S&P Global
Market Intelligence

Workhorse Group Inc. NasdaqCM:WKHS

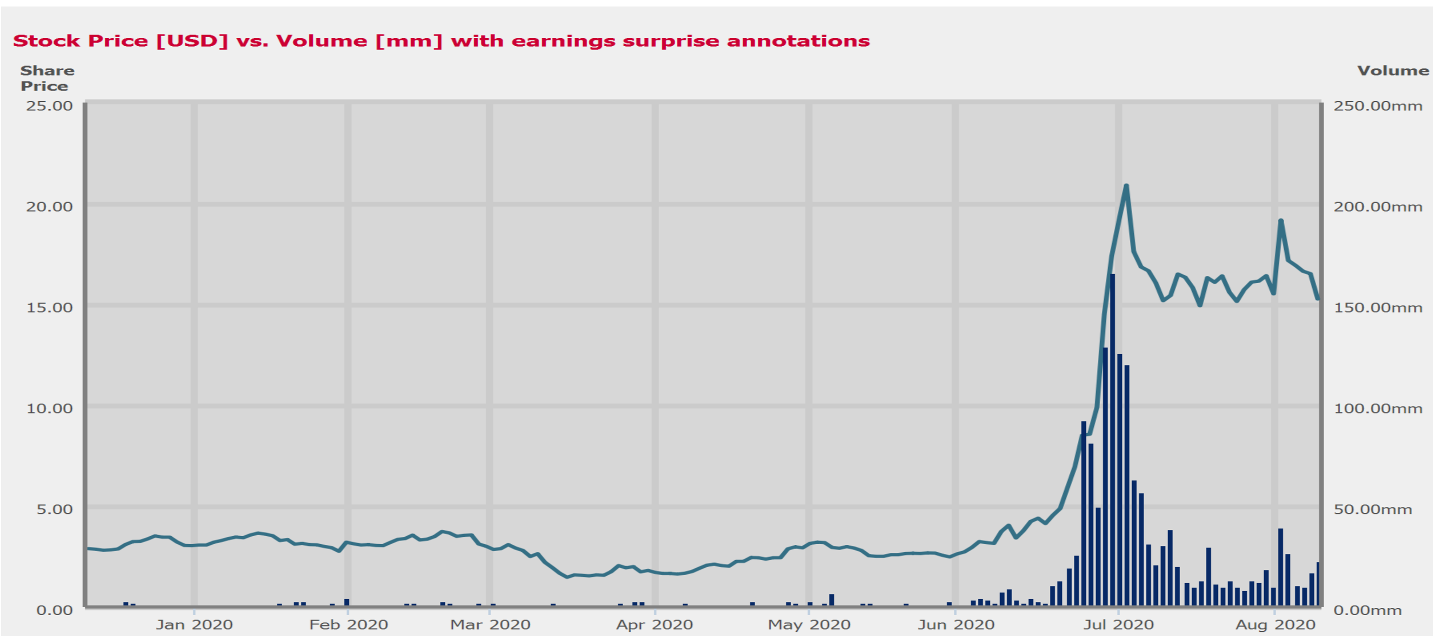
FQ2 2020 Earnings Call Transcripts

Monday, August 10, 2020 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2020-			-FQ3 2020-	-FY 2020-	-FY 2021-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS (GAAP)	(0.11)	(1.76)	NM	(0.11)	(0.26)	(0.28)
Revenue (mm)	0.28	0.09	▼(67.86 %)	5.19	22.38	147.05

Currency: USD
Consensus as of Aug-03-2020 12:57 PM GMT



- EPS (GAAP) -	CONSENSUS	ACTUAL	SURPRISE
FQ3 2019	-	(0.17)	NM
FQ4 2019	(0.10)	0.02	NM
FQ1 2020	(0.13)	0.06	NM
FQ2 2020	(0.11)	(1.76)	NM

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Call Participants

EXECUTIVES

Duane Hughes
CEO & Director

John Graber

Robert Harry Willison
Chief Operating Officer

Steve Schrader
Chief Financial Officer

ANALYSTS

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B. Riley FBR, Inc., Research Division

Craig Edward Irwin
ROTH Capital Partners, LLC, Research Division

Gregory Robert Lewis
BTIG, LLC, Research Division

Jeffrey David Osborne
Cowen and Company, LLC, Research Division

Michael Shlisky
Colliers Securities LLC, Research Division

Pavel S. Molchanov
Raymond James Ltd., Research Division

Presentation

Operator

Ladies and gentlemen, greetings, and welcome to Workhorse Group's Second Quarter 2020 Investor Conference Call. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Workhorse Chief Operating Officer, Dr. Rob Willison. Thank you. Dr. Willison, you may begin.

Robert Harry Willison
Chief Operating Officer

Thank you, operator, and good morning, everyone. We appreciate your taking the time to join us for our call. Before the market opened, we issued a press release with our second quarter results for the period ended June 30, 2020, a copy of which is in the Investor Relations section of our website. We also released our quarterly Form 10-Q.

In a few moments, I'm going to turn the call over to our CFO Steve Schrader who will walk us through our financial results for the quarter. After that, our CEO, Duane Hughes, will provide an update on the businesses as well as provide an outlook for the remainder of the year. We will then hear from John Graber who heads up our aerospace operations for an update on that part of the business, before we turn it over to questions.

But before I begin, 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 quarterly 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 2019 Form 10-K and other periodic filings on file with the SEC provide further detail about the risk factors related to our business.

And with that, I would like to turn the call over to our CFO, Steve Schrader. Steve?

Steve Schrader
Chief Financial Officer

Thanks, Rob, and thank you to all who are joining us for today's call. This morning, we issued a press release, which discusses the results of our operations for the quarter. Additionally, as Rob just mentioned, our Form 10-Q was also filed today. I recommend going through both materials to get more color on some of the information being discussed today.

Now to our financial results for the second quarter ended June 30, 2020. As many of you who have been following Workhorse are aware, and as we announced via press release recently, our first 2 C Series trucks were delivered in July to Ryder. This recent commencement of delivery helps to explain the lack of meaningful revenue in the second quarter. In addition, and to be clear, expectations should be that the vast majority of our 300- to 400-vehicle production target will be manufactured and delivered by the end of the fourth quarter of this year.

Now for the second quarter results. Sales for the second quarter of 2020 were recorded at $92,000 compared with just $6,000 in the second quarter of 2019. Cost of goods sold increased to $1.5 million from $930,000 in the second quarter of 2019. The increase was primarily driven by increases in labor and materials relating to costs for the C Series production.

Selling, general and administrative expenses increased to $3.9 million from $2 million in the same period last year. The increase in selling, general and administrative expenses was due primarily to increases in consulting expense, higher employee-related costs and incentive stock option expenses.

Research and development expenses increased $1.6 million from $1.2 million in the same period in 2019. Increase in engineering, staffing and consulting expenses was related to the design of the C Series.

Interest expense increased by $108.4 million with $124.3 million of expense this quarter compared to an interest expense of $15.9 million from the same period last year. It should be noted that the significant increase in interest expense was almost exclusively due to the change in fair value of our convertible note and the mark-to-market adjustment for some nondilutive warrants issued to lender. Both of these GAAP adjustments are noncash and primarily dependent on the underlying stock components of financial instruments. These large adjustments were the result of the stock price of $17.39 on June 30 compared to $1.81 on March 31.

Net loss was $131.3 million compared with a net loss of $20.1 million in the second quarter of 2019. However, because of the large fluctuations in our mark-to-market accounting for the convertible debenture and some stock warrants, operating income or loss would be a better indication of operating and cash performance. Loss from operations was $7 million in this quarter compared to a loss of $4.1 million in the second quarter of 2019.

As of June 30, 2020, we had cash, cash equivalents and short-term investments of $26.2 million compared to $23.9 million as of December 31, 2019. You may have seen in July that we closed on a $70 million convertible note financing. In addition, we had many investors exercise warrants or options that were granted or obtained in previous financings. If the cash coming in from those exercises and the financing, we currently have $105 million of cash available. We believe this schedule allow us to ramp up the production to hit our target level this year, fund next year's operations as well as take us into 2022 before we may need additional financing, excluding any financing needed to respond to any significant increases in manufacturing, resulting from significant orders or contracts.

With that overview completed, I will now turn the call over to our CEO, Duane Hughes, to discuss some of our major operational updates and provide an outlook for our business in the current quarter and for the rest of the year.

Duane Hughes
CEO & Director

Thanks, Steve, and thank you, Rob, and good morning to everyone on the call. We appreciate you taking the time to join us today. During the first half of 2020, we have all been dealing with the effects of the COVID-19 pandemic. As it relates to Workhorse, specifically, for the most part, except for supplier issues in the first quarter and testing facility closings in the second quarter, we have been able to continue towards the ramping up of our production, while maintaining all safety precautions for our employees.

Designing and building vehicles is certainly the highly visible part of what we do. But our C Series vehicles also have to pass the rigorous standards of federal and state regulators in order to be operated on U.S. roads. To that end, we successfully completed the Federal Motor Vehicle Safety Standards, or FMVSS, testing in June. We are also proud to say that our vehicle designs have been validated by the United States Environmental Protection Agency, EPA, and the California Air Resources Board, known as CARB. Workhorse is the only American, all electric OEM, designing and manufacturing last mile delivery vehicles to complete all these tests.

An additional benefit to our carve zero-emission EV status is that going forward, Workhorse will now have carbon credit capabilities. What this means is through CARB, we will get 1.5 credits through every vehicle we sell. In turn, these credits can be sold to other OEMs to help meet CARB emission standards. At current rates, it is our belief that a typical CARB emission credit can expect to be sold for $200 to $300 on average. While not an immediate contributor to our top line or cash flow as we begin to scale our operations, these credits should be reliable and more impactful as a new source of revenue over time. The EPA issued a certificate of conformity for our 3 C-Series models, which technically gives us permission to sell our vehicles in all 50 states.

In addition to the EPA CoC, after going to another significant testing program, we applied for and received an executive order from CARB that enables us to sell our vehicles specifically in the State of California as well as the 13 other states that follow the stricter California Air Resources Board standards. Essentially, this means that California has approved production of our model year 2020 vehicles, the C1000 and C650. Without the executive order, we would not be able to sell or place vehicles in California and 13 other highly populated states. This approval also allows us to have our vehicles on the California Hybrid Incentive Program, or HVIP, which should provide for a $50,000 incentive per truck after the State of California is expected to appropriate funds later this year.

With respect to production, in June, we delivered a C Series 650 vehicle to Electric Vehicle Fleet Solutions who will use it in support of their field service and training business. In July, we shipped our two C1000 vehicles to Ryder to be used at their service centers in Orange and Santa Fe, California. As part of the North America rollout, Ryder will place the first group of Workhorse C1000 vehicles through COOP, a peer-to-peer truck-sharing platform, connecting fleet managers to businesses that are looking to rent vehicles. In addition, Workhorse electric vehicles will be offered for longer-term leases to the Ryder customer base with service and charging capabilities available out of Ryder's 11 facility charge network across California. Ryder, showcasing our trucks, will lead to an increase in future orders. We are most excited about our relationship with Ryder.

Speaking of orders, in July, a Cincinnati-based company, eTrucks placed an initial order for 20 C1000 vehicles. eTrucks is a buyer, reseller and financier of trucking solutions for small- to medium-sized delivery businesses or SMBs. The SMB fleet operator represents an opportunity for additional sales, and we're looking forward to growing our partnership with another Ohio-based organization to improve last mile delivery for everyone. Pursuing sales agreements with resellers like eTrucks allows Workhorse to expand our sales, our sales reach and take advantage of economies of scale that would otherwise be unavailable through individual transactions.

Moving to another major news item. As I'm sure many of you have recently heard, a few days ago, our strategic partner, Lordstown Motors Corporation announced that it had entered into an agreement with DiamondPeak Holdings Corp., a special purpose acquisition company, or SPAC, that would result in LMC becoming a publicly listed company on the NASDAQ under the ticker symbol RIDE, with the transaction expected to close in the fourth quarter of this year. Lordstown has stated that it's Endurance, an all-electric pickup truck, is expected to be the first full-sized electric pickup truck designed to serve the U.S. commercial fleet market. Lordstown also says initial production will begin in 2021. To date, LMC has disclosed that it has received over 27,000 preorders for the vehicle, representing over $1.4 billion of potential revenue.

With respect to our partnership, I want to start off by reminding everyone of the details in our current agreement and how that will look after the SPAC transaction is finalized. Our IP remains at the heart of the Lordstown Endurance. Several design concepts, first introduced in Workhorse's all-electric platforms, are central to the Endurance design. Among Lordstown's technology differentiator is the integration of hub motor technologies that eliminates the heavy drivetrain, engine, transmission, driveshaft, differentials and axles, typically used in combustion engine vehicles. In exchange for access to this valuable IP, we negotiated a license agreement that would provide Workhorse with a 10% nondilutive equity stake in LMC in addition to other considerations. Subsequent to the SPAC transaction, we will maintain our approximate 10% ownership of the combined company at closing. At an approximate $1.6 billion valuation post-transaction close, that makes our position worth roughly $160 million. Additionally, with the $1.4 billion of preorders already secured, as disclosed by LMC, Lordstown also agreed to pay a 1% royalty on the first 200,000 vehicles sold plus a 4% commission on 6,000 Workhorse W-15 preorders that transfer to LMC as part of the IP licensing agreement. It's worth noting that LMC has agreed to prepay a portion of the license fee in an amount equal to $4.75 million. This transaction marks the fulfillment of a vision that began in January of 2019 when we first approached General Motors about the Lordstown Complex.

The Lordstown assembly plant is a 6.2 million square foot facility, estimated to be capable of producing as many as 600,000 electric vehicles annually. From the outset, our team and the LMC team understood the opportunity available and recognize the synergies that could be realized infusing our technology, the production capabilities of the former GM plant, the vision of the Lordstown leadership and the commitment of the communities in the Voltage Valley today. We are more than excited about our Lordstown relationship and look forward to further strengthening our ties with Lordstown team as they finalize this transaction and begin building trucks in 2021.

Finally, I want to next speak about our engineering, design and production process. Our engineering team has been working on production plants for the second half of the year, and we now have in place a final assembly plan and a build schedule for the remainder of 2020 and beyond. We have developed a multi-vendor strategy and, in particular, a multi-battery strategy. All major body parts will be built in the United States. Our design eliminates traditional multimillion-dollar investments in tooling and molds as well as transportation and can accommodate design changes quickly. We continue to add key personnel in critical areas, including engineering and assembly positions. These additions have quickly provided us with new ideas and plans for improving our design for assembly. The goal of this design for assembly program is to considerably shorten the time it takes to assemble a C Series vehicle and deliver our target vehicle production of 300 to 400 units later with the vast majority coming in the fourth quarter.

And now I would like to introduce John Graber, who leads our aerospace group, to speak about our ongoing projects. John has a long history in military and commercial aviation. He has been the president of multiple public airlines and has extensive experience in worldwide aircraft operations, maintenance and FAA system certification. John?

John Graber

Thanks, Duane. Good morning, everyone. Our aerospace team has made a lot of progress beyond the publicly announced expansion of our last mile delivery patent portfolio and our membership in the Small UAV Coalition. Carrying a significant payload for a practical distance with a high degree of precision and reliability is not easy. But in the second quarter, during continuing heavy flight testing, our team did that, elevating our aircraft's target range, payload and endurance.

In April, our team participated in a demonstration in Lawrenceville, Virginia, with UPS and drone up in front of government officials with the goal of validating the use of drones for emergency and medical situations. It was a good exercise for the team and our system. We learned a lot. One of the things we learned, we validated the notion that autonomous operations are important, especially in times like these. Other participants needed 3 people to operate missions we flew with one. Because our HorseFly system automatically launches our aircraft from our patented truck-top launching system and because our aircraft autonomously flies to the delivery point and from a safe altitude, automatically lowers our cargo with winch and then returns automatically to the truck, we only need 1 person to run the entire mission, not 3. We're closing in on the final design of our HorseFly 1.0 system and an improved root system for launching and recovering HorseFly from a Workhorse truck. I've been involved in Workhorse's aerospace operations for almost 3 years now, first on the SureFly and now with the HorseFly team.

Let me give you a sense of what HorseFly means and is doing for Workhorse. First, last mile transportation is hard, aerospace transportation is harder and integrating the 2, I would submit, even harder. Yet our team is getting it all done. In our fourth year of development, Workhorse aerospace has flown live package deliveries hundreds of times in 3 different states. Our prototype all-electric aircraft flies from our all-electric delivery van, utilizing our patented truck-top launch and recovery system.

All our experience has taught us the last mile drone delivery is standoff, low touch and low cost, but all of that means nothing if you can't sell it in the marketplace. And we found the marketplace requires these core capabilities we designed for, safely and reliably carrying a meaningful payload, carrying at a meaningful distance, doing that simply and autonomously and doing it 7 days a week, 365 days a year.

FAA-type certification is the only path to scaling meaningful long-term commercial revenue operations in the United States, and Workhorse aerospace is on that path. We've designed our aircraft and support systems to meet the FAA's stringent standards to commercial operations. This certification process takes approximately 12 to 18 months. We have an expert aerospace team with a deep understanding of the FAA's process and regulatory requirements, and we've teamed with Moog aerospace to leverage their decades of aviation experience and the development of our systems.

Our systems and design include redundant communications and control, transport standard structural strength and the range of reserve power capabilities that meet regulatory requirements. The key component to drone success is community acceptance. No one wants hundreds of annoying NATs flying over their homes every day, but very few people will care if our aircraft flies over because they won't hear it. And unless they're looking, they won't see it. We've designed our aircraft to be quiet, quiet and unobtrusive. Our patent-pending 1 board wind system allows us to deliver packages from 20 feet or more above your backyard or driveway, keeping us away from your pets, children and plants. We've delivered hundreds of packages and understand what communities will and will not accept.

An additional key component of our HorseFly system is our patent-pending Ares software that allow simple, precise control of the drone by operators. Ares also helps foster customer acceptance by allowing package recipients to opt into delivery, choose their own delivery points for packages at their homes, accepting or rejecting packages and deliveries in real time. And Ares is more than just delivery managed from trucks. Our system allows last mile delivery from fixed-based operators like drugstores, post offices and hardware stores as well. The applications are many and growing.

In summary, HorseFly long-term business case and economics are compelling. Direct operating cost of the aircraft is less than $0.03 a mile. And when you combine our HorseFly aircraft with our C1000 delivery technology, you cut almost all of the carbon out of the delivery process, while reducing the delivery cost up to 80%. This is a true step function improvement in terms of cost and efficiency and greenhouse gases. Personalized integration with our all-electric delivery van will allow us to maintain and grow our early leadership position in the last mile space.

Duane, I'll turn it back over to you.

Duane Hughes
CEO & Director

Well done, John. I appreciate that update. I do trust this provides you all with a better picture of what HorseFly means to Workhorse. There are drone operators, there are delivery truck OEMs, Workhorse's both.

In conclusion, I'll provide a brief comment, as we always do, with respect to the U.S. Postal Service next-generation delivery vehicle program. As many of you are well aware, under our NDA, Workhorse is only able to provide information, which is already in the public domain. As has been the case throughout this process, any further information or announcements will be issued by the U.S. Postal Service. We appreciate the continued interest that we are receiving and will provide updates to the market as we are able. We do not have any updates to share at this time.

That concludes my prepared remarks. Thank you all for your time this morning. We look forward to updating you on our progress going forward, and we're now ready to open the call for your questions.
Operator, please provide the appropriate instructions.

Question and Answer

Operator

[Operator Instructions] Our first question is from Craig Irwin of ROTH Capital Partners.

Craig Edward Irwin
ROTH Capital Partners, LLC, Research Division

So first thing, Duane, if you could please update us on the backlog where it stands at the moment? Is it basically unchanged from the last time you disclosed 1,200 units? And then the Ryder and eTrucks orders, both very nice beginnings with both of these customers. Can you maybe describe the longer-term potential you think is available with these customers? And how should we be thinking about customer orders as far as tempo? Do they generally start small and build larger? And should we be expecting multiple additional orders over the next several months?

Duane Hughes
CEO & Director

Thanks for your question, Craig. It's great to have you on, and we appreciate the opportunity to respond. There's a couple of things I heard in there in terms of your question. So I'll start with the relationship with companies, such as Ryder and Electrical Vehicle Solutions and so on, are truly geared at helping us attract orders from all sizes of fleets. So as you can imagine with the UPSs of the world, right, we can garner large-scale orders. But when you're thinking about fleets with smaller numbers of vehicles, these guys allow us to attract not only their attention and get the order, but then compile those orders together. So we have sizable orders coming in from multiple fleet customers simultaneously. That goes, of course, not just to scale, but to efficiency down the assembly line and so on.

Beyond that, I think your first question was, where do we stand with the current backlog? We're still in that roughly 1,200-unit neighborhood at this point. The 2 orders we sent to Ryder do -- did start to populate their COOP fleet, as we mentioned in our call. But to that point, we do expect all of these channel partners to help us increase our order quantity in our backlog somewhat significantly, clearly, as we can operate now in all 50 states due to our regulatory approvals and so on.

Craig Edward Irwin
ROTH Capital Partners, LLC, Research Division

So one of the things that was absent from your prepared remarks is a discussion of UPS. Many of us look at UPS as an anchor customer, maybe your most important customer you've done business with to date. I know all customers are important. Is there any change or update you can share with us on UPS at this time?

Duane Hughes
CEO & Director

Nothing really except that, that order still is out there. We are continuing to make sure that the trucks that we do deliver to UPS knock it out of the park, if you will. So rather than having the first few vehicles go to them, we're working with their implementation schedule across the different depots where they're going to place these vehicles, starting in the California marketplace as we understand it today. So it's really just a function of working directly with UPS in terms of how they're building out their infrastructure and making sure that we are on queue to not just deliver trucks to those depots, but the trucks that we deliver are, if you will, the best trucks that they've ever received.

Craig Edward Irwin
ROTH Capital Partners, LLC, Research Division

That's great to hear. So last question, if I may, before I jump back in the queue. I should start by saying congratulations for getting your first truck delivered in the June quarter and for getting production going. Can you maybe update us on the tempo of activity and the tempo of deliveries as you are ramping production? What's it going to take to get to the 100 units a month you guys have been talking about for the fourth calendar quarter? And do we sort of start off slow and build into that? Any color here is useful.

Duane Hughes
CEO & Director

Yes. Yes, that's great. Another good question, Craig. And you're right. We do start slow and grow into that. So even in the third quarter, as we are identifying other areas that we can bring our own efficiencies and, I'll say, engineer out cost, that's the phase that we're in now by delivering vehicles, getting customer responses, getting feedback from them and helping us understand, did we miss something in the truck? Do we add something? What are the most valuable things that you're seeing, and then combining that with where we can add efficiencies inside our plant and our assembly process. So I would tell you, in the third quarter, we're only looking at a handful of vehicles compared to that backlog. But that's to lead into what you just said that 100 unit a month capability starting in the fourth quarter, where we are again well positioned to know that we have delivered not just a truck, but a solid quality truck to not just our important customer of UPS, but all of our important customers.

Operator

The next question is from Greg Lewis of BTIG.

Gregory Robert Lewis
BTIG, LLC, Research Division

Duane, in your prepared comments, you touched a little bit on the California $50,000 incentive program. I'm just kind of curious if you could talk a little bit more about that in terms of how many potential vehicles that is, how many years that's going to be in place? You kind of -- just trying to get some more color around that. I mean you mentioned UPS might potentially start off in California. Just kind of if you could walk us through anything there, I think, would be helpful.

Duane Hughes
CEO & Director

Yes, that's a great question, Greg, and I appreciate it. I'll start and if anybody else wants to add more content, they can. But in general, think of it this way, each fleet is able to put in 200 units in California that applies to the $50,000 supplemental voucher program. So when you think about the numbers of not just total vehicles that are on the road in California but the number of fleets operating vehicles in that marketplace, particularly in the last mile delivery segment, our vehicles do apply for at least in that 1,000 cube and 650 cube range, they both apply for the 50 -- or apply to the $50,000 voucher at, again, 200 units per fleet in a calendar year.

Gregory Robert Lewis
BTIG, LLC, Research Division

Okay. Okay, great. And then just one other one for me. You mentioned also about LMC, potentially looking to do a listing later this year. Clearly, you guys have that 10% stake in the company. Steve, this question is probably more for you. Is there -- and we can be -- that can be a long-term investment. But I guess what I'm wondering is, is there anything that precludes Workhorse from potentially selling that 10% equity stake as LMC becomes a public company in the open market?

Steve Schrader
Chief Financial Officer

Craig, thanks. Our 8-K basically show that we have 6 months after closing, and after the 6-month time period, then we have the ability to sell if we want to.

Gregory Robert Lewis
BTIG, LLC, Research Division

Okay, great. And then just one more for me, as it pertains to the U.S. Postal Service contract. Not so much about an update on it, but I mean, clearly, it's a large order. Right now the goal for the union facilities to get to 100 units at a certain point in Q4, just as we think about Workhorse, should USPS -- should Workhorse be lucky enough to win some of that contract, if not the whole thing? How should we be thinking about the opportunities for Workhorse to meet that potential order just given the size of it and, clearly, it sounds like Lord's LMC could be an area where those units get delivered. But I'm just curious, I imagine you don't want to put all your eggs in 1 basket. I'm curious if the management team has done any legwork about potential other facilities, where the USPS vehicles, should they be one potentially get built just given that it's unclear to me about -- we know there's a lot of trucks, what the timing of the deliveries are and just realizing there's a lot of moving parts. Any kind of comments you could give around Workhorse's ability to maybe meet those orders because, frankly, that's a question that we get from a lot of investors about this potential contract win?

Steve Schrader
Chief Financial Officer

Greg, this is Steve. As you know, we can't say anything about the Post Office. So let me say it this way is that Union City certainly has the ability and the history that can be really on any capacity level has done 60,000 chassis, I think, in its history. So it does have that ability to do that. What I will say is that -- what we will look at is the capital we may have to put in there from a standpoint to automate systems and the cost that we would have to do. And we would look at other areas and places that we could do actually subassembly and subcontracting. And I think you mentioned earlier, at least first is Lordstown. And Lordstown is a great example of that where it's a 6 million square foot facility that we would take a portion of that probably, and they could possibly do it at a lower cost than what we could do it for us. So that's certainly something we would evaluate. Duane might have more to kind of add here, too.

Duane Hughes
CEO & Director

Yes. Clearly, we have been evaluating that. And that's been part of our long-term strategy, at least understanding if and when it would be capable. But it goes beyond just the plant itself, it's also the technology. So we mentioned our IPLA, Greg, and that licensing agreement, one of the things we recognize is our ability to, I'll say, share components from different suppliers. As you might recall, these 6 prototype vehicles that we delivered to the Post Office all used hub motor technology and, of course, Lordstown Motors Endurance product is coming out with hub motor technology itself. So not only can we scale our operation more efficiently perhaps through Lordstown Motors, but we can also scale our supply chain more efficiently by sharing a quantity of parts that are purchased from the same suppliers and beyond. So there's a lot of things that we're looking at as it relates to Lordstown, particularly because of our 10% ownership in our IPLA, but also because of the proven performance that plant provides, which is, again, similar to our Union City plant. We have a lot of experience and a lot of capability there. The question is what becomes the most efficient process and location to ultimately build and deliver any vehicles that we build and deliver going forward? And it's not just related to Postal Service type things.

Operator

The next question is from Jeff Osborne of Cowen and Company.

Jeffrey David Osborne
Cowen and Company, LLC, Research Division

A couple of questions on my end. I was wondering if you could just touch on the Duke partnership and how that's progressing.

Duane Hughes
CEO & Director

Yes. I think -- this is Duane, Jeff. Thanks for the question. Good to hear your voice again. Let me -- let's Steve start with the first answer to that.

Steve Schrader
Chief Financial Officer

Yes. I think Duke's still a strategic partner with us, especially from the infrastructure side. And we're in talks with them quite a bit from a standpoint of going forward. So we view them as the first choice for supplying infrastructure to our customers, and they certainly view us as the first choice of supplying the trucks for their infrastructure.

Duane Hughes
CEO & Director

Yes, I don't think we can speak to other things that are happening right now because they're not publicly available. But Duke remains a key strategic partner of ours above and beyond infrastructure. As Steve points out, that's clearly a number one thing. But also, they can operate, if you will, within our channel partner world. As both a channel partner and side-by-side with our channel partners. So Duke is among the top of our strategic partners.

Jeffrey David Osborne
Cowen and Company, LLC, Research Division

It's great to hear. I just had a couple of other modeling questions. Just with all of the movement on the converts and the warrants, can you just update us on what the share count should be in the third quarter? It looked like you had about 74.7 million per the Q and then another 24 million and change that were antidilutive from options and warrants. So where should that be given the warrants are fully exercised?

Steve Schrader
Chief Financial Officer

Yes. I think the very first page of the 10-K that we released today, I think, has 105 million shares outstanding.

Jeffrey David Osborne
Cowen and Company, LLC, Research Division

Got it. And then how do we think about the OpEx run rate? You mentioned some expenses for gearing up for the C1000 launch. You then had things sequentially down in SG&A and R&D. Is the run rate that you had around $4 million and $1.5 million for R&D and $4 million for SG&A a good baseline for the second half or no?

Steve Schrader
Chief Financial Officer

Yes, Jeff, for the second half, I think it's a good run rate to think about $5 million to $6 million for a run rate for nonproduction-related items. To the extent that we are buying supplies and components to get to 5 a day in the fourth quarter, obviously, we're going to be paying more for that.

Jeffrey David Osborne
Cowen and Company, LLC, Research Division

Got it. And then my last question was just on the -- in past calls, you've alluded to doing a $40 million credit line. Is that something you're still working on? Or does the $70 million convert take away the need for that? I just wasn't sure what your working capital needs would be, especially as you enter the first half of next year.

Steve Schrader
Chief Financial Officer

Yes. I think the $70 million convert plus the exercise of the warrants and options that were out there Put Us in a situation where we have $105 million of cash right now. So unless there is a big order, a big contract, possibly the ability to kind of maybe lower our cost of capital with things that are existing on our balance sheet, we're pretty well set through the 2022 time period.

Operator

The next question comes from Mike Shlisky of Dougherty Colliers Securities.

Michael Shlisky
Colliers Securities LLC, Research Division

I want to start out with some questions about the emissions credit that you had mentioned earlier. I'm kind of curious, is there a certain point where those credits have value? Is it when California starts to officially require fleets to have EVs? Or do you start accruing those credits today? And then maybe secondly, as part of that question, is there a point where you think some kind of trading market will develop for those credits?

Duane Hughes
CEO & Director

Yes. I think it's really, Mike -- and number one, thanks, Mike, for your question. We appreciate you being online. And this is Duane. I would tell you that those credits are available immediately to us when we start delivering vehicles in that marketplace and then also in other marketplaces as well who create programs. For us, it's a matter of creating our own process in order to, us, say, use those carbon offset credits. So setting up relationships with other OEMs, who could take advantage of using those carbon offsets. So it's on us, it's our responsibility to create our own marketplace with the other OEMs, but they are available immediately to us as we start delivering vehicles to that market. Now with that said, for us, it's a function of 1.5 credits per vehicle we deliver and 1.5 credits, I think we referenced this in our talking points is, we're somewhere between, I'll call it, right around $300. I think it's $200 per credit each vehicles worth of credit in 1/2, which would calculate the $300 per vehicle.

Michael Shlisky
Colliers Securities LLC, Research Division

Okay. And just on -- just a follow-up there. There are other zero-emission deal companies out there that make all kinds of different vehicles. Do you think they'll also get credit? I'm just trying to figure out can people buy their credits from different sources? And will you be able to mark those up if people really need them or mark them down if everyone's got their vehicles on the road by those California deadlines?

Duane Hughes
CEO & Director

Yes. I would say that there's going to be other EV OEMs who are able to have carbon offsets. I would tell you this to date. This is our first time we've had carbon credits available to us. I think it's based on a class vehicle, it's all-electric vehicle and so on. But as you get into larger-scale vehicles in the past, the larger classes, the heavier class vehicles, I don't believe we're available for carbon credits earlier. So I think they're starting to make that available. And I think that's one of the reasons why you see our opportunity in the class of vehicle we're in to now have available carbon credits.

Michael Shlisky
Colliers Securities LLC, Research Division

Okay. That's great color. I also wanted to touch on maybe your exit production rate for the year and possibly sort of the bottom range for 2021 as far as what you might start the year on production. I know you want to get to 100 vehicles a month for the fourth quarter. Is there any sense as to where you might start the quarter, where you might end the quarter, whether that ending exit rate is kind of a good place to start for 2021?

Robert Harry Willison
Chief Operating Officer

Yes. This is Rob Willison. Really, the ramp starts from here and goes up. And what we're really looking at is fourth quarter to do the 100 a month. But beginning next year, really taking that up a good bit past that, 150, up to 200 a month as the market allows. As Duane had said earlier, there's a number of fleets that are now seeing EVs as obviously green, obviously good for the environment. But the bottom line is they're less expensive to operate and better for the drivers. So I think some are a little tepid out there to wait to try these out, but we're really seeing quite a huge interest by fleets, and we'll see that production increase next year.

Steve Schrader
Chief Financial Officer

Mike, this is Steve. I think what I would say, too, is, obviously, like Rob said, we're trying to get to 100 a month in the fourth quarter. And you asked a lot about 2021. I think the next goal is, once we achieve that and do it on a regular basis, make quality products, would then be 150 a month and 200 a month. We can't give you a guidance on that yet in 2021 as to when we would get there from a standpoint of what month. But that's certainly the next 2 goals. And I think when we get to the 200 a month, will be gross margin, probably hit our targets. Now getting gross margin positive is always the first step from a standpoint of anybody that's mass producing for the first time. And going from, in a lot of cases, putting a selling equipment, in our case, is doing R&D. So -- but again, our goal is to eventually get to that 15 to 20 a day.

Michael Shlisky
Colliers Securities LLC, Research Division

Got it. Great. And just to confirm, all those -- all your previously stated gross margin and EBITDA breakeven targets and comments, those are still valid with the same exhaustion levels going forward?

Steve Schrader
Chief Financial Officer

We do believe that when we get like 200 a month, that will be at our production -- our gross margin target is like 15% to 20%, but I say that in all of us -- sitting here, too, we have to do it first. We have to do 100 a month first, and we have to kind of see where that goes. So you don't get credit until you do it, so...

Michael Shlisky
Colliers Securities LLC, Research Division

Got it. Maybe just one last one for me. You kind of touched on it in your previous answer here, but curious as to what's the level of order increase that you're getting, maybe this quarter, this past quarter versus the prior quarter? Do you get a sense that there's been any issue due to COVID-19 with folks unable to get a test drive in? And do you think once they'll have a vaccine or the virus gets a little bit less of an impact on our economy, you'll just see a lot more test drives after that point versus the current time?

Steve Schrader
Chief Financial Officer

I think the virus has definitely impacted us from a standpoint of, like you said, orders. Because, yes, customers want to see them on the road, they want to touch them, they want to feel them, they want to drive them. And I think from that standpoint, it's probably been slow. I think as soon as we start delivering more orders out there, that the orders will come in. We certainly anticipate higher orders this year and by the end of the year. So we have -- we're pretty confident in that, and we'll go forward and see what happens.

Operator

The next question is from Pavel Molchanov of Raymond James.

Pavel S. Molchanov
Raymond James Ltd., Research Division

Lots of discussion today about domestic opportunities. But of course, on the other side of the Atlantic, we're seeing the European green deal and the European climate law and, if anything, a faster push for electrification. And I'm curious what kind of conversations you may be having with either prospective customers or prospective manufacturing partners within the EU?

Duane Hughes
CEO & Director

This is Duane. I'll start with that, and then I'll let anybody else jump in. But yes, we get a bit of outreach from -- on the other side of the pond, if you will, as well as over here, whether it's in Brazil or all the way into Canada and so on. So part of that is a homologation process that we are prepared to handle and go through. The second part is really the size of the vehicle and the platform. As you know, we're focused on our C1000, which is a 1,000 cube size vehicle. And when you think of a traditional parcel delivery guys here and the size of their vehicles, they're a bit larger than what is used over in the European theater. So we do have our 450 solution and smaller than that. So we are looking at how we determine the appropriate or the right-sized vehicle, if you will, for that marketplace to be able to open it up to us on the platform level that matters to them.

Rob, do you want to add to that?

Robert Harry Willison
Chief Operating Officer

Yes. So our vehicle can be sold into Canada. It was designed that way. We've announced before, we're seeking refrigerated vehicles, and there's a large U.S. and market in the U.K. for that. And we've had some preliminary talks in the U.K. and the Scottish government as well. So we want to make sure that we roll out in a systematic way with quality. There's a large demand for this. We're trying to do it judiciously and economically.

Pavel S. Molchanov
Raymond James Ltd., Research Division

Yes, for sure. You guys also touched on the kind of precautions and social distancing that you have implemented to keep our workforce safe. I'm -- can you just talk about how the kind of physical manufacturing or labor process has changed in the last 100 days given the new normal that we're all living in?

Robert Harry Willison
Chief Operating Officer

Yes. That's a great question. It's -- what we've really looked at maintain the social distancing and a lot of that has come down to some subassemblies, limiting the number of people that group together at final assembly. And then all the face masks, the face shields, all the PPE that we do and as much as every manufacturer keep the factory safe, except on an amount of across multiple shifts as well. So we don't have the same number of people working at the same station and something.

And John, you might want to touch on that from a HorseFly perspective?

John Graber

In the aerospace area, we spend a lot of time thinking about, of course, how to work apart, and our aircraft is designed and our trucks are designed to facilitate 1 or 2 people involved in something. So social distancing is no problem. We emphasize PPE to everybody. When you get into the guidance, it's pretty clear, and we're very respectful of the notion that we use PPE, we socially distance, we do the hand washing and we separate our people at work. It works really well for us so far.

Robert Harry Willison
Chief Operating Officer

And maybe talk just a little bit about in the new truck configuration with the HorseFly to infrared. Infrared, is it?

Duane Hughes
CEO & Director

Or ultraviolet.

Robert Harry Willison
Chief Operating Officer

Yes. So one of the recognition going forward with last mile delivery, and we do have a preliminary patent on this, but it's using UVC in the cargo area and the drivers area when unoccupied to kill bacteria, cut down some of the dangers of COVID and other contagious diseases.

Operator

The next question is from Chris Souther of B. Riley FBR.

Christopher Curran Souther
B. Riley FBR, Inc., Research Division

So with the first shipments going to Ryder, I'm just curious between then UPS as part of the mix this year. Can you talk about what the expectations are and sort of with the larger customer versus the tail of smaller fleets through the channels like Ryder and eTrucks, what the expectations were going to be going forward?

Steve Schrader
Chief Financial Officer

Yes. I think, for the most part, we'll be kind of spreading around to all the customers this year. Part of it's working with them and when they want to receive them and where they want to get them at. For example, if they want them in California, even though we're part of the HVIP on list and eligible for the rebates, the state hasn't funded the program yet and probably won't for the fourth quarter. So again, if you would want trucks in California, you probably have to wait until the fourth quarter, too. So again, I think each of the customers we've already talked about are going to be getting trucks this year, and it's just a matter of working with them as to when they'll get them.

Christopher Curran Souther
B. Riley FBR, Inc., Research Division

Understood. So can you talk a bit about like what percent of vehicles you thought were previously going to be going into California? Has the voucher eligibility changed that geographic mix? Or was that already kind of a big part of it with the expectation that would be potentially there?

Duane Hughes
CEO & Director

Yes, this is Duane. I would tell you right now, in our current backlog, we'd be roughly looking at 10% to 15% of the initial deliveries, if you will, of the initial backlog going into California and probably increasing past that pretty quickly. But based on where we currently believe these vehicles will be being placed within our current customer base, roughly 15% would be going to California.

Operator

At this time, this concludes the company's question-and-answer session. If your question was not taken, you may contact Workhorse's Investor Relations team at wkhs@gatewayir.com. I'd now like to turn the call back over to Mr. Hughes for closing remarks.

Duane Hughes
CEO & Director

Well, thank you for joining us on our call today. We especially want to thank our employees, our partners and clearly, our investors for their support. We appreciate your continued interest in Workhorse, and we look forward to updating you on our next call. Operator?

OperatorThank you for joining us today for Workhorse Group's Second Quarter 2020 Earnings Conference Call. You may now disconnect.