Ampco Pittsburgh Corporation

First Quarter 2023 Earnings Results

May 16, 2023

CORPORATE PARTICIPANTS

Kim Knox - *Corporate Secretary*

Brett McBrayer - *Chief Executive Officer*

Mike McAuley - *Senior Vice President and Chief Financial Officer*

Sam Lyon - *President, Union Electric Steel Corporation*

Dave Anderson - *President, Air and Liquid Systems Corporation*

PRESENTATION

Operator
Welcome to the Ampco Pittsburgh Corporation first quarter 2023 earnings results conference call. All participants will be in a 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 a question, please press star, then two. Please note this event is being recorded. I'd now like to turn the conference over to Kim Knox, corporate secretary. Please go ahead.

Kim Knox
Thank you, Viashanvi, and good morning to everyone joining us on today's first quarter 2023 conference call. Joining me today are Brett McBrayer, our chief executive officer, and Mike McAuley, senior vice president and chief financial officer. Also joining us on the call today are Sam Lyon, president of Union Electric Steel Corporation, and Dave Anderson, president of Air and Liquids Systems Corporation.

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 risk 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 statements, due to various risk factors, including those discussed in the corporation's most recently filed Form 10K 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. To access the earnings release or the webcast replay, please consult the investor section of our website at ampcopgh.com. With that, I will turn the call over to Brett McBrayer, Ampco Pittsburgh CEO. Brett?

Brett McBrayer
Thank you, Kim. Good morning and thank you for joining our call. As shared in yesterday's press release, Ampco Pittsburgh achieved a net income of $0.7 million, or $0.03 per share in quarter one of 2023. Sales were up 11 percent versus the prior year and 12 percent over the prior quarter. We experienced backlog growth in both of our Forged and Cast Engineered Products and Air and Liquid Processing segments, with total backlog up 16 percent versus the prior year and three percent over the prior quarter.

Our Air and Liquid Processing segment has now seen five consecutive quarters of record backlog. We continue to see strong demand for our products in North America, with softness continuing in Europe. The recently announced blast furnace restarts, however, in Europe indicate demand may be recovering. Our processing actions and expanded surcharges continue to improve the performance of our Forged and Cast Engineered Products segment.

Our U.S. equipment modernization program remains on track with completion expected in the fourth quarter of this year. From a health and safety perspective, our company had a solid quarter as we continue to focus on our goal of zero injuries in the workplace. David Anderson, President of Air and Liquid Systems, will now discuss his segment's performance in more detail.

Dave Anderson
Thank you, Brett. Good morning. In the first quarter of 2023, we continued to see the positive results of our strategic growth plan. One of our initiatives was to strengthen our sales force both internally and for our third-party representative network. The results of this quarter show the tremendous progress we have made with our sales teams.

Sales increased 42 percent versus prior year as all three divisions achieved double digit sales growth. Q1 sales of $28 million was the highest for any quarter in the last 10 years. Even with the higher sales level, our backlog grew once again to a new record this quarter, as order activity continues to be very strong. This means we have now achieved a new record backlog for five consecutive quarters.

As our sales have continued to grow, we have also addressed our manufacturing capacity to make sure our production capabilities allow our sales growth plans to continue forward. On April 1st, we leased 61,000 square feet of additional manufacturing space in Lynchburg, Virginia, that was needed as a direct result of the sales growth we are seeing at both our Aerofin and Buffalo Air handling businesses.

Operating income for Q1 was $3 million versus an income of $2.7 million in the prior year. The prior year income included $0.7 million in income for a one-time employee benefit policy adjustment. Excluding the one-time adjustment shows operating income growth of 50 percent versus prior year. With a record backlog, quarterly revenue at the highest level in more than a decade, and increased manufacturing capabilities, Air and Liquid is well positioned to continue forward with our growth plans in the quarters ahead.

Brett McBrayer
Thank you, Dave. I will now turn the line over to Sam Lyon, President of the Forged and Cast Engineered Products segment.

Sam Lyon
Thanks, Brett, and good morning. We had a strong first quarter with an operating income of $2.2 million versus a loss of $0.4 million in Q1 of 2022. A significant improvement in operating results year over year primarily reflects our pricing strategy initiated in January of ‘22, implementing surcharges for energy and transportation and base price increases.

In 2022, the world faced unprecedented inflationary headwinds, fueled by post pandemic demand issues, supply chain restrictions, the Russian Ukraine conflict, and the ensuing Europe energy crisis. In Q1 of 2022, sales pricing initiatives lagged our increased costs, particularly for raw materials, energy, transportation, and supplies. By June of ‘22, inflation hit a 41 year high of approximately nine percent before moderating. Counter to the instability of 2022, the first quarter of 2023 benefited from the tailwind associated with deflation and positive surcharge recovery as higher cost inventory was sold through.

In the forged engineered product area, referred to as FEP, a softening of the energy market, particularly in the U.S., lowered overall demand. Lower demand for oil and gas, high inventory levels for our customers, and increased imports have resulted in an approximately 70 percent decrease in the backlog of FEP products year over year. In the last month, we are seeing an increase in quoting activity for both oil and gas and distribution bar and anticipate improved shipments in the second half of 2023.

The World Steel Association estimates that the global steel demand, excluding China, will increase by 2.3 percent in 2023. Our customer base states similar sentiments, as evidenced by the restart of seven blast furnaces, the modernization of two additional blast furnaces, and investments in new aluminum rolling mills in the United States. Our forge roll backlog is robust, showing a 26 percent year over year increase and is reflective of a positive North American steel industry outlook, driven by increased demand from the automotive industry. Our total backlog was $258 million at the end of Q1, the third quarter of sequential growth and the highest of the last eight quarters.

For 2024, the World Steel Association estimates the demand to increase by another 2.5 percent in the U.S., with Europe growing by a robust 5.6 percent. Pricing negotiations are complete for 2024 for many of our larger roll customers. We are continuing to see a robust demand for our forged rolls and steady demand for our cast rolls made in Europe. The ability to increase pricing has remained strong as the market recovers and our customers desire to purchase locally to protect their supply security.

In our Burgettstown facility, we have installed the first of five new machining centers as part of our capital expansion and improvement program in the U.S. We are currently in the testing phase of the equipment, and the preliminary results are in line with our expectations. We are excited about the forthcoming positive impact on our operating results as we achieve the commissioning of the first machine tool. The remaining four machine centers and the new furnaces are scheduled to be commissioned by year end.

Brett McBrayer
Thank you, Sam. At this time, Mike McAuley, our Chief Financial Officer, will share more detail regarding our financial performance for the quarter.

Matt McAuley
Thank you, Brett. As shared in the press release and shown in the corporation’s Form 10-Q filed last week, Ampco Pittsburgh reported net income in the first quarter of 2023 of $0.7 million or $0.03 per diluted share. This compares to an approximate break-even position in the prior year.

Ampco’s net sales for the first quarter of 2023 were $104.8 million, an increase of approximately 11 percent compared to net sales for the first quarter of 2022. Net sales in the Air and Liquid Processing segment grew 42 percent year over year, driven primarily by higher shipments of heat exchange coils and air handling units. Net sales for the Forged and Cast Engineered Products segment in the first quarter 2023 were approximately three percent higher than the prior year period, primarily due to higher roll pricing and shipment volumes, offset in part by a decline in shipments of other forged engineered products and an unfavorable foreign exchange translation effect.

Income from operations for the first quarter of 2023 was $2.0 million. This compares to a loss from operations in the prior year of half a million dollars. Higher pricing and overall shipment volumes were the primary drivers for the improvement, despite the impact of lower manufacturing overhead cost absorption due to higher plant downtime this year in the Forged and Cast Engineered Products segment. In addition, the prior year quarter included a $1.4 million benefit for a change in an employee benefit policy, which reduced SG&A as well as cost of sales in Q1 of last year. Therefore, the underlying improvement in operating results versus prior year was even larger on a non-GAAP basis.

Interest expense for the quarter increased compared to prior year due to a rise in both total debt and interest rates. Backlog on March 31, 2023, of $380.6 million increased approximately three percent sequentially and rose 16 percent from a year ago. Backlog for the Forged and Cast Engineered Products segment increased approximately two percent sequentially and approximately seven percent year over year while backlog for the Air and Liquid Processing segment continues to be at record highs, up five percent sequentially and up 40 percent versus prior year.

Net cash flows used by operating activities was approximately $4.3 million for Q1 2023, primarily in support of working capital. This represents a significant improvement from Q1 of 2022 due to improved operating results and lower investment in overall working capital in the current year quarter. Capital expenditures for the first quarter of 2023 were $3.7 million primarily for the Forged and Cast Engineered Products segment. At March 31, 2023, the corporation's balance sheet and liquidity position included cash on hand of $6.1 million and undrawn availability on our revolving credit facility of approximately $31.0 million.

Operator, at this time, we would now like to open the line for questions.

QUESTION AND ANSWER

Operator
Thank you. We will now begin the question and answer session. To ask a question, you may press star, then one on your touchtone phone. If you're using the speakerphone, please pick up your handset before pressing the keys. If at any time, your question has been addressed and you would like to withdraw your question, press star, then two. At this time, we will pause momentarily to assemble our roster.

Our first question comes from Justin Bergner with Gabelli Funds. Please go ahead.

Justin Bergner
Hi, Brett, Mike, and the rest of the team. A couple of just clarifying questions -- so, I guess to start, I thought I heard you talking about 2024 pricing contracts on the Forged and Engineered Products side of the business. Did I hear correctly that you're entering into contracts for 2024, or was that just the consummation of 2023 contracts?

Sam Lyon
Justin, this is Sam. Yes. So, all the big customers, Arcelor Mittal, U.S. Steel, Cleveland Cliffs, people like that -- so, we are currently in negotiations for 2024, and many of those -- our allocations and pricing are established.

Justin Bergner
And is it earlier than normal to begin at this stage in the year?

Sam Lyon
No, it's actually -- it's a little earlier than last year just because lead times are going out. But it's typically done around this time of the year, even a little earlier sometimes.

Justin Bergner
Great. And then, the comment, I think, you made about the projected demand increase in the U.S. and Europe -- those were 2024 numbers as well?

Sam Lyon
Correct.

Justin Bergner
Okay. Switching to sort of more general financial questions -- the capex number -- did I hear it was $23 million, or did I hear too high of a number? And what is the projected current sort of anticipation for the 2023 year?

Mike McAuley
For the current quarter, I think we quoted $3.7 million for Q1.

Justin Bergner
Okay, thank you.

Mike McAuley
That was total capex. And then, for the full year, we are projecting in the range of $22 million or so.

Justin Bergner
Okay.

Mike McAuley
So, it’s going to be stepping up in the next couple quarters, coincident with the delivery of the machining assets that we’re -- that Sam described.

Justin Bergner
And I wanted to turn my attention to those. If all the machining assets are delivered by year end, how many quarters thereafter should one expect those assets to be operating at normal efficiencies or run rate efficiencies?

Sam Lyon
Probably six weeks to three months. Roughly, a quarter to get them up and running fully.

Justin Bergner
So, the full operating efficiency benefit should be sort of in the numbers by the second quarter or the mid part of 2024?

Sam Lyon
Yes.

Justin Bergner
Great. Thank you.

Operator
Again, if you have a question, please press star, then one to be joined into the queue. The next question comes from David Wright with Henry Investment Trust. Please go ahead.

David Wright
Hi, good morning. One for Dave. On the additional space in Lynchburg, will you have much capex to get that up and going?

Dave Anderson
David, no. There's not a lot of capex involved in it. Basically, putting in a crane is all we need to do. Everything is really minor. So, there's not a lot of capex for it.

David Wright
And how about labor to staff it? Is that going to be much of an issue?

Dave Anderson
No, we already have a good bit of the labor. They've been training in recent weeks. So, we expect we'll hit the ground running pretty quickly.

David Wright
That's great. Sam, I wanted to ask about forged and engineered products -- the drop in revenue in the first quarter is noticeable. And thanks for your commentary about the causes. I wondered -- what could we be thinking about for the entire year? Could we get to 2022 numbers or even 2021 numbers? Could it remain muted down here?

Sam Lyon
Let me just look at a file here. One second, David. I mean, the -- go ahead, Mike.

Mike McAuley
We think for the full year 2023, we should be exceeding 2022 sales for the Forged and Cast Engineered Products segment for full year '23 versus 2022, David.

David Wright
Right. But I was asking about FEP, which was like $43 million last year and just $5 million in the first quarter of this year.

Sam Lyon
We anticipate that to increase in the second half. But that's kind of yet to be seen. There are -- the frack spreads are increasing. The inventory is diminishing. We're starting to see activity. So, we fully expect next year to be higher than the 2022 number. But, again, that's yet to be seen.

David Wright
Right. So, if we went back three or four quarters, this was kind of an important part of the turnaround in that excess capacity could be used and you were going to step up the marketing efforts. I'm wondering, as we are today with new equipment starting to come in and the roll business being stronger and, I guess, more profitable, are forged engineered products still as important at the margin?

Sam Lyon
Yeah, they're still in our plans because, number one, it diversifies us and allows for some different markets. When the rolls may be down a little bit, that would be up a bit. So, it's still important to us. We're still going after it. But you are right. The increase in the forged rolls particularly -- the forged rolls in the United States is offsetting the drop in the FEP at this point in time. But we're not stopping our efforts to grow that side of the business.

Mike McAuley
But, David, we are staging our receipts of equipment and prioritizing our machine tools -- our machining assets first and the furnaces later. So, we acknowledge that there's been a market

factor going on in oil and gas. And so, what's coming in and what's going in first are the large lathes and the furnaces are coming later.

David Wright
Thanks. And then, two for you, Mike. SG&A costs in the first quarter -- is that going to be run rate for the year?

Mike McAuley
I don't think that we have an unusual quarter in that regard. I think the only major variable would probably be any movement in foreign exchange or if we have higher commissions on -- depending on where forged engineered products might go, depending on that last conversation we just had about that question. Those would be the variables in SG&A.

David Wright
And then, lastly, any sense of when the debt might peak, the absolute balance?

Mike McAuley
I expect the debt to peak probably by Q4 of this year based on the capex, the timing of that. And I think it will probably be reaching a peak of $119 million, $118 million, something like that.

David Wright
That's great. Thanks for answering these questions. And hey, that black ink is great and the progress that you're making, the plan that's starting to show up. So, continue. Good luck there.

Operator
Next, we have a follow up from Justin Bergner from Gabelli Funds. Please go ahead.

Justin Bergner
Thank you. Given the improved profitability of your forged and engineered products segment this quarter, would it be safe to say that your pricing mechanisms have caught up with your costs as it relates to some of these lagged surcharge -- lag surcharge or other pricing mechanisms that you might have put through? Or should we see further improvement in sort of that price cost dynamic as we get to the later quarters of this year?

Sam Lyon
I'd say it's caught up. And we don't know what's going to happen with some of these things right now. The energy market has been pretty stable as has been the raw materials and scrap. Some movement, but right now, it should be, I think, fairly well caught up. Do you agree, Mike?

Mike McAuley
I agree.

Justin Berger
Okay. Thank you.

CONCLUSION

Operator
As we have no further questions, I would like to turn the conference back over to Brett McBrayer for any closing remarks.

Brett McBrayer
Thank you. Our focus on improving financial performance continues with actions underway to accelerate growth and expand margins. The completion of our equipment modernization anticipated at the end of this year is a significant component of this strategy with full benefits expected to be realized in 2024. I want to thank our employees for their continued hard work and dedication. Their relentless focus on improving our business has been impressive. I also want to thank you, our shareholders, for your continued support. Thank you for joining our call this morning.

Operator
The conference has been concluded. Thank you for your participation. You may now disconnect.