Ampco-Pittsburgh Corporation

First Quarter 2018 Earnings Results

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CORPORATE PARTICIPANTS

John Stanik – *CEO*

Mike McAuley - *SVP, CFO and Treasurer*

Melanie Sprowson - *Director of Investor Relations*

PRESENTATION

Operator
Good morning and welcome to the Ampco-Pittsburgh Corporation First Quarter 2018 Earnings Results Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the "*" key followed by "0." After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*" then "1" on your telephone keypad. To withdraw your question, please press "*" 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, Carrie, and good morning to everyone joining us on today's first quarter conference call. I'm joined by John Stanik, our Chief Executive Officer, and Mike McAuley, Senior 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, please consult the Investors section of the 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 first quarter.

Mike McAuley
Thank you, Melanie.

Good morning to all our listeners today, and thank you for joining the call. Our earnings release for the first quarter of 2018 was issued this morning, and I hope most of you had a chance to read it. I will give you a financial review for the quarter by taking you through the consolidated P&L, and then I'll provide more color at the operating segment level, and then I'll review some of the key balance sheet and cash flow activity.

Before I begin, let me indicate that, effective with the beginning of 2018, the Company had implemented a few new accounting pronouncements, as will be detailed in our Form 10-Q being filed later today. For Ampco-Pittsburgh Corporation, only one of those new accounting standards had a significant effect on our Q1 P&L, and that is ASU 2017-07, improving the presentation of net periodic pension cost and net periodic postretirement benefit cost.

The amended guidance does not change the amount of net periodic benefit cost to be recognized, only where the components of it are to be recognized in the income statement. Previously, all components of net periodic benefit cost were reported above and hence as part of income from operations.

Beginning in 2018, only the service cost component remains recorded against income from operations, but the other components like interest cost, expected return on planned assets and the amortization of actuarial losses and prior service cost reside in other income expense net on our P&L.

The new standard was required to be adopted retrospectively, meaning prior year amounts had been adjusted as if the new standard were in effect. Accordingly, any comparisons I make today to the prior year also consider retrospective application of the new standard.

Ampco's net sales for the first quarter of 2018 were $115.1 million. This compares to net sales for the first quarter of 2017 of $103.5 million. Net sales in the Forged and Cast Engineered Products segment increased approximately 15% compared to prior year, driven primarily by higher sales of forged engineered products to the oil and gas industry. Sales of forged and cast mill rolls also increased.

Net sales for the Air and Liquid Processing segment for the first quarter of 2018 declined approximately 3% from the prior year quarter. I'll comment more on the business segment results in a moment.

Gross profit as a percentage of net sales was 17.7% for the first quarter of 2018 versus 18.1% for the first quarter of 2017. The decrease is primarily due to higher raw material and operating costs than a year ago.

Additionally, unabsorbed costs relating to the idling of the cast roll foundry, which was in full operation in the prior year, further impacted costs, but this effect was substantially offset by a higher volume of shipments and improved pricing.

Selling and administrative expenses were flat at $15.5 million or 13.4% of net sales for the first quarter of 2018 compared to 14.9% of net sales for the first quarter of 2017. The improvement in the percentage of net sales year-on-year was due to the fixed portion of the expenses spread over larger sales volume.

Depreciation and amortization expense of $5.9 million for the first quarter of 2018 was approximately flat with the prior year, also. Loss from operations for the first quarter of 2018 was $1.1 million. This compares to a loss from operations in the prior year of $2.6 million. The improvement reflects the impact of higher overall shipment volumes and higher product pricing, more than offsetting the effect of higher raw material and operating costs as well as a lower cost absorption related to the idling of one of our cast roll foundries. I'll expand on operating income changes a bit further in my segment level discussion momentarily.

Other income expense net for the first quarter of 2018 improved nearly $4.1 million versus prior year for three key reasons. In the current quarter, we recorded a one-time benefit of $2.4 million associated with a contractual settlement with a third-party. We recorded higher pension and other postretirement benefit income of approximately $1.1 million year-on-year, and we incurred approximately $400,000 of one-time cost in the prior year related to the extinguishment of debt of ASW Steel, which we acquired in November 2016.

The income tax benefit for the current year quarter includes, among other things, the effect of releasing a valuation allowance, which was previously established against the deferred tax asset of one of our foreign subsidiaries on the basis that it is now more likely than not that its deferred tax assets will be realized. We continue to maintain valuation allowances for the majority of our deferred tax assets.

As a result, the Corporation reported net income of $0.9 million or $0.08 per common share for the first quarter of 2018 compared to a net loss of $4.8 million or $0.39 per common share for the first quarter of 2017.

Now, here's a bit more detail on our operating segment results. Net sales for the Forged and Cast Engineered Product segment for the first quarter 2018 increased approximately 15% compared to prior year. Despite the loss of a key customer to a plant closure, higher sales volumes and prices of forged engineered products to the oil and gas industry was the primary driver.

Shipment volumes and pricing for forged and cast mill rolls also rose year-on-year. The segment recorded improved operating income compared to an operating loss in the prior year quarter. This is due to higher shipment volumes and improved pricing, partially offset by the effects of higher raw material pricing and higher operating costs as well as unfavorable cost absorption related to the idling of that cast roll foundry I mentioned, which was in full operation a year ago.

Net sales for the Air and Liquid Processing segment declined approximately 3% for the first quarter of 2018 versus prior-year as lower sales of centrifugal pumps to U.S. Navy shipbuilders was partly offset by higher sales demand for custom air handlers. Segment operating income declined compared to the prior year as a result of the lower volume and product mix.

Backlog at March 31, 2018, approximated $347 million, a 6% increase from the $326 million in backlog at December 31, 2017, and a 34% increase from the backlog at March 31, 2017. The backlog increase compared to December 31, 2017, reflects higher order intake in most of the Corporation's businesses.

Now to review some changes in the working capital accounts and some other cash related items - accounts receivable at March 31, 2018, increased $4.3 million from December 31, primarily from higher sales. Inventories at March 31, 2018, increased $10.6 million from December 31, 2017. The inventory growth is primarily due to increased production levels and finished goods inventories in the Forged and Cast Engineered Products segment on higher demand and some delayed shipments.

Accounts payable at March 31, 2018, increased $5.2 million from the balance as of December 31, 2017, reflecting higher raw material and operating expenditures associated with the higher production activity.

Cash and cash equivalents of $23 million at March 31, 2018, increased $2.3 million compared to the balance of December 31, 2017. Some key uses of cash so far in the quarter included trade working capital growth to support the sales and production growth I just reviewed and capital expenditures of about $2.9 million in the quarter.

Drawings on the Ampco revolving credit facility are $36.4 million as of March 31, 2018. In addition to the cash balance, the Corporation also has remaining availability on the revolver of approximately $40 million at March 31, 2018.

I will now turn the call over to John Stanik for his remarks. John?

John Stanik
Thank you, Mike.

Good morning. As Mike reported, revenue for the quarter in Q1 grew by approximately 11% year-over-year, and once again, we achieved improvement in reducing year-over-year operating loss. Revenue deviated from our expectations in January and February due to light shipments of product in those two months, much of which was due to customer shipment postponements.

Naturally, this also had a negative effect on margin and operating income compared to our expectations. I'm pleased to report that, as the quarter proceeded from month-to-month, our operating results improved, and this was expected.

Below the operating income line, there were a few interesting developments. First and foremost, due to an accounting standard change, pension income beginning on January 1, 2018, was moved from operating results to below the operating income line. I'll note that, if this required change had not occurred, the Company would've posted positive operating income for the quarter.

I'll also reiterate that, for the prior-year report to maintain an apples-to-apples comparison, the pension income impact was moved accordingly. Currency exchange impact was negative in the first quarter, equaling approximately $800,000. This too is an other income/expense line reporting item.

And finally, there was a sizable contractual settlement with the third-party, which provided a nonrecurring benefit of approximately $2.4 million. Due to the terms of the settlement, we are not able to disclose any details about the party involved or what was settled. All of this resulted in a positive net income and also a considerable year-over-year improvement in operating results.

During the early part of the first quarter, I instituted a number of organizational focus groups to concentrate on certain areas of the Company which I believe are not performing to expectations. These groups, which meet weekly, have specific targets and expectations. As a matter of fact, I personally chair one of these groups.

Additionally, due to the inconsistencies in our manufacturing operations in 2017, we have added senior resources to support the plants in the training of the many new manufacturing employees that have been hired over the course of last year and to increase maintenance and equipment reliability. We have added a continuous improvement function within operations that will expedite LEAN practice implementation and various training initiatives.

I'll ask you to remember that when the market recovered early last year, we needed to add a large number of new employees. It was a challenge to recruit the personnel that had specific experience in the manufacturing areas that were necessary. Therefore, we're dealing with a certain level of inexperienced operators. This added function will be responsible for providing the required training as quickly as possible.

Finally, within a few weeks, we will be adding a Global Maintenance Reliability Director to assist us in building and refining our proactive maintenance capability.

I want to speak for a moment about the price increases that we instituted last year as they relate to yet another surge in raw material costs that ensued over the course of this year's first quarter. The price increases introduced during the 2018 contractual bidding season, which actually took place from March to August of 2017, are certainly in effect today.

However, a renewed increase in raw material costs, which has occurred since January for alloys, also transpired. And since we do not have complete coverage of our customer base with variable surcharges to cover these more recent material cost, this constitutes a problem for us, and this is the purpose of the price increase that we reported in our announcement on April 18, 2018.

We realize that 8% to 10% sounds like a significant increase to our customers, but it is a value that we believe is fair. This increase will be implemented as quickly as possible, but the vast majority will be committed to the 2019 contractual bidding season, which began a couple of months ago and will run through this summer. We continue to negotiate with the customers who do not have the surcharge currently to implement one as soon as possible.

During the first quarter, we negotiated a new collective bargaining agreement with our largest manufacturing facility in the forged business, Harmon Creek. I'm very pleased with the fairness and cooperation that was demonstrated by the United Steelworkers Union. The contract includes freezing the defined pension benefit plan and also includes increases in contributory healthcare. Both of these areas are extremely vital to the Company remaining competitive over the course of the contract.

VICTURA™ - Since the introduction of the new TwinAlloy™ product family in December, the Union Electric Åkers sales team has reported successful trials in different mill types and applications and across three continents. In most cases, VICTURA™, the first grade in our new series, is the number one performer in these trials. In other instances, VICTURA ranks among the top three.

As of April, I'm pleased to say that we have achieved 50% of our 2018 VICTURA projected sales volume already. There is growing excitement in the roll market for this new breakthrough product line, and we have seen customers beginning to convert orders over to the new VICTURA TwinAlloy grade.

I'll speak for a few moments about tariffs. The one thing that I'm confident about reporting in regards to the latest development on tariffs is that nobody's happy. Relief for certain countries and negotiated deals aren't making steelmakers happy, and the rest of industry is concerned about trade wars and rising costs.

Regarding our operations in Canada, the temporary exemption from tariffs has been extended until June 1 as NAFTA continues to be discussed. The data I have seen would indicate that less steel has been imported into the U.S. since the advent of the tariffs, but exemptions for certain countries or negotiated deals with others could dilute the potential impact of a general tariff on steel imports.

I can tell you this as it relates to our business, customers are extremely interested in the reliability of supply of rolls, and this is what's important to us. Compared to even last year, there is much more concern about not having rolls when our customers need them.

We are being asked to bid multiple years of supply in order to commit our capacity and guarantee product availability when the customer needs it. This is all very positive. The latest statistics imply that rolling mill utilization is up at least 12% from 12 months ago, and that's a substantial number.

While a few forecasters are beginning to express concerns about the state of the industry in 2019, we do not see any negative trends or any concerns from within the industry, especially which would affect us. Adding to that, with oil continuing to hover around $68 or $67 a barrel, we expect frac block shipments to remain strong at least through the end of 2018.

Regarding our equipment business, revenue dropped slightly year-over-year for the first quarter. That was primarily due to lower sales of centrifugal pumps to U.S. Navy shipbuilders year-over-year. The shipments to the U.S. Navy in the first quarter of 2017 were unusually high due to delays of those shipment in late 2016. Figuring all this in, the small reduction has not resulted in an appreciable reduction in operating income, and this group continues to perform consistently.

Succession Plan - Regarding the identification of my successor, I'm pleased to report that the board search committee is evaluating a long list of qualified candidates, and I expect that progress will be made during the second quarter related to interviews and follow-up discussions.

Having said that, within the Corporation, there were a lot of balls in the air right now related to improvement programs and other key areas of interest. The thrust of this is that this call may not be my last with you, although that is uncertain. My intent is to continue to assist the Company as long as I'm requested to do so.

Looking Ahead - As we look at the second quarter, backlog is up for both blocks and rolls, as Mike reported. I expect sequential revenue growth compared to the first quarter, and I believe, barring any currently unforeseen circumstances, improvement in our operating income line when compared to last year's second quarter. This will depend on the traction that is gained by the organizational focus groups that I mentioned earlier and their success in hitting their targets. As you may imagine, we are very focused on helping these groups to be successful.

Thank you. That concludes my comments. We will now take your questions.

QUESTION AND ANSWER

Operator
We will now begin the question and answer session. To ask a question, you may press “*” 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 “*” then “2.” At this time, we will pause momentarily to assemble our roster,

The first question will come from Justin Bergner of Gabelli & Company. Please go ahead.

Justin Bergner
Good morning, John. Good morning, Mike.

John Stanik
Morning, Justin.

Mike McAuley
Morning, Justin.

Justin Bergner
First question just relates to the inventory and the delays. Can you just remind me how much the inventory increased quarter-on-quarter, and sort of what was the cause of the shipping delays, and are they fully behind you?

John Stanik
The answer to your first question is about $10 million of inventory increase. The answer to the second question is no, some of these delays still have not shipped, which isn't terribly uncommon, unfortunately, in our business. We expect all of them actually to ship in the second quarter, but they did not ship in April. So, we had a light April just as we had a light beginning to the first quarter.

Justin Bergner
Is the shipment a transportation constraint, or is it a bottleneck on your manufacturing side?

John Stanik
Really, the delays we're talking about have nothing to do with us. One, the largest one had to do with a letter of credit that the customer did not get finalized. It's for China. And the others are a question of shipment related payments, so--and credit holds.

So, those are the two that I'm referring to, and I guess the remainder of the light shipments in the beginning part of 2018, the January/February light shipments were probably due to us and not getting our intermediate materials completed on time. Now, those issues are behind us as we had a very substantial shipment month in March.

Justin Bergner
Okay. Switching gears to the surcharges, I think you said last quarter that two-thirds of your shipments were on a surcharge mechanism, and I'm not sure if I recall this correctly, the goal was to sort of get to 80% plus. Has that two-thirds moved up, and if not, sort of of what will be the trigger points or sort of time horizons for that to move up?

John Stanik
No, it hasn't moved appreciably. The timing of new contracts or updated contracts for each of those customers will proceed over the course of this summer bidding season, and that would be the opportunity for us to go back to them and negotiate adding a surcharge. Included in that number--and remember, we talked to you in March, so it was less than two months ago--we did incorporate a surcharge for very large customer that didn't have one prior to 2018.

So, we expect to make more progress. Is the 80% realizable? We're really not sure, but we're going to give it everything we can because it's apparent in these last, let's see, I guess it would be nine months, that pricing for certain things, whether it's electrodes or refractory or scrap or metal alloys, is becoming quite volatile. So, it's important that we try and get as many of these in place as possible.

And even if we do, though, I ask shareholders to remember that there is a delay or a lag, as I've discussed on several previous calls, from when those surcharges actually hit the P&L, but that's our strategy.

Justin Bergner
Okay, thank you. And then lastly on the tariffs, I just sort want to make sure I understand the basics. I mean, in the U.S., to the extent you're producing in the U.S., imported forged and cast rolls will be subject to the tariff, and so you should have increased volume and pricing for such rolls that are made in your U.S. operations? Is that--?

John Stanik
--I'm not sure I understand the question, Justin.

Justin Bergner
So, imported forged and cast rolls to the U.S. Subject to sort of resolution of the European tariff situation, those could be subject to 25% tariffs or quotas. And so your U.S. operations and other parties' U.S. operation should benefit from improved volume and pricing to the extent tariffs or quotas take effect. Is that--I'm just trying to make sure that the usual rules of the game apply to your sort of niche of the steel industry?

John Stanik
No, I don't think that’s a good assumption. First of all, I think that Sweden and the U.K. are obviously ally countries, and we have the expectation that either exemptions for those countries or quotas will basically have no effect. And for our competitors who reside in Germany or Austria or Italy or those countries, we expect that they will also have exemptions and/or quotas.

So, I think the playing field from Europe will be level. Remember--but, let’s go back a step and remember that these tariffs we believe strongly do not involve rolls. Rolls are not on the list of tariffed materials. So, the tariffs are for more fundamental steelmaking than for rolls. Does that answer your question?

Justin Bergner
That does answer my question. So, just by virtue of taking raw steel and putting it into a roll, an international producer in Europe would avoid the tariff regime potentially entirely.

John Stanik
Yes.

Justin Bergner
Okay. Thank you. That does answer--.

John Stanik
--Now, let me add something. There is and always has been a desire from North American customers to receive rolls from North America, if for no other reason than just to have that reliability for quick turnaround of product as opposed for having material coming from another continent or across the ocean. So, there's a lot of interest right now by our customers to bring back the one plant that is idled. It's far too early to talk about whether and when that will happen.

But, I will mention because it's such a big issue and it has such--that idle plant has such a major effect on our financial performance that this would be a very positive thing for the Company if we can work out with the customers commitments for these rolls--and these would be additional rolls, not the current backlog that we have.

And I just want to mention that is something that's in consideration, but that will take a period of several months if and when that decision is made.

Justin Bergner
Okay, thanks. I'll hop back in the queue if there are other questions from other folks.

John Stanik
Okay.

Operator
Again, if you have a question, please press "*" then "1" at this time.

Our next question is a follow-up from Justin Bergner of Gabelli & Company. Please go ahead.

Justin Bergner
Okay, thanks. Just to wrap up on the import tariff question or lack thereof, obviously, you have a lot of operations in Europe including those that send rolls to the U.S. Do you see the sort of tariff situation as more of a sort of driver of uncertainty versus a distinct positive or negative, or how do you sort of size up the overall dynamics of the tariff situation as it relates to you?

John Stanik
Me personally, I think this a positive for our customers in North America, and I think that even with the dilution that may occur through permanent exemption for quotas from certain countries, I think it will dramatically improve the amount of steelmaking that has to be made in North America. So, for us, for our customers, it's almost assuredly a good thing. If it's a good thing for them, it's a good thing for us.

If it has a global impact on dumping or underpriced product that extends beyond North America, and I think it will eventually if not quickly, then I think that's a good thing for our Company from the standpoint that we're a global manufacturer. And I think there are things going on in China that have to do with environmental restrictions and other business type decisions that are being made by that government that also should or at least could have an impact on our business in China.

So, with respect to tariffs, I think that there will be a positive long-term impact for our customers, which is good for us, and I think that there are other positive things going on in the world that could also be a positive for us.

Justin Bergner
Okay, great. And then just one clarification question - the comment about rolling mill utilization up 12%, was that specific to the U.S., and was that up 12% or 1,200 basis points?

John Stanik
U.S., and it was 1200 basis points, excuse me.

Justin Bergner
Okay, thank you. And hope to maybe see you on the next call, as well.

John Stanik
Thank you.

Operator
Seeing no further questions, this concludes our question-and-answer session. I would now like to turn the conference back over to John Stanik for any closing remarks.

CONCLUSION

John Stanik
Our strategies continue to be executed successfully. Although our financial performance improvement quarter-to-quarter has been incremental, it has consistently been positive, and that should continue. We are working tirelessly to smooth out our rough spots in operations and to diversify our revenue base. We remain very positive about both the short-term and long-term future of this Corporation. Thank you for your time, and have a great remainder of your day.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines. Have a great day.