AMPCO-PITTSBURGH CORPORATION

Moderator: Melanie Sprowson
August 3, 2016
10:30 a.m. ET

Operator: This is conference # 49553018.

Operator: Good morning. My name is (Dan) and I will be your conference operator today. At this time, I would like to welcome everyone to the Ampco-Pittsburgh Corporation's Second Quarter Earnings Call.

All lines have been placed on mute to prevent any background noise. After the speaker's remarks, there will be a question-and-answer session.

If you would like to ask a question during this time, simply press star then the number one on your telephone keypad. If you would like to withdraw your question, you may press the pound key. Please limit yourself to one question and one follow up question, and rejoin the queue if you have further questions. Thank you.

Melanie Sprowson, Director of Investor Relations, please go ahead.

Melanie Sprowson: Thank you, (Dan). Good morning, and thank you for joining Ampco-Pittsburgh Corporation's second quarter 2016 earnings conference call. I'm joined today by John Stanik, our Chief Executive Officer; and Mike McAuley, Vice President, Chief Financial Officer and Treasurer. Before we begin, I need to make the following reminder regarding forward-looking information.

Statements or comments made on this call may be 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 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 Web site later today and remain available for two weeks following the conclusion of the call. To access the earnings release or the Webcast replay, please consult the Investors section of our Web site at Ampcopgh.com.

Now let me turn this call over to Mike McAuley, who will provide an overview of the second quarter 2016 results.

Mike McAuley: Thank you, Melanie, and good morning, everyone. Before I begin my review of the second quarter financials, let me remind our listeners today that our results for this second quarter of 2016 include a full-quarter effect of the acquisition of Åkers AB and certain of its affiliated companies, which was completed on March 3, 2016.

Any comparisons made with the prior year and sequentially versus Q2 will be heavily influenced by the inclusion of this acquisition now and our results. We only had one month's worth of activity for this acquisition recorded on our Q1 2016 results. In addition, while our press release for this morning provides commentary on both the quarter and year-to-date, I'll focus my comments today primarily on Q2's results.

Sales for the Corporation for the second quarter of 2016 were $93 million; this compares to sales for the second quarter of 2015 of $60 million. Total sales for the current quarter for the Forged and Cast Engineered Products segment were nearly double the level of sales recorded in the same period of the prior year, driven primarily by the inclusion of the acquired Åkers businesses. Sales for the Air and Liquid Processing segment for the second quarter of 2016 were down slightly from the prior year, and I'll comment more on this segment results in a moment.

Gross profit is a percentage of net sales was 17 percent for the second quarter of 2016 versus 19.6 percent for the second quarter of 2015. The decrease is primarily due to the effects of purchase accounting associated with the acquisition, which impacted gross margin by approximately 240 basis points in the current quarter.

Selling and administrative expenses were $15.2 million for the second quarter of 2016 in comparison to $9.2 million for the second quarter of 2015; an increase of $6 million. Included in Q2 2016 are selling administrative costs for the acquired Åkers businesses of approximately $4.7 million, along with certain other acquisition-related costs incurred during the quarter.

Depreciation and amortization expense of $5.5 million for the second quarter of '16 is up versus the prior year, primarily from the inclusion of Åkers. Operating loss for the second quarter of 2016 was at $4.9 million, compared to a loss of $806,000 in the second quarter of 2015. The current quarter operating loss includes unfavorable pre-tax, purchase accounting and other acquisition-related costs of approximately $3 million as well as the effect of low-priced unprofitable sales from the historic Åkers contracts.

Compared to the second quarter of 2015, other income expense for the second quarter of 2016 included dividend income from a minority-owned joint venture in China. This was offset by higher interest expense primarily related to the seller notes and on some modest acquired debt associated with our Åkers acquisition as well as a foreign exchange loss of approximately $0.5 million in the current year quarter, compared to a modest foreign exchange gain recorded last year, given the strengthening of the U.S. dollar in Q2 primarily against the pound Sterling.

The Corporation's income tax provision for the second quarter of 2016 reflects the discreet item of full valuation allowances recorded against the net deferred tax assets of certain of our international operations. This discreet charge of $1.4 million in the quarter is attributable to having hit a threshold of cumulative loss positions in these entities.

Additionally, no tax benefit has been recognized on the losses incurred by these operations during the quarter, given their cumulative loss position. As a result, we are unable to record a net tax benefit in the quarter on our loss before income taxes.

From a bottom line perspective, the Corporation incurred a net loss of $6.5 million or $0.53 per common share for the second quarter of 2016, which includes the after tax impact of the previously mentioned unfavorable purchase accounting and other acquisition-related costs of approximately $0.24 per share and the unfavorable tax valuation allowances of approximately $0.12 per share. By comparison, the three months ended June 30, 2015, the Corporation's net loss was $520,000 or $0.05 per share.

Now looking at our segments, sales for the Forged and Cast Engineered Product segment for the three months ended June 30, 2016 were up more than 90 percent compared to the prior year level, driven predominantly by the inclusion of the Åkers businesses which added sales of $40.4 million for the current year quarter. This was offset in part by a lower volume of legacy European cast roll shipments, particularly to the European customer-base.

Legacy forged roll sales volumes improved versus prior year, but were approximately offset by a decline in the volume of open-die forged product shipments to the oil and gas industry. The segment recorded an operating loss for the quarter, driven by the inclusion of Åkers, including the unfavorable effects of purchase accounting and acquisition-related costs totaling approximately $3 million in the quarter, as well as the effect of low pricing in legacy contracts from Åkers.

Sales for the Air and Liquid Processing segment for the three months ended June 30, 2016 were 3.4 percent below the prior year quarter. The change is largely driven by lower heat exchanger coil shipments to the coal-fire power generation market. Operating income for the segment declined slightly primarily from lower volumes.

Backlog of June 30, 2016 was approximately $249 million, a 65 percent increase from the $151 million in backlog at June 30, 2015, primarily driven by the acquisition of Åkers. Backlog is down approximately 10 percent sequentially compared to March 30, 2016, principally due to lower order intake in cast rolls in Europe and translation impact on the change in foreign exchange rates. Backlog for legacy Union Electric Steel is steady sequentially and up slightly in the Air and Liquid Processing segment, compared to March 31, 2016.

With respect to the balance sheet, accounts receivable increased approximately $29 million at June 30, 2016 from December 31, 2015. The increase represents the inclusion of accounts receivables for the Åkers Group of about $33 million as of June 30, 2016, offset by foreign exchange translation effects in collections. Inventories also increased approximately $28 million at June 30, 2016 from year-end. Of this amount, $27 million represents inventory for the acquired Åkers Group.

In addition, higher purchases of raw material to support higher planned sales in our pumps business on the second half was largely offset by net inventory draws in other businesses. Accounts payable at June 30, 2016 increased almost $19 million from the balance as of December 31, 2015, mainly reflecting the balance of payables in the acquired Åkers Group.

Cash and cash equivalents of $46.5 million at June 30, 2016 declined $48.6 million compared to the balance of $95.1 million at December 31, 2015. Selected significant cash flows year-to-date included the cash portion of the Åkers acquisition purchase price, which was approximately $29 million, a payment of dividends of approximately $3 million, payment of asbestos-related liabilities, net of insurance recoveries of about $2.6 million and capital expenditures year-to-date of approximately $3 million.

I will now turn the call over to John. John?

John Stanik: Thank you, Mike. Good morning and welcome to our call. As you can see, it was a complex quarter, and consequently, I have a lot of news to communicate today. Let's begin with a brief recap of some of the highlights of the second quarter results. Although Mike covered this topic well, I want to offer my highlights for emphasis.

Once again, acquisition-related costs had a major impact on the results and overshadowed improvements made by our Forged and Cast Engineered Product segment. As one would expect, our sales increased dramatically year-over-year. This is attributable to the Åkers acquisition.

As we look at the $4.9 million operating income loss, purchase accounting treatment had a negative pre-tax impact of $2.9 million. Historical and contractual pricing, i.e., adverse contracts, remain key issues. And these, along with the low cast roll order volumes, are the primary weights upon the business in Q2.

A major point that deserves mention relates to synergy capture year-to-date, versus year-to-date P&L impact. We continue to make progress capturing synergies during Q2. Year-to-date, gross synergies secured are estimated in the range of $3 million, but our operating results are bearing the burden of upfront integration costs like severance as well as acquisition transaction costs incurred.

We expect to capture significantly more synergies in the coming months, and we expect the related costs to achieve those synergies to decline from Q2 levels during the remainder of 2016. The point I'm making is that our integration and synergy capture progress has been obscured by upfront costs, so our progress is greater than it may appear. Remember that Q2 represents only months two, three and four of our ownership of Åkers.

During our last quarter call, I referred to the need to right-size manufacturing for current business levels. While current business conditions in the steel industry are showing improvement, I still believe some right-sizing is appropriate. Consequently, we have provided notice to our employees at a few of our facilities as required by law before completing any reductions in force.

Our plan is to stay somewhat flexible and not to go as lean as prior month's utilization levels would suggest in case business continues to improve. A part of the reason for this thinking is stronger bookings that occurred in June for both forged and cast rolls. The reductions in force that I am referring to will occur partially in Q3 and partially in Q4. The delay is required because of the aforementioned process and notice periods.

Since I mentioned June bookings, I'll talk now about the state of the steel industry, as it has evolved during the second quarter. Several steel preliminary anti-dumping tariffs have been issued in the United States and Europe.

Based on second quarter financial reports from major steel companies, our customers, these tariffs have resulted in positive impacts such as increase in pricing and reduced imports of steel. Of the major steel producers who have reported second quarter results, significant year-over-year income improvements have occurred. I'm hopeful that June's bookings are an indication of some level of recovery for the industry that will be sustained for some period of time.

During the second quarter, we announced our intent to increase pricing for our forged and cast roll products. The increase is effective July 1, 2016. We believe that the timing was right and that this is an appropriate move on our part. We are expecting an average increase of 5 percent. The actual amount per customer will depend on the respective current pricing and recent history of business with each customer. It's too early to report any conclusions about the success of the price increase.

However, I will say that we are determined to improve the gross margins of our Forged and Cast Engineered Product segment.

We have taken thus far great steps to reduce our costs, improve efficiencies, and we have suffered much internal pain to do so. We will do everything we can to secure these increases form our customers, who appear to be enjoying improved financial performance. The increase we're requesting represents only a small part of product margin that has been lost over the past few years, and this increase should not be our last; rather, it is a form of compromise with our customers to begin to share in a small way for us the benefits that they are receiving currently.

In the past, I've talked about our efforts to diversify our Forged and Cast Engineered Product segment into the open-die forged products area. I am pleased to say that in July, inquiry levels for oil and gas industry-related products have increased.

In our press release, there was mention of the year-over-year comparison to the related business level, which has been down significantly in 2016 from first half 2015 levels. Should this recent increase in activity continue, it's possible that we may get a boost in this area in the second half of the year. I realize that oil prices have again declined, but market analysts are predicting an increase in activity and we have already received a few new orders.

During Q2, we secured a $100 million asset-based credit facility from a syndicate of three regional banks. This facility gives us added capital flexibility and the potential to continue to follow our strategic initiatives and be active in potential acquisitions.

Currently, we are looking into a few targets that would enhance our position in either one of our two operating segments. The credit facility provides us with a possible source of funding beyond our cash and equity resources. As I have said in the past, there are a number of interesting acquisition opportunities currently in interesting areas due to the prolonged, depressed conditions in the metals industry.

I've talked about the financial performance of the Åkers acquisition along with some of the accounting treatment items that hit the P&L in March and the second quarter. There has been a decrease of $3.1 million in the purchase price of Åkers based on the networking capital adjustment procedure included in the original purchase agreement. This adjustment has served to reduce the outstanding aggregate amount of the seller notes from $25.7 million to $22.6 million. This brings the total purchase price currently to $72.6 million from the original $80 million purchase price.

Since early 2105, we have been working on the potential restructuring of our Chinese joint venture that has had consistent poor financial performance. We are finally nearing the end of the process. Although, still subject to a few regulatory approvals in China, an agreement in principal has been established among us, our J.V. partner, Masteel Group Holding Company, and the new third party whereby we will sell a portion of our original ownership to that new third party.

This third party will take over the day-to-day operation of the restructured company. The new party, we believe, will give us an enhanced opportunity to make this venture profitable based on their historic performance. The remuneration for the partial sale of our ownership equity will be approximately $2.4 million in installments. The net effect on P&L should be a third quarter item.

What I have shared with you thus far has been news exclusively associated with our Forged and Cast Engineered Product segment. Regarding Air and Liquid Processing performance, I'm pleased to report once again that the financial performance continues to be stable and is profitable for all three businesses included in the segment.

We continue to work to replace the loss of the coal-fired power plant market segment for Aerofin, and hope to see some improvement in volume late this year or early next.

During Q2, we were advised that Ampco-Pittsburgh Corporation was added to the Russell 2000 and Russell 3000 Indexes. Following Russell Investment's annual reconstitution of its U.S. indexes at the end of June. Since that time, I'll mention our average daily trading volume has increased.

Let's look ahead. It's difficult to discuss third quarter financial performance considering all that is expected to occur in the coming quarter. This will be our second quarter of Åkers ownership and there remains much to do. Also, items such as the price increase, plant reductions in force, acquisition accounting adjustments, and the Chinese J.V. equity sale, all make this difficult. From a backlog standpoint and tentative customer projections for deliveries of products, revenues in Q3 should be in the same ballpark as the second quarter, plus or minus.

I believe and expect that we will continue to make progress capturing synergies, but beyond that, there are too many moving pieces for me to make any statement about operating income. I will say that should revenue in Q3 be similar to Q2's level, operating loss should be reduced significantly as some of the unusual noise in accounting treatments that we have incurred so far are behind us.

At this point, I will open up the call for questions.

Operator: And if you would like to ask a question, please press star then the number one on your telephone keypad. We'll pause for just a few moments to compile a Q&A raster.

And again, to ask a question please press star then the number one on your telephone keypad.

And we have no questions in the queue at this time. I turn the call back over to the presenters.

John Stanik: OK. I do have a closing comment. I believe we are making significant progress integrating Åkers into the Corporation. The second quarter was very early in our ownership, but we are clearly, at least from our standpoint, seeing progress. I'm also very encouraged by recent positive developments in the steel and the oil and gas industries. Should these recent developments continue, I would expect a positive future effect on our financial performance.

We continue to execute our strategic plan, we continue to attack our cross structure and to match our manufacturing capability to market needs. I am confident we are heading in the right direction and I'm confident that we are making progress.

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

Operator: This concludes today’s conference call. You may now disconnect.

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