# Ampco-Pittsburgh Corporation

## Second Quarter 2017 Results Conference Call

## August 8, 2017 at 10:30 a.m. Eastern

**CORPORATE PARTICIPANTS**

**John Stanik,** *Chief Executive Officer*

**Michael McAuley,** *Vice President, Chief Financial Officer and Treasurer*

**Melanie Sprowson,** *Director, Investor Relations*

## PRESENTATION

### Operator
Good morning and welcome to the Ampco-Pittsburgh Corporation Second Quarter 2017 Results Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star, then 1 on your telephone keypad. To withdraw your question, please press star, then 2. Please note this event is being recorded.

I would now like to turn the conference over to Melanie Sprowson, Director of Investor Relations. Please go ahead.

### Melanie Sprowson
Thank you, Anita, and good morning to everyone joining us on today's second quarter conference call. I'm joined by John Stanik, our Chief Executive Officer, and Mike McAuley, Vice President, Chief Financial Officer, and Treasurer.

Before we begin, I would like to remind everyone that participants on this call may make statements or comments that are forward-looking and may include financial projections or other statements of the corporation's plans, objectives, expectations, or intentions. These matters involve certain risks and uncertainties, many of which are outside of the corporation's control. The corporation's actual results may differ significantly from those projected or suggested in any forward-looking statement due to a variety of factors, including those discussed in the corporation's most recently filed Form 10-K and subsequent filings with the Securities and Exchange Commission. We do not undertake any obligation to update or otherwise release publicly any revision to our forward-looking statements.

A replay of this call will be posted on our website later today and remain available for two weeks following the conclusion of the call. To access the earnings release or the webcast reply, please consult the Investor section of our website at ampcopgh.com.

Now let me turn this call over to Mike, who will provide an overview of the company's financial performance for the second quarter.

### Michael McAuley
Thank you, Melanie. Good morning everyone, and thank you for joining our call. I hope you had a chance to read our earnings release issued this morning. I will focus my discussion today on our Q2 2017 results, walking you through the consolidated P&L first and then providing more detail at the segment level. Then I'll turn the call over to John Stanik for his comments.

Ampco's net sales for the second quarter of 2017 were $110.6 million. This compares to net sales for the second quarter of 2016 of $93.3 million. Net sales in the Forged and Cast Engineered Products segment rose 23 percent compared to the prior year, driven primarily by the inclusion of the acquired ASW Steel business. Net sales for the Air and Liquid Processing segment for the second quarter of 2017 approximated their Q2 2016 level.

Selling and administrative expenses were $14.9 million, or 13½ percent of net sales for the second quarter of 2017, and this includes the impact from the recovery of a receivable associated with a customer bankruptcy. This compares to SG&A of $15.2 million, or 16.3 percent of net sales, for the second quarter of 2016. Depreciation and amortization expense for the second quarter of 2017 increased slightly versus prior year due to the acquisition of ASW.

Loss from operations for the second quarter of 2017 was $2 million. This compares to a loss from operations in the prior year of $4.9 million, which included the Åkers acquisition-related costs and purchase accounting impacts. I'd like to bridge that further for you in my segment level discussion momentarily.

Other expense net for the second quarter of 2017 was modestly favorable versus prior year, but there are a few moving pieces here. Interest expense is up modestly on the full year effect of debt associated with the Åkers acquisition, and the amortized cost of interest on our revolving credit and security agreement executed in May of last year, but this was offset by foreign exchange gains recorded this year, with the weaker dollar versus foreign exchange losses recorded in last year's quarter.

Year to date, the story is a little different. Other expense net is unfavorable by $2.2 million year to date versus prior year. Of this, interest expense is $1.1 million higher from the full year effects of debt connected with the Åkers acquisition, early termination of the ASW credit facility debt, and the interest and fees on the Ampco revolver. Even though the dollar weakened in Q2, it's still stronger year to date, so we have foreign exchange losses recorded year to date 2017 versus gains recorded year to date last year, so quite a swing there.

The modest income tax benefit for the current year quarter reflects two key issues. First, we continue to include valuation allowances against the majority of our deferred income tax assets, which we began recording in part in Q2 last year, as three-year cumulative losses began being triggered in certain subsidiaries. However, an income tax provision has been recognized for certain subsidiaries this year, not in or not likely to be in a three-year cumulative loss position. Secondly, we recorded a discrete item in the quarter of a half million dollars for the receipt of state income tax refunds. As a result, the corporation incurred a net loss of $1.9 million, or 16 cents a share, for the second quarter of 2017 compared to a net loss of $6.5 million, or 53 cents per common share, for the second quarter of 2016.

Now I'll give some color on our operating segment results. Net sales for the Forged and Cast Engineered Product segment for the second quarter of 2017 rose 23 percent compared to prior year. The majority of this was due to the addition of sales from ASW Steel, which we acquired in November of 2016. Higher shipments of forged engineered products, primarily frac blocks for the oil and gas industry, were nearly offset by lower shipment volumes of mill rolls than in the year ago quarter.

This segment recorded a small operating loss for 2Q 2017 as higher operating and raw material costs and lower absorption, resulting from the temporary idling of a foundry during the quarter were only partly offset by the benefit of the higher sales volumes and the recovery of a portion of a pre-petition accounts receivable associated with a customer bankruptcy. This compares to larger operating losses in the year — in the prior year periods, which reflect comparatively lower sales volumes and unfavorable purchase accounting effects associated with the Åkers Group acquisition last year.

Net sales and operating income for the Air and Liquid Processing segment for the second quarter of 2017 are comparable to prior year quarter levels. Backlog at June 30, 2017, approximated $301 million, a 29 percent increase from the $234 million in backlog at December 31, 2016. This increase is primarily from higher order intake, particularly in mill rolls and frac blocks as well as higher order intake in each of the Air and Liquid Systems businesses.

Now, taking a look at working capital movements and cash, accounts receivable at June 30, 2017 increased approximately $9 million from December 31, 2016, primarily from higher sales, offset in part by collection of some older receivables and some mix changes. Inventories at June 30, 2017, increased approximately $12.8 million from December 31st. The inventory build is primarily due to increased production levels in the Forged and Cast Engineered Products segment on higher order booking levels for frac blocks and roll demand.

Accounts payable at June 30, 2017, increased approximately $5.3 million from the balance at December 31st, reflecting the higher production levels. Cash and cash equivalents of $21 million at June 30, 2017, is stable sequentially and declined $17.1 million compared to December 31st. Some significant uses of cash year to date included the inventory build to support sales growth, which I just mentioned. Capital expenditures of just over $6 million year to date, dividends paid of $2.2 million, retirement of the revolver balance and the term loan assumed in the ASW Steel acquisition, which was approximately $8 million, inclusive of early repayment fees, which we effectively refinanced by drawings on the Ampco revolver of about the same amount but just staged a few months later. And it's worth noting that the corporation has significant additional undrawn capacity available under its revolving credit facility.

I'll now turn the call over to John Stanik. John?

**John Stanik**
Thank you, Mike. Good morning. I'll begin my comments with additional explanation of our second quarter. We continue to make progress in improving the financial performance of our company. In fact, I would say we are ahead of where we thought we would be at the end of the second quarter. I know that, because that progress occurred despite some significant negative factors. Since the fourth quarter of 2016, we have seen significant increases in the cost of major raw materials used in the manufacturing of forged and cast engineered products. I'll give you a few examples.

As a result of the recovery in North American oil and gas markets and additionally cutbacks in production, molybdenum prices have risen by approximately 40 percent in 2017. Ferrochromium increased approximately 74 percent during the same period. These increases are due to the growth in production output of stainless steel in North America and therefore increased consumption, and also to some degree the consolidation of producers. Roskill Information Services, a metals and minerals research company who provided this data, predicts that these raw material prices will remain strong at least through 2017.

And, finally, scrap, which is the largest volume raw material we utilize in our melting operations, is up 83 percent during the same period. Comparatively, quarter over quarter, raw material cost increases accounted for nearly $1 million in the second quarter alone versus last year. Remembering that there's approximately a six-month delay in the various pricing surcharge models that are utilized to recover such cost increases from our roll customers, there can be no relief beginning until Q3. In fact, to make matters worse, we actually paid to customers net surcharge credits in amounts approximating $200,000 during the second quarter due to raw material cost decreases that occurred in the second half of 2016. Obviously, this exacerbated our cost problem.

Another issue that occurred during the second quarter was that of product mix. We shipped a higher proportion of smaller rolls than larger rolls. Typically, small rolls generate lower profit margins. I don't have a value for this, but the result is a general lowering of gross margin.

The next item has to do with our plant in Pennsylvania. As we have communicated in previous calls, we have reduced operations at our Pennsylvania cast roll plant beginning in April of 2017. The operating loss at this site alone was more than $2½ million in the second quarter. While some of the costs associated will be reduced in Q4, a sizable operating loss will continue for the remainder of 2017 and then abate.

And last but not least, we struggled to add the production staff necessary to manufacture and ship the increasing volume of business we received. Due to low regional unemployment rates and higher industry activity, machinists are in short supply. This shortage is resulting in increased wages for this kind of expertise, and some recently hired machinists are leaving to pursue higher wages. Of course, our collective bargaining agreements lock in wages for us. Consequently, we were forced to outsource a significant amount of work, thereby surrendering some of the margin that we would have realized had we had the necessary manpower in Q2. The spend for this approached $700,000 in the quarter.

There was one positive cost development in the second quarter that Mike mentioned that has to do with the effects of foreign currency exchange. The net effect of foreign exchange, which is recorded in the Other Income/Expense for the second quarter, was positive by $360,000, but it is still negative by $700,000 for the year.

Although we reported a loss from operations of approximately $2 million for the second quarter, the sum of the negative impacts of the headwinds I've provided totals roughly $4½ million on the operating line. As time progresses, these problems will fall off and future performance should improve as a result.

Now let's look at some positive developments. Despite the problems that I mentioned with staffing and the cost of raw materials, we were able to grow revenue significantly by minimizing late shipments to customers. This performance, in my opinion, directly resulted in more bookings initially in early Q2 for 2017 and later in Q2 for orders delivering in 2018. June margins were approximately 150 bps higher than year to date. This is encouraging. I don't believe that this was due to price increases but, rather, due to the high volume of production and consequently higher fixed cost absorption. Of course, our continued implementation of Lean techniques, cost reductions, and productivity gains also contributed to the margin increase.

Additional force reduction resulting from the continuation of the idling of that Pennsylvania cast roll plant occurred during Q2. Another reduction is possible in the third quarter, after which we will be down to approximately 25 percent of the original workforce. The monthly negative impact to P&L for this plant should continue through the third and fourth quarters, approximating $900,000 to $1.1 million per month, but during the fourth quarter, there should begin to be some relief in benefit costs from the forced reductions in April and early June. And, as a reminder, the reason that we are idling this plant is to bring our manufacturing capacity utilization to its highest point after the acquisition of the Åkers Group.

The company announced another price increase for the Forged and Cast Engineered Products segment early in July. The target increase of approximately 10 percent is an attempt to continue to recover more of the cost increases suffered in 2017 that I previously described. Throughout the second quarter, we have continued to raise the price for all product lines and have been successful, with highest increases for orders received for shipment in 2018. The second quarter was also a period during which we received growing levels of open die forged product sales. The majority of the increase is for frac blocks. In fact, we expect we will set records for the monthly manufacturing of blocks to our highest levels ever beginning in September.

I'm also happy to report that other open die business orders, beyond oil and gas frac blocks, are also being received and manufactured. Internally, we have formed an open die forged business development team whose sole focus is to study market potential, specific product requirements, and obtaining trials for our manufacturing operations so that we continue to increase sales in this new and important area going forward.

Roll new product development continues to move forward. The first new roll product will launch in December of this year. Trials continue to go extremely well. In fact, customers who have successfully trialed this product are requesting orders for next year, and additional customer trials are planned. All new products will demonstrate superior longevity and will be priced accordingly as a premium performance product.

Next I'd like to make a few comments about our June 14th dividend announcement. You may recall that in previous quarterly conference calls, I've mentioned that our Board thoroughly reviews the appropriateness of continuing the dividend payout each and every quarter. During 2017, the metals market has recovered somewhat, and nearly all forecasts that I have read predict 2018 also to be a strong year. Our order book for 2017 is nearly sold out, and we are rapidly receiving orders for 2018. It became clear to us that we were getting close to capacity level with certain of our critical manufacturing processes and that we could obtain even more volume at attractive prices.

But beginning in late Q1 and into Q2, we identified specific capital investments that are needed in order to do so. While there is no single major investment, the combination of high return projects is significant and totals in the millions. Additionally, remember that the seller notes issued in connection with the acquisition of the Åkers Group, are due in early 2019; nearly $30 million, which is not a trivial amount for us.

Finally, as we continue to grow Ampco-Pittsburgh, acquisitions are certainly possible. At this time, I will not discuss what these acquisitions may be, but I will say that we are definitely interested. All of these factors combined caused us to suspend the dividend to pursue higher returns for our cash generation. As we expect the company to return to profitability and to grow that profitability, the Board will reassess the status of the dividend on a quarterly basis in and through 2018. We appreciate the acceptance and the patience of our current shareholders for this decision.

Let's look ahead. Historically, the third quarter every year is the period during which we revisit our strategic plan and modify it as is appropriate. This year we will be adding significant detail to our diversification initiatives into the open die forging marketplace. The plan will be finalized and presented to our Board of Directors at the end of Q3. 2018 is the third year of our three-year strategic plan. The detail that we are adding is extremely important as it will create the early roadmap for the further evolution of our business.

Next year we will create a new five-year strategic plan, which will address the needs of the company to grow and hopefully approach the $1 billion revenue level during that period. Looking at the shorter term, i.e., the third quarter of 2017, and based on customer delivery requests holding, we expect a small revenue increase over the second quarter. More significantly, we expect last year's price increases and raw material surcharges to begin to hit P&L.

They will not hit simultaneously, but during the quarter, they are expected to increase monthly. As I mentioned earlier, we are hoping to set a new volume record for frac block production in September that we hope will grow even further through year end. I do have a word of caution. July was the month during which we conducted annual plant maintenance shutdowns at most facilities. This of course reduced our production volume, which in turn will cause the third quarter revenue line to start slowly. We will see if we catch up in August and September and thereby overcome the weaker July revenue month.

The third quarter is also normally a substantial bidding period for 2018 roll business, and as we related in the July price increase announcement, we will continue to push price and thereby recover higher costs for our raw materials. Sequential improvement from our financial performance in Q3 is certainly possible but not yet assured. It depends on the mix of the products which will actually ship and the impact of the price increase and surcharge for the products which do ship during the quarter. Our Air and Liquid Processing segment is sold out through the quarter, and we expect the typical stable and strong performance that we have been accustomed to receiving previously from that segment.

We will now take your questions.

## QUESTIONS AND ANSWERS

**Operator**
We will now begin the question-and-answer session. To ask a question, you may press star, then 1 on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star, then 2. Please limit your questions to one question and one follow-up. If you have additional questions, please rejoin the queue.

Our first question comes from Michael Gaugler with Janney. Please go ahead.

**Michael Gaugler**
Good morning, everyone.

**John Stanik**
Good morning, Michael.

**Michael McAuley**
Hi, Mike.

**Michael Gaugler**
I wanted to follow up a bit on your third quarter commentary. You know, you kind of alluded to price increases and raw material surcharges as being a positive, and then kind of backed off a little bit in terms of July having some shutdowns in plants and whatnot. So I'm just wondering, are we looking for margin improvements in 3Q, or are we relatively static at this point.

**John Stanik**

No, we're looking for increases, Michael. I think that the point of my comments — I guess, let me back up a step. We are very close to becoming a consistent profitable company, we believe, and I'm trying to, honesty here, trying to ask our shareholders to be a little patient. We're at a tenuous situation right now, where things are improving nearly in every single facet, but with the shutdowns, which typically last a week, we've not been able to catch up with all of the sales that we should have delivered in September, so our revenue was light. We believe our costs, although I haven't seen the costs for July yet, will be in line with what we've been accruing and expecting to spend on maintenance. So I'm just trying to hedge our bets a little bit and hopefully overproduce for the third quarter.

If our customers — and this is something we always have to worry about; I've mentioned it many times in the past — if our customers decide to delay shipments for three months, six months, which in the past has happened a lot, then that can throw our revenue projections into a less accurate position. So we're still moving forward. We're still pleased with where we are, we still very much look forward to the fourth quarter for sure and 2018, but I'm just a little bit concerned right now, because we're on this brink here, and I don't want to indicate over expectations.

**Michael Gaugler**
Understood. The comment you made about the total of the negative impacts in 2Q around $4½ million was very helpful, because if you just put that back on the operating line, yeah, you guys are more solidly profitable X those charges, and knowing a good chunk of those are going to fall away, certainly does look good going out into late in the year and '18.

**John Stanik**
Great.

**Michael Gaugler**
The other items I had, I noticed a jump in the equity gains line for the Chinese joint venture. It's just noticeable — wondering what was behind that, and is that a new run rate, or should we be looking more back maybe towards where our things were in the first quarter?

**John Stanik**
Yeah, I think maybe Mike and I both will have an answer to that, but let me give you the less numerical answer. All three joint ventures — the one with the acquisition of Åkers has just been fantastic, and we're very, very pleased about how that operation is running and is growing, and we plan to actually invest in expansions there. We're doing very well with sales throughout Southeast Asia.

The other two joint ventures, one which is the 25 percent equity stake, that business has been profitable. It is significantly profitable this year. One of the very largest government owned roll companies in China has temporarily idled, which has caused a shortage of rolls in China, and the two joint ventures that — the one we restructured that used to be with Masteel, and the other one, which is called Gongchang, have been picking up a lot more orders, so we believe that all three Chinese operations could actually be profitable this year, which is a huge turnaround from where those — at least one of those businesses has been in the past. Mike, do you have anything to add?

**Michael McAuley**
Yeah, I would say, Mike, looking at the P&L for the quarter, there's that like a half million dollars yearly income item for the earnings in that Chinese joint venture. That happens to be the Masteel

joint venture that we're reporting using the equity method, so, you know, the P&L results show there.

We did have a one-time item, in the quarter — and that's the payment for the sale of our equity in that affiliate to another Chinese roll maker, which we described in earlier calls about the restructuring of the Masteel joint venture. So we are receiving payment for that equity on an installment basis and recognizing it as we go, and we — and this was a quarter in which we received the second such installment.

**Michael Gaugler**
Okay, that's very helpful. And one — just one last one for John. The oil and gas end market, just wondering from your vantage point, you know, I know you said the order book's strong, but the end market itself, is it fairly steady staked, and you're taking share in terms of the orders and the demand, or is just the overall market accelerating?

**John Stanik**
Michael, pardon me, but I missed the first two words of your question. Did you say in the New Orleans —?

**Michael Gaugler**
In the oil and gas market.

**John Stanik**
Oh, I'm sorry, okay. Yes, I think it is stable. The oil price has been up and down during the quarter as we all know, but based on what we're hearing, what we're reading from the energy companies, those that are planning cutbacks seem to be planning cutbacks in exploration and deep well drilling, and the fracking businesses seem to be steady. We're looking at things regionally, and we know that we could be growing our sales beyond the current record levels by maybe another 40 percent or at least 25 percent before the end of the year. So we like where we're positioned, we like the commercial partners that we have representing us, and we're looking for continued strength, hopefully, through — at least through 2018.

**Michael Gaugler**
Okay. I'll — thank you, gentlemen. I'll jump off here and let someone else ask questions.

**Operator**
The next question comes from Justin Bergner with Gabelli & Company. Please go ahead.

**Justin Bergner**
Oh, good morning, John. Good morning, Mike.

**John Stanik**
Good morning, Justin.

**Michael McAuley**
Morning, Justin.

**Justin Bergner**
First question would be the customer bankruptcy recovery. Have you guys quantified that yet, or should we expect that to be quantified in the Q?

**Michael McAuley**
It will be in the Q, Justin, but I think you may remember that in the fourth quarter, I think we did disclose the amount of a reserve that we took for the bankruptcy of one of our customers for the Chapter 11 pre-petition receivable. It's — you know, we recovered approximately 92 cents on the dollar for that, and it was $1.5 million less in the fourth quarter that we disclosed as the reserve.

**John Stanik**
So about $1.3 million, Justin.

**Justin Bergner**
Okay. Secondly, I just wanted to make sure I understood all the moving parts of this $4½ million. I guess it seemed like the largest piece was reduced operations at your Pennsylvania cast roll plant. That was in excess of $2½ million, the outsourcing of some machinist work that was — I don't know if that was $700,000, or the $700,000 sort of included the associated volume benefit. And then what are sort of the other pieces that get me to that $4.5 million-plus of headwinds?

**John Stanik**
The raw material cost increase was about a million. The surcharge credits were about $200,000. And the outsource spend was around $700,000. Some of those numbers are a little conservative, and I —

**Justin Bergner**
In regards to the outsource spend, though, you would have had to spend some money if you had the internal staff, or —

**John Stanik**
Well, our workers were here. You know, if we had the people here, we would have had additional staff. We would have gotten additional favorability in fixed cost absorption, but, most importantly, when we outsource, we're paying those people that we outsource a profit, and, you know, what I hate most about that situation is that's our profit that we're giving away, and with pricing as tight as it is, it hurts. So I think in combination, that's a pretty safe that's pretty safe number.

**Justin Bergner**
Okay. And then, finally, you mentioned the outlook for Q3 and sort of the uncertainty of it, but hopefully better results than Q2. I just wanted to verify, you were talking about forged and cast roll profitability in Q3 versus Q2, and you were talking about it being less negative in Q3 or actually potentially positive in terms of that segment's EBIT?

**Michael McAuley**
Yeah, well — I mean, we — in terms of Q3?

**Justin Bergner**
Yeah. I was just trying to understand if your comment was talking about the potential for that business to be positive or just the potential to have a lower loss than Q2.

**John Stanik**
In terms of the segment itself, we expect that to be profitable. Will it be profitable in combination with the Air and Liquid segment to overcome our overhead expenses? That's the part that we're not sure of, and with respect to my comments, what I'm trying to do here, Justin, very candidly, is maintain my credibility. So I want people to understand the moving pieces and knowing that our July revenue month was about $7 million lower than we thought it would be, we're off to a slower

start, and while we honestly expect a better quarter than we had in the second quarter, there are some moving pieces that historically tell us that things could be not what they're expected. So all I'm trying to do here is I'm not trying to seem overly negative. I'm not trying to give negative predictions here so that we look good in the third quarter. I'm just trying to maintain credibility and not provide unreasonable expectations.

**Justin Bergner**
Understood. Thank you.

**Operator**
This concludes our question-and-answer session. I would like to turn the conference back over to John Stanik for any closing remarks.

**CONCLUSION**

**John Stanik**
Thank you. Hopefully, my remarks illustrate that the remainder of 2017 is looking to be a continuation of a positive transitional period for Ampco-Pittsburgh. We believe that we will soon return to profitable performance and do so thereafter on a consistent basis. A stronger market should mean a continued high level of utilization of our manufacturing assets. Re-investing the cash opportunistically which the business generates should ensure more revenue growth and growing profitability.

I won't forecast whether the third quarter will have an operating profit or not, but I think my comments demonstrate that we feel we are close, even considering that slow start we talked about for July. Any quarter in the near term that provides a profit should not be a surprise, and unless market conditions change, should be an indication of sustainable growing profitability in the future for our company.

Thank you for listening and have a great remainder of your day.

**Operator**
This conference has now concluded. Thank you for attending today's presentation. You may now disconnect.