Ampco-Pittsburgh Corporation

Third Quarter 2018 Earnings Results Call

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CORPORATE PARTICIPANTS

Brett McBrayer – *Chief Executive Officer*

Michael McAuley – *Senior Vice President, Chief Financial Officer & Treasurer*

Melanie Sprowson – *Director, Investor Relations*

PRESENTATION

Operator
Good morning, ladies and gentlemen. Welcome to the Ampco-Pittsburg Corporation Third Quarter 2018 Earnings 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 one on your telephone keypad. To withdraw your question, please press star then two. We do ask that you limit your questions to one and one follow up, but you may reenter the queue at any point. Please note that this event is being recorded.

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

Melanie Sprowson
Thank you, Denise. Good morning to everyone joining us on today's third quarter conference call. I'm joined this morning by Brett McBrayer, 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 & 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 will remain available for two weeks following the conclusion of the call. To access the earnings release or the webcast replay, please consult the investor's section of our website at ampcopgh.com. With that I will turn the call over to Brett McBrayer. Brett.

Brett McBrayer
Thank you, Melanie. Good morning, everyone. I'll begin by reviewing a few of the key highlights from our third quarter 2018 results and also critical activities the organization has been engaged in since our last call.

As noted in today's press release, Ampco-Pittsburgh ended the third quarter of 2018 with sales of $112.2 million or an 8% improvement over the third quarter of 2017. Additionally, our sales ended the first nine months of 2018 at $354.7 million or an 11.6% improvement from the prior year.

Loss from operations was $6.7 million for the quarter compared to $3.2 million from our prior year quarter. For the first nine months, our loss from operations was $9.4 million compared to a loss of $8 million last year. The key drivers of this decline in quarter three operating income performance were the following: the United States tariff impact on our Canadian subsidiary, ASW; lower frac block sales in production; and higher operating costs. Mike McAuley, our CFO, will explain these results in more detail in a few moments.

An important question is what will Ampco-Pittsburgh be doing differently and what is our focus going forward? As I shared in our last earnings call, I wanted to gain a clear understanding of our current condition and leverage points for success as I stepped into my role four months ago. I visited several of our key customers and their facilities, both in North America and Europe, as well as 13 of our manufacturing locations both domestically and overseas. Following these exploratory visits, we began a deeper analysis of our portfolio and levers for improvement.

Based on this analysis, we announced last week the commencement of our restructuring with a divestiture of a non-core asset, the Vertical Seal Company, a division of Akers National Roll Company. This action was one of several currently in process. We anticipate our first round of actions will conclude in the second half of 2019. We expect our future business construct will yield a much improved cost structure and be better positioned to serve our customers now and in the future. Our actions will include improving the utilization and efficiencies of many of our key assets as well as the elimination of assets that are not deemed critical for our success.

Due to the sensitive nature of many of these actions, I cannot share the full details at this time.

In my recent face-to-face shift crew meetings, which are continuing through this month, I can say without hesitation that we have a talented and engaged workforce that is fully capable of delivering our required business transformation. With our significantly improved liquidity position, we are also focused on wisely reinvesting back into our business in areas that will drive bottom line improvements.

I will now turn the call over to Mike McAuley for a more detailed review of our Q3 financial results. Mike.

Mike McAuley
Thank you, Brett. Good morning, everyone, and thank you for joining our call today.

I will start off by giving a financial review for the third quarter by taking you through the consolidated P&L, followed by providing more color at the business segment level, and then I'll review some of the key cash flow activities in the quarter.

Ampco's net sales for the third quarter of 2018 were $112.2 million. This compares to net sales for the third quarter of 2017 of $103.9 million. Net sales in the Forged and Cast Engineered Products segment increased approximately 8% compared to prior year benefitting from higher sales of mill rolls and forged engineered products.

Sales for the Air & Liquid Processing segment for the third quarter of 2018 increased approximately 9% from the prior year quarter, primarily due to higher sales of centrifugal pumps to US Navy shipbuilders. I'll comment more on the segment results in a moment.

Gross profit as a percentage of net sales was 12.3% for the third quarter of 2018 versus 15.9% for the third quarter of 2017. The decrease is primarily due to unabsorbed costs of our Canadian operations, which is being adversely affected by tariffs and lower segment margins due to product mix and higher operating costs. These impacts were partly offset by a higher volume of shipments and improved product pricing.

Selling and administrative expenses were comparable at $14.5 million for the third quarter of 2018 versus $14.2 million for the third quarter of 2017. Depreciation and amortization expense of $5.7 million for the third quarter of 2018 was comparable to the $5.5 million for the third quarter of 2017. Loss from operations for the third quarter of 2018 was $6.7 million. This compares to a loss from operations in the prior year quarter of $3.2 million. The higher overall volume of shipments and higher product pricing were more than offset by the full quarter effects of tariffs, lower contribution margin and higher unabsorbed costs given the contraction in demand for frac blocks and equipment maintenance issues.

I will expand on operating income changes a bit further in my segment level discussion momentarily.

Other income expense net improved for the third quarter of 2018 when compared to the prior year quarter due primarily to higher pension and other post-retirement benefit income.

The income tax provision for the current year quarter includes income taxes associated with our profitable operations. An income tax benefit is not able to be recognized on losses for certain entities since they remain in a three year cumulative loss position. As a result, the corporation reported a net loss of $7.0 million or $0.56 per common share for the third quarter of 2018 compared to a net loss of $2.2 million or $0.18 per common share for the third quarter of 2017.

Here's a bit more detail at the business segment level. As I previously mentioned, net sales for Forged & Cast Engineered Products segment for the third quarter of 2018 increased approximately 8% compared to prior year. The current year period benefited from higher sales of mill rolls and forged engineered products. While sales of frac blocks have declined for the period, sales of other forged engineered products, primarily within Canada, more than compensated.

Despite the increase in net sales, the segment's operating results declined versus prior year due to higher operating costs, including the impact of equipment reliability issues, the full quarter effect of tariffs imposed by the United States on imports of steel products from Canada, and lower contribution margin and higher unabsorbed costs given the contraction in demand for frac blocks.

Net sales for the Air & Liquid Processing segment increased approximately 9% for the third quarter of 2018 versus prior year. Higher sales of custom air handlers and centrifugal pumps to the US Navy shipbuilders were offset by a lower volume of heat exchange coil shipments to the fossil-fueled power generation market.

Segment operating income increased compared to prior year due to the higher volume of shipments and favorable product mix.

Backlog at September 30, 2018, approximated $356 million, an increase of approximately 9% from the $326 million in backlog at December 31, 2017, and an increase of approximately 7% from the prior year backlog at September 30, 2017. The backlog increase compared to December 31, 2017, reflects improved demand, particularly from mill rolls, and higher order intake. Approximately $218 million of the current backlog is expected to ship after 2018.

Now, I will review a few selected significant cash related items. Cash and cash equivalence of $14.8 million at September 30, 2018, decreased compared to the December 31, 2017 balance. Some key uses of cash for the year thus far included asbestos payments of $5.5 million and capital expenditures of $8.8 million.

Drawings on the Ampco revolving credit facility are $13.8 million at September 30, 2018, which reflects a decrease compared to $20.3 million at December 31, 2017. At September 30, 2018, in addition to the cash balance, the corporation also has remaining availability on the revolver of approximately $45 million, net of an availability reserve associated with proceeds from a sale and leaseback financing transaction, which will be used towards the settlement of the promissory notes and interest due in March 2019.

I will now turn the call back over to Brett for some closing remarks. Brett.

Brett McBrayer
Thanks, Mike. As mentioned previously, we have commenced our first round of business restructuring activities. The entire organization will be engaged in the exchange process. We have multiple actions in different stages of maturity with more to be initiated in the coming months. I look forward to sharing the conclusion of each of these actions and our improvements through 2019.

Thank you. We will now take any questions.

QUESTIONS AND ANSWERS

Operator
Thank you, Sir. We will now begin the question and answer session. To ask a question, you may press the star then one on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, you may press the star then two. Again, we do ask that you limit your questions to one and one follow up, but you may reenter the queue at any time.

Your first question comes from Mr. Justin Bergner of Gabelli & Company. Please go ahead.

Justin Bergner
Hi, Brett. Hi, Mike.

Brett McBrayer
Good morning.

Justin Bergner
I just wanted to address liquidity. First off, is it sort of safe to assume that the proceeds from the sale leaseback transaction and the recent asset sale, which hasn't been explicitly quantified, will sort of be used more or less in equal amounts to pay the promissory notes when they become due?

Mike McAuley
Yes, those two forms of capital raised were intended to cover the promissory notes due in 2019. So we have got more than enough liquidity now with those actions, plus the availability on the revolver to handle that maturity coming due.

Justin Bergner
Then just a follow-on question on liquidity, just to make sure I understand. The $45 million availability on the revolver, is that effectively the availability before you would be exposed to the interest coverage, I believe it's interest coverage covenant under the revolver's terms or is it a smaller amount before you would be exposed to that covenant?

Mike McAuley
The covenants and our credit agreement are a fixed charge coverage ratio and it is a covenant like a credit agreement because it's an ABL. The fixed charge coverage ratio doesn't become required or it springs to life only if liquidity falls below a certain level and we have more than enough cushion there, so I don't expect it to be an issue. So that $45 million is availability, true availability under the revolver, plus there is a reserve in there that covers the value of the sale leaseback. It will be put towards the retirement of the notes. So you might be thinking that we have $45 million plus the proceeds that we're raising in the form of reserves which are dedicated towards the retirement of the subordinated promissory notes.

Justin Bergner

Okay, so you actually do have availability that's above the – so the sale leaseback, even though it's being used to retire the promissory notes does increase availability under the revolver?

Mike McAuley
Essentially, yes.

Justin Bergner
Okay. Thanks. I'll see if there are any other questions in the queue.

Operator
Once again, if you would like to ask a question, please press star then one. And our next question will be from David Wright of Henry Investment Trust. Please go ahead.

David Wright
Good morning. Reference the restructuring, you said you wanted to focus on core business, improve the cost structure, eliminate other assets. Can you put some context around that, what you see as Ampco's core business? I mean, it sounds like the company is going to be smaller as a result of this, but can you give us any vision of what the result is going to look like?

Brett McBrayer
I would say this, we are, we have, and will continue to be a roll manufacturer. That will continue to be a focus for us. The Air and Liquids System segment of the business we still see as a critical portion of what we do as Ampco-Pittsburgh. A lot of this restructuring will be looking at improving our efficiencies, our flow paths, the way to go to market in an improved condition. As I go through this process with the team, it's about taking out waste and steps in the business that we see as obstacles for us to improve our bottom line.

David Wright
So it sounds like less of a focus on asset sales and more of a focus on process?

Brett McBrayer
It will be both. We'll look at both. As I stated earlier, we'll look at assets that are underutilized that we can improve the efficiencies of, which will allow us to eliminate other assets in our portfolio. And so through these improvements I think we'll see, we will see opportunities to remove assets from the corporation.

David Wright
Okay. Mike, can you give us any update on the tariff situation, or perhaps quantify how it's affected you and what kind of a benefit the company would get if the tariff situation was solved?

Mike McAuley
The tariffs is one of the key drivers for the results in the quarter. It's really a couple of combined factors that have hurt our Canadian operations. Certainly, the tariff impact having a full quarter effect on that and we brought that up on the last earnings call that we were facing new headwinds. That and we foresaw a decline in frac block demand relating to contraction in demand through the supply chain.

Now, sure enough, in the third quarter we're feeling both of those impacts. And in fact, both of those impacts are weighing heavily on our Canadian subsidiary. The tariffs for obvious reasons; the trade activity, selling into the US has made it more expensive compared to competition and that has really resulted in problems with trade sales, lower production absorption, etc. But the other factor that's there as well is this contraction in frac block demand, which is our Forged Engineered Products offering into oil and gas, our Canadian operation provides the feedstock material, stainless material, which is a primary product and is subject to the tariff as well, but the demand is also down. So, it's a coincident of two coincidental timing issues related to both factors that have negatively impacted the results of our Canadian operation.

David Wright
Thanks very much. Good luck as you work through these things.

Brett McBrayer
Thank you.

Mike McAuley
Thanks.

Operator
And the next question will be a follow up from Justin Bergner of Gabelli & Company. Please go ahead.

Justin Bergner
Thank you. I just wanted to address a couple questions around some of the comments you made so far. On ASW, just remind us if you've applied for exemption and if there are any developments there. Then secondly, you mentioned some equipment reliability issues. Can you sort of address those, how much they weighed on utilization or profitability and what steps you're taking to get those behind you?

Mike McAuley
With respect to the tariffs, for certain technical reasons, which we believe are valid, we have indeed applied for exclusion relief through the proper channels and we have continued that process. With all of the applications for relief, it's a timing issue in terms of response. There's an open period for challenges from industry participants, but we've been working through that and waiting for definitive responses, so we have definitely pursued the tariff relief avenue.

We've also engaged in a process of engaging our congressional leaders with appeals for assistance. So, we've done as much as we think we can with regard to seeking relief.

I think it's up to speculation, but now that we're through the midterm elections that could have an impact. Where do the tariffs go from here is also up for speculation. I don't want to speculate where it's going to go from here.

But then to answer your second question on equipment reliability, we did have some equipment failure in one of our businesses. It did cause some fairly significant downtime. It affected product mix in the sense that certain product lines which tend to carry higher margins than other product lines were directly affected, and as a result we had shipment delays, higher maintenance cost and then the absorption effect of not being able to inventory the production. We just had a lack of production from the equipment downtime.

So that's something that we're working on and in effect addressing as fast as we can. Now with the improved liquidity position, it's not really an issue of capital availability so much as it is ability to affect the repairs with long lead items for spares. Any thoughts, Brett?

Brett McBrayer
What I would just add to that, Justin, as I noted before, we're going through this restructuring phase of the business. Out of that will be a clear definition of key assets and where we invest wisely the money

we raise as a business. So, we are very focused on putting the money where it needs to be to help move the bottom line in the right direction.

Justin Bergner
Okay. Just a quick follow up. If you were to eliminate the reliability issues and the ASW losses, would the core business be close to breakeven run rate? On a related topic, if the ASW issue persists, could you let's just say the steel tariffs are here for a while and you don't get exemption, is closing that an opportunity, closing that down an opportunity to sort of cut the losses? Or would that have ramifications on your US business at sourcing some of those slabs?

Mike McAuley
Well, those are some good questions, Justin. We haven't disclosed profitability of individual divisions below the segment level; however, I can say that year-on-year that particular subsidiary was responsible for the largest change in the operating income for the segment. It is a factor and that's the reason we highlighted it in our press release, in our disclosures on the call today. So, yes, it's a significant swing factor.

If you're looking strictly at the Forged & Cast Engineered Products segment, had we not been, I think you're on the right track with thinking about that. I just don't want to get into too many disclosures below the segment level detail.

What was the other part of that question?

Justin Bergner
ASW, if it continues to lose money and you don't get tariff exemption, can you effectively close it or temporarily close it? Would there be implications on the slabs, the US businesses that source those slabs, is that an option if the tariffs are here for the next five years?

Brett McBrayer
We're looking at all options in terms of ASW and the impact of the tariffs. Obviously, we are not taking a victim stance in this. We are being proactive. We are reaching out and looking at other potential avenues from a customer/supplier relationship in terms of ASW. Some new discussions have evolved since the tariffs have come into effect, which are encouraging. However, we'll continue to look at the business and the impact of that business and make determinations in the future. But, we will aggressively, as I said before, make sure that we're doing everything we can to keep all avenues open for ASW in light of a situation where the tariffs remain intact in the future.

Justin Bergner
Okay, understood. Thank you.

Operator
As a reminder, if you would like to ask a question, please press star then one. Our next question will come from Greg Venett, an investor. Please go ahead.

Greg Venett
Good morning. On ASW, is there any way from a standpoint of just trade, do we know is Canada a net importer of billets or what ASW produces? And does ASW mainly export to the United States for you to use internally or did you have other US customers for your product? What percentage of ASW's products are used internally and then what percentage of ASW goes Canada versus the United States?

Mike McAuley

Hi, Greg. It's Mike.

Greg Venett
Hi, Mike. I don't know if you can share that information or not.

Mike McAuley
I can give you a little. I would say Canada, from a total trade standpoint, I would say Canada is a net importer overall.

Greg Venett
Of what ASW produces?

Mike McAuley
Of primary steels, yes. Like you get some billets and things like that. But ASW traditionally, the majority of their sales have been exports into the US. So, with the tariffs that's obviously a negative development because there are alternatives for customers in the US that they can seek and that's been an issue.

But as Brett mentioned, we're not sitting still and watching this happen to us. We're reacting. And how we're reacting is we're looking and building more of an order book in Canada. And in the quarter, in fact, we had higher sales of products in Canada, so we've been moving in that direction and we've expanded the Canadian order book for ASW steel, which is a good thing, because it's an expansion of business and prepares us for even better balance when the tariffs come off. So, that's kind of how that's playing.

Then with respect to the split of sales from ASW as a facility with respect to intercompany versus trade, presently, with the decline in frac block demand, which has been a primary kind of internal, ASW is the internal source for the stainless material, that's down. That's down significantly from where it was. But it had constituted a significant portion of total facility sales.

In the recent quarter, with that demand being down, company demand being down, trade sales of the business are the largest majority of the sales. So it moves up and down.

Greg Venett
Okay. Is ASW, when the frac block sales were going well, was ASW operating at optimal capacity or was there excess capacity that you could produce even more if you had other customers let's say in Canada?

Mike McAuley
I think it's fair to say that the capacity of ASW and the size of the business has capacity to do more. Even if we go back to 2017 levels of production when intercompany transfers and we had a higher level, or the earlier portion of this year or the end of 2017 we had a higher demand for material flow for supporting the frac block business.

Greg Venett
You may have already mentioned this, this will be my last question, the reliability issues, the maintenance, capex or the down time, that sort of thing, was any of that at ASW or was that kind of spread throughout a number of different facilities? Was it concentrated in any one facility?

Mike McAuley
It was not ASW. It was another facility here in the US in the third quarter, the one we're referring to.

Greg Venett

That's something that you can control, so you anticipate through your maintenance capex spending that you can use your revolver on now, will that be done in the first quarter, second quarter or fourth quarter, actually?

Brett McBrayer
What we're trying to do with this improved liquidity position is, as I said before, target the maintenance spends, the capital improvements on the critical assets for our success. I mean, there's some that are pretty obvious to us in the business that we're attacking now. Those will progress through this quarter and into 2019 and I'm sure new ones will be identified as we go along this path. But it's going to be an ongoing improvement process, as you know, from a maintenance and reliability perspective. It really never ceases. We brought in some key resources in the organization that's helped us have a better focus on how to attack this in a much wiser, I would say, fashion, but we will continue the focus on making sure that the assets respond as they need to, to make sure we improve the business.

Greg Venett
Okay. Thank you for all your hard work.

Brett McBrayer
Thanks, Greg.

CONCLUSION

Operator
Ladies and gentlemen, this concludes our question-and-answer session and it will also conclude our conference call for today. We thank you for attending today's presentation. At this time you may disconnect your lines.