Ampco-Pittsburgh Corporation

Third Quarter 2022 Earnings Results Call

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CORPORATE PARTICIPANTS

Michael McAuley – *Senior VP, CFO and Treasurer*

Brett McBrayer – *CEO and Director*

Dave Anderson – *President of Air and Liquid Systems Corporation*

Sam Lyon – *President of Union Electric Steel Corporation*

PRESENTATION

Operator
Good day and welcome to the Ampco-Pittsburgh Corporation Third Quarter 2022 Earnings Results Call.

All participants will be in a 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.

Please note this event is being recorded.

I would now like to turn the conference over to Michael McAuley, CFO. Please go ahead.

Michael McAuley
Thank you, Jason, and good morning to everyone joining us on today's third quarter 2022 conference call. Joining me today are Brett McBrayer, our Chief Executive Officer. Also joining us on the call today are Sam Lyon, President of Union Electric Steel Corporation, and Dave Anderson, President of Air & Liquid 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 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 statements, due to various risk 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. To access the earnings release or the webcast replay, please consult the Investors section of our website at ampcopgh.com.

With that, I will turn the call over to Brett McBrayer, Ampco-Pittsburgh's CEO.

Brett McBrayer
Thank you, Mike. Good morning and thank you for joining our call. As shared in our recent press release, Ampco-Pittsburgh recorded a net income of $0.8 million in our third quarter of 2022, delivering an earnings per share of $0.04.

We experienced a sales growth of 23% for the quarter and were up 14% year-to-date, versus prior year. The backlog for Air & Liquid Systems broke another record this quarter with no weakness in site.

In December, we will receive our first piece of new equipment for our U.S. asset modernization.

Our positive performance for the quarter was achieved, despite significant negative headwinds from European energy prices, they impacted volume in our facilities in Sweden, the U.K. and Slovenia.

We continue to see softening in the European market, which will continue, as long as energy prices remain at historically high levels. The North American market, however, remains strong for both Forged and Cast Engineered Products and Air & Liquid Systems.

From a safety perspective, I'm pleased to report that our performance for the quarter continues on a positive trajectory.

Now at this time, I will turn the call over to David Anderson, President of Air & Liquid Systems for comments on his segment's performance.

Dave Anderson
Thank you, Brett. Good morning. At the end of the third quarter, Air & Liquid Systems achieved another historic high in our backlog. This is the third consecutive quarter our backlog has reached a new record.

Backlog levels have increased 54% over the past nine months and 80% over the past 12 months.

We continue to see significant order activity, as the changes we have made to our sales force continue to show positive results. .

Sales in Q3 increased 20%, compared to prior year, primarily due to higher shipments of heat exchangers and custom air handling units. We continue to manage short-term supply chain-related issues, including extended lead times on materials and customer requested deferrals.

Operating income for Q3 was consistent with the prior year, as higher shipments were offset by unfavorable product mix. Year-to-date, operating income was 12.6%, above prior year.

Air & Liquid Systems is now 9 months into our multiyear strategic growth plan. Q3 sales were 22% higher than Q1 of this year, and our backlog has continued to achieve record highs, each quarter. In the quarters ahead, we will continue forward with multiple growth initiatives, as we build on the positive momentum we have already achieved.

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

Sam Lyon
Thank you, Brett. The Forged and Cast segment's backlog decreased 10%, sequentially, in the third quarter of 2022 and was up 2% since the beginning of the year. This is mainly due to choppy ordering patterns, a reduction of activity in the oil and gas business and unfavorable currency translation of our foreign backlogs.

The currency translation accounted for 30% of the decline, sequentially in Q3 and year-to-date, has reduced our backlog by approximately $16 million.

We had a very strong booking month of $35 million in October, which increased our backlog 6%.

We are seeing strong activity in the U.S. rural market, as there has been a shift towards a more local supply chain. Europe is soft, due to high energy costs there. We continue to flex costs and transfer products to our locations that can deliver the most value to our customers.

The intermediate term outlook for the U.S. is very strong with new projects being installed by Big River Steel, Nucor, Novelis and most recently, Steel Dynamics with their announced $2.5 billion aluminum mill. We traditionally have had a very strong position in aluminum mills.

We're also working toward a zero-carbon footprint in Sweden and are targeting certification to this effect, in 2026. This plant already has an extremely low carbon footprint and is 100--electricity is 100% supplied by non-CO2 producing generation.

Inflation has begun to moderate and, in some cases, has become deflationary. Key inputs such as scrap and moly oxide are in a deflationary position, when compared to the end of 2021. Transportation has moderated and is roughly flat, when compared to January of 2022.

Ferrochrome has remained stubbornly high due to the location of supply and energy-intensive nature of producing this material. Energy in the U.S. has moderated, as well as in the U.K., where we have experienced the largest headwinds.

The U.K. government has recently announced a price cap for natural gas and electricity, which has lowered the cost by more than 50%, which will last to the end of Q1 of 2023.

As stated previously, we worked tirelessly to get these volatile costs incorporated into a surcharge to insulate our business and results from these types of swings. We have been successful in this arena.

In addition, we have been able to increase base pricing in 2022 and 2023, but not at a level of general inflation. We will be focused on increasing base pricing and future contracts to recover costs such as general operating supplies to improve profitability. As Brett stated, our expansion and modernization programs for our U.S. plant assets continue forward.

The first machine will arrive in December with commissioning scheduled to be completed in Q1 of 2023. We will be completing acceptance testing on the next two machines, this quarter. Machine two and three are scheduled to be fully operational in Q2 and Q3 of 2023.

We are excited about these investments as they will provide a lower cost structure in our rural business and further growth in the nonrural business.

I will now turn it back over to Brett.

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

Michael McAuley
Thank you, Brett. We issued our Form 10-Q for the third quarter of 2022, yesterday, so I will just summarize some highlights for Q3, here.

Ampco's net sales for the third quarter of 2022 were $99.6 million, an increase of approximately 23%, compared to net sales for the third quarter of 2021, led by 23% sales growth in the Forged and Cast Engineered Products segment, which was driven by higher pricing, including surcharge revenues and higher shipments.

Net sales for the Air & Liquid Processing segment in the third quarter of 2022 were 20% higher than the prior year period, due to higher shipment volumes in the heat exchanger and custom air handling businesses.

Loss from operations for the third quarter of 2021 was $0.1 million. This compares to a loss from operations in the prior year quarter of $2.8 million.

The Forged and Cast Engineered Products segment operating results improved for the third quarter of 2022, compared to prior year primarily due to improved recovery of costs and higher shipments.

Air & Liquid Processing segment's operating results were comparable to the prior year period, despite the sales increase, given the less favorable sales mix, which was due to supply chain issues.

Other income expense net improved overall for the third quarter of 2022, primarily due to higher foreign exchange transaction gains, in addition to the timing of dividend income from one of the corporation's Chinese joint ventures.

This more than offset higher interest expense, driven by both higher borrowings and higher interest rates.

At the bottom line, the corporation reported net income attributable to Ampco-Pittsburgh of $0.8 million or $0.04 per diluted share for the third quarter of 2022, compared to a net loss of $1.6 million or $0.08 per diluted share for the third quarter of 2021.

Capital expenditures for the third quarter of 2022 were $6.7 million and are $13 million year-to-date, primarily in the Forged and Cast Engineered Products segment.

At September 30, 2022, the corporation's balance sheet and liquidity position included cash on hand of $12.2 million and undrawn availability on our revolving credit facility of approximately $35.6 million.

During the quarter, the corporation closed on some key financing transactions that, significantly, improved our liquidity position and to provide future financing for the strategic modernization CapEx plan in our U.S. Forged operations.

On August 30, 2022, our Air & Liquid segment completed a sale and leaseback transaction for its real estate at two plants in Virginia valued at $15.5 million, with a subsidiary of Store Capital, a major real estate investment trust.

This deal also included a supplemental disbursement agreement with UES of up to $2.5 million for building improvements at the Carnegie, PA, finishing plant for upgrades to be completed associated with the UES modernization program.

In addition, on September 29, 2022, UES entered into a master loan and security agreement with a leading equipment finance lender in which UES can borrow up to $20 million for specified equipment for its modernization CapEx program.

During the quarter, we drew $4 million on this facility to reimburse past supplier progress payments. These proceeds, plus the proceeds from the air and liquid sale on leaseback were used to pay down the credit line creating substantially more availability on the line. Hence, the transaction did not increase total debt.

As a result, as a subsequent event, in October, Air & Liquid also completed the sale and leaseback of its North Tonawanda, New York property to Store Capital.

These important financing transactions significantly enhanced our liquidity and positioned us to execute on our strategic capital reinvestment plan and looking forward to support our sales growth initiatives, ahead.

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 “*”, then “1” on your touchtone phone. If you are using a speaker phone, please pick up your handset, before pressing the keys. To withdraw your question, please press “*”, then “2”.

At this time, we’ll pause, momentarily, to assemble our roster.

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

Justin Bergner
Good morning, Brett. Good morning, Mike.

Brett McBrayer
Good morning, Justin.

Michael McAuley
Good morning, Justin.

Justin Bergner
I just want to better understand some of the financing transactions in the quarter and after the quarter. Maybe three quick clarification questions there. The $2.2 million, I didn't fully capture what that related to, as a financing transaction. That would be the first.

The second would be just a little more clarity on the $4 million that was drawn on the equipment financing facility to reimburse some past payments. And then the third, you mentioned sale-leaseback transaction in October for Air & Liquid handling for our New York facility, but I'm not sure you mentioned the amount.

Michael McAuley
Thanks for the question, Justin. So, start from the top. The--as part of the sale lease transaction--sale leaseback transaction we completed in September. We had an additional element that was included in the deal to fund up to $2.5 million of building improvements at our Carnegie PA roll finishing facility.

The link here is that in 2018, the company did a sale-leaseback transaction for its plant properties in Union Electric Steel U.S. to Store Capital. So, Store Capital is our landlord at that plant. And it only seemed to make sense that if we were going to be upgrading the building with a leasehold improvement that perhaps, we could--Store Capital could fund that for us.

It's all part of the $27 million CapEx that we had baked into that--into the improved--the total CapEx upgrade program in Union Electric, and we had the opportunity to do that. So, that's what that $2.5 million is for. We haven't received any reimbursements from it yet. The project is still in process.

But it's about expanding the use of the Carnegie facility to open a new machining bay and install other--some other equipment and reinforce a portion of the building that previously hadn't been used for such heavy work. So, that's the first thing. Is that clear?

Justin Bergner
Yeah, so, is that money that is part of the equipment financing facility, and you said you haven't been reimbursed for it?

Michael McAuley
No, let's separate things. Store Capital and sale leaseback are separate. I'm focusing on that right now. I'll get into equipment finance, next. This is part of sale-leaseback, and it's an extra piece to get financing to do a leasehold improvement to a property that was previously sold.

Justin Bergner
Got it.

Michael McAuley
It's only $2.5 million. We haven't received any cash for it yet. It's for what's coming.
Okay. Got it.

Michael McAuley
Now, and maybe we'll stay on sale leaseback for a second, before getting into the equipment financing. We expanded our relationship with Store by moving over into the Air & Liquid segment, and we elected to do a transaction that was originally intended to be a $20 million total transaction; we just broke it into two pieces.

There was some environmental testing that was desired at the North Tonawanda, New York facility, which took a little while. There were no findings, so it just--it got separated in time. So, we closed on the Virginia facilities first, the two Virginia facilities in the sale-leaseback. That was a $15.5 million inflow.

And then as a subsequent event outside of the quarter in October, just to finish the thread here, we did close on the North Tonawanda facility for $4.5 million. So, that makes up the total $20 million that will be now new book debt for us on the balance sheet long-term, but the proceeds were used to pay down the credit line in all instances.

So, there's no total increase in debt. But as you will note on the debt footnote in our Form 10-Q from yesterday, you will see that spiked out or you'll see that balance for sale and leaseback grow or be larger than it was.

Justin Bergner
Great, that’s helpful. I guess then the third piece was the portion of the equipment financing.

Michael McAuley
Yeah, we wanted to kind of have a more of a permanent or longer-term financing put in place for that important and high-cost equipment. So, we've been thinking rather than as we have been doing, use our credit line to support progress payments for these large machine tools; it was about time for us to get some permanent financing for that.

So, we entered into an agreement to provide funding not only for progress payments, but for the term portion of each machine. So, for the progress payments, we've got the term loan in place at 8%. And then when each machine goes online, those term loans turn into individual term notes, depending on when each machine is installed because the machine acts as collateral for that loan.

And we drew $4 million on it because we have incurred--we've actually incurred more than that, but we're trying to manage our total interest cost, and it's a nice way for us to manage liquidity going forward to seek reimbursements on the past progress payments kind of to maintain an even liquidity. And then eventually, we'll be using that line to finance the equipment, long-term.

Justin Bergner
Okay, that was very helpful. So, the $4 million was for the progress payment on the first machine?

Michael McAuley
It's not a couple of machines. It was on several machines of the bunch, but yes.

Justin Bergner
Okay, great. That's very helpful for that detail. And then on the credit line, the revolving credit line, none of these financing transactions limit you there, right, because that's more tied to working capital and this is tied to longer term?

Michael McAuley
It's actually a great boost to availability on the credit line because we were using a credit line to --we've been using the credit line to fund everything, including CapEx, and it was getting heavy on the CapEx. So, we released pressure on the credit line with these borrowings.

But again, I'll just say that these new agreements that we have in place have not increased our total debt. because all proceeds that have been brought in have reduced the credit line and now the credit line has lots of space.

Justin Bergner
Got it. Yeah, I was just trying to clarify that there was nothing based on these other financing transactions that limited your availability under the credit line?

Michael McAuley
Oh, no.

Justin Bergner
Okay. And then maybe lastly, in the prepared remarks, you--Brett, you talked about the headwinds for sales. Did the planned downtime materially impact the third quarter sequential sales and profit in the Forged and Cast Engineered Products? And then maybe some clarity on why the oil and gas piece tapered a bit, sequentially.

Brett McBrayer

Yeah, the planned downtime did have a material impact for the quarter. We took some significant outages across all of our businesses. And again, from a proactive perspective to make sure we maintain the assets we have in place and be able to perform, moving forward.

I'll let Sam, Justin, just speak a little bit about the oil and gas industry and give a little bit more color on that topic.

Sam Lyon
Yeah, Justin. On the oil and gas side, we moved from some second-tier customers, some first-tier customers on the frac block side of the business. I won't get into any names. One of them has started procuring overseas, again.

And so, we're diversifying in some other people. We're anticipating that, that won't last very long. There are some protections in place, tariff protections in place. So, I think that that's a temporary thing, but it will have an impact a little bit in Q4 and into Q1, as we backfill that volume that we had with a particular customer.

Justin Bergner
Okay, thank you.

Michael McAuley
Thanks, Justin.

Operator
Again, if you have a question, please press “*”, then 1”. And our next question comes from David Wright from Henry Investment Trust. Please go ahead.

David Wright
Hi, good morning, everyone.

Michael McAuley
Good morning, David.

Brett McBrayer
Good morning, David.

David Wright
Okay, start out with Dave. So, you mentioned that business is going gangbusters. You mentioned the new 5-year strategic plan. How much--can you break down maybe how much of what you've seen this year is a result of just strengthen the economy, existing things in the pipeline, closing versus efforts to expand to new customers and new markets producing orders?

Dave Anderson
David, the first part I would say is it's predominantly the third one. It's predominantly expanding our sales force. We have dedicated resources, internally, and hiring some people in Q1 of this year. That has paid off for us.

And we spent a lot of this year adding to our independent sales rep network. We have expanded that, considerably. So, that's the dominant answer. Not really so much the second one, closing of older things. Certainly, there is some on your first point of the economy.

But I would say in order, it's the third one. It's the expansion of our sales force, then somewhat the economy and not really number two, the closing of orders.

David Wright
And then just to stay on that, that’s still some pretty good quick success. Is that more a function of just getting into new markets? Or are the brand names so well-known and well thought of that it's been easy for the--easy is not the right word--that it's been helpful to the new reps in getting orders.

Dave Anderson
Some of both. It's been really helpful. We do have good reputations in the markets we compete in. And our new reps have been a combination, in some cases, of swapping out ones that weren't particularly performing at the level we wanted. And also pushing out, geographically, into some new markets.

So it's the combination of those things. And we have added significant independent sales reps this year, more than a dozen changes that we have made. So, that is a significant addition to our force.

David Wright
Okay. Well, great. Thanks for talking about your efforts there and continued good luck.

Dave Anderson
Thank you.

David Wright
Sam. You mentioned machines one, two and three, one in December, two in Q1 and three in Q2. Do those comprise, basically, the equipment program?

Sam Lyon
There's--there will be one more--so there's four machines that we're buying--one, two, three, sorry, five machines. So that's three of the five and then there's also two furnaces that we're putting in that will help us to melt more. So, this is probably the first, I'll say, third of those three machines to be the first third of it, the total.

David Wright,
And I know it's taken a long time to get these machines. Do you feel pretty confident that the delivery schedule is going to hold?

Sam Lyon
Yeah, because we're actually--the one machine, the containers arrived here in the United States, a week or so ago. And so, we'll be getting that to install. The other two machines are actually fabricated, and we are going there to witness.

So, what they do is they build the machine, we fly over and make sure it runs right and performs the specifications, then they disassemble and ship it here. So, the machines are actually assembled in Europe, right now, and we'll be going there to witness and make sure that they perform according to specification.

David Wright

Okay. And then you mentioned the strong bookings and the new projects for the new mills being built. I think that you cited four of them. The aggregate effect of those new facilities will be felt by the company like over what periods?

Sam Lyon
Like the mill fills will happen in, say, '23 and early '24, end of '23 and '24, and then they'll ramp them up. So, it's future work, but the good news is it's in the United States, and it's where we're strong and have a strong presence.

David Wright
So, shipments would start in the latter part of '23?

Sam Lyon
Yeah, like the Big River Steel is much further along. The aluminum mill won't be built until '24. Steel Dynamics is building, but they'll--we're already in discussions with all of them about initial requirements into '23 and '24.

David Wright
Okay. So then just, Brett, I'd say that it's been a tough time with all the different moving parts, COVID, supply chain, increased input costs. And the company really hasn't had any bad quarters. You've had some--a lot of kind of small loss quarters.

And so, that's got to make everybody feel good. It makes me feel good. Aside from the anticipated savings that the new equipment will produce, once it's all in, what, in your mind, is the other kind of large, largest moving part that you need to turn to really get to sustained profitability?

Brett McBrayer
Well, really the big piece, I would say, David, and thank you for your comments. Beyond the investment in the capital in the UES assets here in the U.S. is really accelerating further the growth in the Air & Liquid Systems side. It's a huge opportunity for us.

And as Dave has talked about what's happening right now, we believe we are on the cusp of something much bigger from a top line and a profitability standpoint. And just going back to UES, it's really pricing. Sam noted that in his opening remarks that we've got to continue to push the prices in the market.

We're seeing from a demand perspective that the customers value our products, and we want to make sure that we cover continuing increases of costs and that we are able to take more money to the bottom line.

David Wright
All right. I don't want to leave Mike out. Consistently amazed at your ability to pull financing rabbits out of the hat. And so, great job there, particularly with all the sale leasebacks done at much lower capitalization rates than I would imagine are available in the market today.

Michael McAuley
Thank you, David.

David Wright
Good luck going forward. Thank you for taking my questions.

Michael McAuley
Thank you, David.

Operator
Our next question is a follow-up from Justin Bergner from Gabelli Funds. Please go ahead.

Justin Bergner
Thanks, guys. A couple of follow-ups. For the Big River steel mill and the Steel Dynamics aluminum mill, you were, I think, suggesting that the orders and revenue would be an end of 2023 event for Big River Steel and end of 2024 event for the Steel Dynamics aluminum mill. Is that the timing you're thinking?

Sam Lyon
Yeah, I just want to be clear. I need to go back and check the timing on that. We're just in discussions. We're not even sure, sometimes the mill builder buys the rolls, sometimes the actual customer buys the rolls. We're just in negotiations or not negotiations. We're reviewing specifications, right now.

So, I don't want to really quote when the timing of that's going to be and how they're going to ramp up and how they're going to build.

So, my only point was that it's significant capacity expansion in the United States and the two aluminum mills, Novelis and Steel Dynamics. So, the first two new mills built in over 30 years here in the United States. So, my only point was just to say that our market -- that we're strong and is growing, but the timing is kind of--I don't want to quote a time, at this point.

Justin Bergner
Okay. And it seems like from your comments, you expect to hopefully have business with the Novelis Mill, too. I mean, what has characterized your strong position in aluminum mills?

Sam Lyon
It's just, it's performance. So, the amount of tons that they get for the cost of the roles that they buy. So we've just had, whether it be Kaiser or Alcoa or Novelis that we've had good performance and strong market share with all of them in the past five, 10 years or more.

Justin Bergner
Okay, got it. And then on the Air & Liquid Processing side, who are you taking share from? And what parts of the business are you taking share, perhaps aided by the improved sales force?

Brett McBrayer
I would say, Justin, it's not one particular customer, and it's really across all three of our businesses. Our backlog is up at all three of them. Part of it is geographic moving out into new markets, as we've added independent reps. And--but I don't think there's one particular customer, one competitor. We're seeing it across the board.

Justin Bergner
Okay. But do you think this is a share dynamic. It's not like a market dynamic where late cycle activity is favorable for orders, and you and others are all seeing a better environment, you think it's mainly share? .

Brett McBrayer

I think it's majority share. There's certainly some of the other, but I think the dominant part is share, yes.

CONCLUSION

Operator
There are no more questions in the queue. This concludes our question-and-answer session. I would like to turn the conference back over to Brett McBrayer for any closing remarks.

Brett McBrayer
Thank you, Jason. We have and we will continue to take actions to mitigate the negative headwinds we are facing in Europe. The improvements we have made across our businesses has, unfortunately, been overshadowed from the impact of the war in Ukraine.

I'm excited to see the positive steps the organization is taking to position ourselves for improved profitability. I again want to thank our employees for their hard work, focus and commitment to our success. Thank you for joining our call, this morning.

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