pay down debt with excess cash flow because I would hurt my availability. Now, I if we have cash we can pay down the facility entirely and preserve our capacity.

On top of that, we extended the facility and we lowered our interest rates. So we thought it was a good opportunity to take advantage of a very favorable lending environment. We're also pleased that we did it with Bank of America. We had a relationship with Bank of America. They were already one of the members of the existing facility, so they know us well. And they've been with us on the credit facility side for a while. Additionally, they got involved in our first secondary, so they've known us pretty well. That made us feel comfortable as well.

In terms of the M&A strategy, no real change. I think we've been signaling that as we've grown as a company, we are open to larger deals, but we're not under any pressure to do a deal. We're comfortable doing deals, we're not doing deals. We're very excited about the core business, but I think we're a little more willing to do bigger deals if the deals meet our strategic and financial criteria. As Mike said it starts with strategy. If the strategy fits, then you can decide if it meets your financial returns and checks all those other boxes. Did I miss any of your question, Rafe?

Rafe Jadrosich
Analyst, Bank of America Merrill Lynch

Q

Just the multiples that you're seeing out there for potential M&A targets?

A

Yeah. As you know, we've been fairly frugal on the multiples we paid. I mean, it's a case by case basis, right? I mean, multiples have been expensive for quite a while. The multiples we've paid have been fairly I'd say below market given the assets we've gotten. But depending on the quality asset you get and I think there is a possibility for higher multiples or there's a possible – use for the same multiples we're already paying. But clearly it's a very – it's a stellar market and it's been for a number of years.

Rafe Jadrosich
Analyst, Bank of America Merrill Lynch

Q

Okay. Great. Thank you.

Operator: Thank you. Your next question comes from Jim Duffy, Stifel. Go ahead, please.

Peter Clement McGoldrick
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Hi, guys. This is Peter McGoldrick on for Jim. Thanks for taking my questions.

A

Hey, Peter.

Peter Clement McGoldrick
Analyst, Stifel, Nicolaus & Co., Inc.

Q

I've got a question for you, could you give an update on your strategy to enlist new customers as you expand beyond the core enthusiasts. How this is trending compared to your expectations, and is there anything specific you can share between the bike and Powered Vehicle divisions there?

A

Yeah. From my perspective, it's critical to us long term to make sure we diversify and expand that customer base, and we do that through innovation and technology and looking at adjacencies that met well with our core business. So just like we do in RideTech where we moved to street performance to go on road. Our brand works very well in that category. We think that's at a huge TAM for us to go after. So that acquisition albeit small was [indiscernible] (44:09) create a new way to get to an entirely new customer base with our brand and with the RideTech brand. So we already continue to do things like that either organically or through acquisitions and to open doors and getting these into the industry.

I believe in a very diversified portfolio, I think it's important to a long-term sustainable success. And we -- like I said, I think our brand has a very passionate enthusiast base and we never know. The mountain biker may have a Corvette in his garage or a Ford Raptor in his garage. Either case we can advance that relationship. So we're doing well. We think it continues to grow, and we think it's important for our strategy.

Peter Clement McGoldrick
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Thank you. Then a question for Zvi, could you share a picture of your inventory on hand? Is the growth related to the upcoming manufacturing relocation? And how comfortable are you with the level of makeup to support your growth outlook?

A

Yeah, I would tell you that there's three major – I mean, our inventory grew a little bit faster than our sales grew. It actually grew, and I'd say there's three major factors. Number one, we've had a bit of a shift in strategy in the elements of our business to increase sell rates, and in certain cases of a build to stock model or as to a build to order model. The RideTech acquisition, of course, we only got a little bit of their sales, not a full quarter of their sales, also they have lower inventory turns than ours.

And then the third factor was with the increase in OEM business, that business tends to have safety stock requirements that tend to be a little bit higher than the core business. So I would tell you none of the inventory build related to getting in front of the Georgia move. Is that helpful?

Peter Clement McGoldrick
Analyst, Stifel, Nicolaus & Co., Inc.

Q

That is helpful. So would that normalize towards the fourth quarter?

A

I mean, the factors that I just talked about, I'd expect to continue into the fourth quarter. None of those factors are transitory. Having said that, I mean, this team over the long term, once we're in Georgia, is always going to strive to improve the working capital profile of the business.

Peter Clement McGoldrick
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. Thank you.

Operator: Thank you. Your next question comes from Alex Marrocia from Berenberg. Go ahead, please.

Alex Maroccia
Analyst, Berenberg Capital Markets LLC

Q

Hey. Good afternoon, guys. Thanks for taking my question. I just have a quick one for you. So you finished the quarter with a net cash position which looks to be trending higher based on the guidance. How should we be thinking about future capital allocation given the cash? I know you hit on M&A earlier and the new facility in Georgia, but are there some other CapEx plans or share repurchase plans in the future?

Zvi Glasman
Chief Financial Officer & Treasurer, Fox Factory Holding Corp.

A

There's no change to our capital allocation strategy. We have a few major priorities, first and foremost to reinvest in the business. An example of that would be the Georgia build-out, previous example of that would be our Taiwan build-out previous example of that would be our Taiwan build out or ERP program. Note, first and foremost, we invest in the business. Acquisitions is our probably our second biggest priority, but we are not under – we're only going to do acquisition just as when they make sense. If they don't make sense, we're happy to do a deal, we're happy not to do a deal. And then beyond that, we have done things like share repurchases in the past. And depending on market conditions and acquisitions and future needs, we always look at them.

Alex Maroccia
Analyst, Berenberg Capital Markets LLC

Q

Okay. Great. That's it. Thanks a lot.

Operator: Thank you. Your next question comes from Ryan Sundby, William Blair. Go ahead please.

Ryan Sundby
Analyst, William Blair & Co. LLC

Q

Yeah. Hi, guys. Thanks for taking my question.

A

Hi, Ryan.

Ryan Sundby
Analyst, William Blair & Co. LLC

Q

Mike, you talked about kind of the desire to balance between OEM and aftermarket. And I think the path forward for OEM is pretty straightforward, but I'm just wondering how you grow aftermarket? Is that adding product around the FOX brand in aftermarket or do you think there's ways to kind of grow the FOX brand in aftermarket as well? And if so, what are the some of the levers you pull there? Thanks.

Michael Dennison
Chief Executive Officer & Director, Fox Factory Holding Corp.

A

Yeah, you're right, we're pretty aggressive in the FOX brand in the aftermarket space. It actually resonates very well. We sell upgrades. We sell upgrades for the [ph] FOX Raptor (48:40), we sell upgrades for Jeep, we sell upgrades for a number of different brands that we find the customer base is very eager to have, and we get significant demand from our partners and the channels to fulfill that. So innovation for us is really – begins with race, goes into aftermarket, and then lends itself to OEs. So that innovation in the aftermarket it helps drive that demand and keep it fresh, so the customers out there are getting access to some great technologies that they can use in their vehicles or their Powersports products, and I think that's very helpful. At the same time, in both our SSG business and in the PVG business, we have really strong OEM relationships which we think are very important to us that we want to maintain.

So, balancing them is a bit of a [ph] finesse (49:32) sometimes. Georgia will help us a lot on the Powered Vehicles side. I think in SSG. Taiwan does very well at it. So that's how we think about it. We think that that aftermarket space is absolutely a great area for us. And then, of course, through acquisition, RideTech is an aftermarket business [ph] we own 100% (49:52). So as we add those businesses, and Sport Truck is another example that, that helps us continue to drive and maintain that part of the business.

Ryan Sundby
Analyst, William Blair & Co. LLC

Q

Great. Thanks for the color.

Operator: Thank you. There are no further questions. At this time, I would like to hand the conference back to management for closing remarks.

Michael Dennison
Chief Executive Officer & Director, Fox Factory Holding Corp.

Thank you for your questions and interest in FOX. On behalf of all of us at FOX, I'd like to thank our customers and our suppliers for their support, and our employees for their hard work, all of which will be important to our continued success. We look forward to speaking with you guys again when we report our 2019 third quarter results. Have a good evening. Thank you.