Ampco-Pittsburgh Corporation

Second Quarter 2023 Earnings Conference Call

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CORPORATE PARTICIPANTS

Kim Knox – *Corporate Secretary*

Brett McBrayer – *Chief Executive Officer*

Mike McAuley – *SVP, Chief Financial Officer and Treasurer*

Sam Lyon--*President, Union Electric Steel Corporation*

Dave Anderson--*President of Air & Liquid Systems Corporation*

PRESENTATION

Operator
Good day. and welcome to the Ampco-Pittsburgh Corporation Second Quarter 2023 Earnings 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 question. To ask a question, you may press “*”, then “1” on a touchtone phone. 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 Kim Knox. Please go ahead.

Kim Knox
Thank you, Marlise, and good morning to everyone joining us on today's second quarter 2023 conference call. Joining me today are Brett McBrayer, our Chief Executive Officer; and Mike McAuley, Senior Vice President, Chief Financial Officer and Treasurer. 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 webcast replay, please consult the Investors section of our website at ampcopgh.com.

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

Brett McBrayer
Thank you, Kim. Good morning, and thank you for joining our call. As shared in yesterday's press release, we recorded an earnings per share of $0.02 for the second quarter and $0.06 per share, year-to-date.

Our operating income, year-to-date, is triple that of prior year with solid performances from both segments. Of particular note is the continuing growth of the Air & Liquid segment with another quarter of record-breaking backlog. I challenged Dave Anderson, our Air & Liquid Segment President, to more than double its revenue of 2022. Based on his recent performance, I believe he has taken that challenge to heart.

Much work is still ahead as we position ourselves for a strong 2024 and beyond. The completion of our capital improvements in our U.S. forged assets is critical, and I'm pleased with our progress to date. I also want to note our strong safety performance with recordable and lost time injury rates continuing to improve.

I'd now like to turn the call over to Dave Anderson, President of Air & Liquid Systems.

Dave Anderson
Thank you, Brett. Good morning. We continue to see the positive results of our strategic growth plan as sales in the first six months of this year are the highest in Air & Liquid's history. Sales in Q2 increased 29% versus prior year with year-to-date sales up 35% over prior year.

Year-to-date, all three businesses have achieved more than 20% sales growth, compared to prior year. Even with the higher sales level, our backlog grew once again to a new record this quarter as our expanded sales force continues to exceed expectations. This means we have now achieved a new record backlog for six consecutive quarters.

The new manufacturing space we leased in Lynchburg, Virginia, at the beginning of Q2 is now operational and will provide additional capacity for our businesses as we continue to grow.

We are also excited to share that we are working on a U.S. Navy additive manufacturing project at Oak Ridge National Laboratory. Over the next 12 months, we will be working on designing additive manufactured pump parts for the U.S. Navy. Additive manufacturing of these parts has great potential to shorten supply chain lead times and increase capacity.

Segment operating income for the first six months of 2023 was 13% above prior year, due to the increased sales. 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 30% versus prior year.

Revenue and operating income have already increased. Our backlog is now 92% higher than it was 18 months ago. And with our new facility in Lynchburg, we have increased our manufacturing capabilities. All of this means we are in a strong position to continue forward with our growth plans in the quarters ahead.

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

Sam Lyon
Thank you, Brett, and good morning. Q2 of 2023 marked the third consecutive quarter of positive operating income. We finished the quarter with an operating income of $3.9 million, which included a one-time benefit of $1.9 million related to a foreign government energy reimbursement. Excluding this benefit, operating income was $2 million, roughly consistent with our Q1 results.

Q2 revenues were $77.6 million versus the prior year of $79.6 million. Lower top-line revenue reflects decreased variable surcharges due to lower energy and raw material costs and a weaker dollar.

The cast roll market is stable, while the forged roll market has strengthened and is approximately 25% higher versus 2022.

Forged Engineered Product revenues continue to be depressed. We anticipate recovery for the FEP market starting in the back half of 2023 and continuing in 2024. For 2024, the World Steel Association estimates steel demand to increase by 2.5% in the U.S., with Europe also seeing modest growth, compared to this year.

Our customer base reports similar sentiments, expecting sustained healthy demand from the automotive industry, solar energy sector and U.S. infrastructure programs. This confidence is supported by investments in new steel and aluminum rolling mills, primarily in North America.

The forged roll market is strong, approximately up 25%, year-over-year, as North American manufacturers are leaning more heavily on domestic producers to ensure reliability of supply.

Our backlog remains strong into 2024. Negotiations are complete with most of our large roll customers, and our value proposition has allowed us to maintain or grow share with favorable pricing for 2024.

Energy and transportation surcharges remain in place for most of our customers, which will smooth our operating income and protect against unforeseen volatility.

As Brett mentioned, our capital improvement plan in the United States continues to progress with completion expected in the fourth quarter.

Four of the five new machining centers have been received and our various stages of installation and startup. We've completed over 30 rules in the first machine with efficiency improvements of over 20%. We are very encouraged by these results and look forward to many years ahead with minimal maintenance costs and unplanned downtime.

The imminent completion of this strategic project positions us well to support the growth in the North American steel and aluminum industries.

Brett McBrayer
Thank you, Sam. I'd now like to turn the call over to Mike McAuley, our Chief Financial Officer, who will now share more details regarding our financial performance. Mike?

Mike McAuley
Thank you, Brett. As expressed in our press release and in the corporation's Form 10-Q filed last night, Ampco-Pittsburgh consolidated net sales for the second quarter of 2023 were $107.2 million. That's an increase of 4.5%, compared to net sales for the second quarter of 2022.

Net sales in the Air & Liquid Processing segment grew 29%, year-over-year, driven by a higher volume of shipments in all three businesses, but most notably heat exchange coils.

Sales, net sales for the Forged and Cast Engineered Products segment in the second quarter of 2023 declined 2.5%, compared to the prior year period, as Sam explained, driven by lower demand for FEP products in the oil and gas and steel distribution markets, lower surcharge pass-throughs and unfavorable foreign exchange translation, offset in part by higher mill roll shipment volumes.

Income from operations for the second quarter of 2023 was $3.3 million. This compares to income from operations in the prior year quarter of $2.1 million. Higher overall shipment volumes, the foreign energy credit Sam referred to, and better manufacturing cost absorption were partly offset by higher costs and a less favorable sales mix.

Interest expense for the quarter increased compared to prior year, due to a rise in both interest rates and in total debt, in part, due to ongoing expenditures for the strategic capital investment program in the U.S. forge business.

“Other-net” declined for the quarter, primarily due to losses recorded on foreign exchange in the current year quarter compared to gains on foreign exchange recorded in the prior year quarter.

Backlog at June 30, 2023, of $370.2 million rose approximately 6% from a year ago, with Air & Liquids segment backlog at a record high, and with the Forged and Cast Engineered Products segment backlog reflecting the decrease in FEP demand and roll order timing differences.

Net cash flows used by operating activities was approximately $2.8 million for Q2 2023, and was a use of $7.1 million year-to-date June, primarily in support of working capital.

This represents a significant improvement from 2022, due to improved operating results and lower change in working capital in the current year periods. Capital expenditures for the second quarter of 2023 were $6.4 million, primarily for the Forged and Cast Engineered Products segment, inclusive of the forged business' strategic capital program.

We expect CapEx and usage of the equipment finance facility to step up in Q3 with the milestones expected for that capital expenditure program.

June 30, 2023, the corporation's balance sheet and liquidity position included cash on hand of $9.5 million and undrawn availability on our revolving credit facility of $22.4 million.

In addition, the equipment financing facility has remaining capacity of $9.4 million as of June 30, 2023.

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

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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. If at any time your question has been asked and you would like to withdraw your question, please press “*”, then “2”.

At this time, we will pause, momentarily to assemble our roster. And as a reminder, for a question, “*”, “1”.

Our first question comes from David Wright from Henry Investment Trust. David, please go ahead.

David Wright

Good morning. I apologize for any background noise. Reading from the press release, SG&A is up pretty noticeably, sequentially and year-over-year. Mike, can you give some commentary about that? And also what does SG&A look like for the next couple of quarters?

Mike McAuley
Yeah, David, good morning, thank you for the question. SG&A is elevated compared to prior year for a couple of reasons. One is, with the higher income, variable compensation accruals are higher than they were last year when we had lower income. We're also experiencing, like a lot of public companies, that you may be listening to and which you may own, a higher level of self-insured health care costs.

It's quite noticeable. When we think and based on discussions with our insurers and our specialists that a lot of it is related to the pandemic and people deferring at health care for a few years and now it's starting to catch up with most companies, and we're no stranger to that either. So, we are seeing elevated self-insured health care costs, in addition to things like typical wage inflation and so forth.

The other thing is that we did start a new facility in Air & Liquid, and there's some additional costs associated with that until we get to a more ramped-up scenario.

David Wright
So, should we look at $14 million a quarter for the next couple of quarters, as well?

Mike McAuley
I think that SG&A for 2023, consolidated, will be about $13 million in Q3 and in Q4.

David Wright
Okay, great. Thanks very much, appreciate you taking the questions.

Brett McBrayer
Thanks, David.

Operator
And our next question comes from Justin Bergner from Gabelli Funds. Justin, please go ahead.

Justin Bergner
Hi. Good morning, Brett, good morning, Mike, good morning, rest of the team.

Brett McBrayer
Good morning.

Justin Bergner
I guess my first question would be on cash flow and working capital. So, your sales in your Forged and Cast rolls are kind of more in the flattish territory. The inventories are remaining high. So, what's the outlook for inventories in the second half? And should we expect an inflection to positive operating cash flow, as working capital gets worked down?

Sam Lyon
Justin, this is Sam. Mike might have some specific numbers in front of him. But in general, we expect inventory to come down. We had our outage that occurred at the very, very end of Q2 and into Q3 for our North American assets, and we took two weeks out. So, we built inventory ahead of that to flow through the rest of the operations to support the customer base, and that will flow out over the next two quarters.

Mike McAuley
It's Mike. I might add to that a little bit. In addition to the kind of the reduction in inventory that's expected in the second half, we think that cash flow from operating activities should be almost neutral for the full year as we catch up with the drop in inventories.

But the one thing to keep in mind is while that's cash flow from operating activities, based on higher income, offset by working capital and other things with the cash add-backs. The other thing to keep in mind is CapEx is going to continue to be a bit elevated while we complete the investments in the U.S. forged business. So, we do think that CapEx is going to be higher. So if you're thinking the next step like free cash flow, it's going to be difficult for that to turn positive with the CapEx that we have on deck.

Justin Bergner
Got it. That's helpful. And then what's the sort of CapEx guide for the year? And does the equipment finance facilities sort of cover all your needs there, or do you have to sort of kind of go into the revolver?

Mike McAuley
The equipment finance facility is a $20 million facility. It covers the vast majority of the strategic CapEx. In fact, that particular equipment serves as the collateral for the facility. So, it largely covers it, it's not 100% coverage, but our credit agreement has a $20 million allowance for such incremental or supplemental financing outside of the bank group.

We expect to use most of that. And so, I'm not concerned about funding for the CapEx at all. We've got it covered, pretty much. We are funding part of it out of pocket for things like foundation and utilities, some engineering. But the bulk of the cost is covered by the equipment financing facility.

And in terms of kind of giving you some kind of guidance or outlook on CapEx, Q3 should be our highest CapEx quarter of the year, and then we should drop back down into a lower--probably our lowest quarter in Q4. And we're thinking something in the range of $22 million total CapEx for full year of 2023.

As we go forward into '24 and '25, we're going to be obviously stepping down quite significantly and back into more historical levels of total CapEx in the out years.

Justin Bergner
Okay. And then more historical would be sort of 15-ish or--

Mike McAuley
--I would say 15-south of 15.

Justin Bergner
Yeah, okay. All right, thank you. And then lastly, would you say that pricing has sort of caught up to costs now based on the Forged and Cast Engineered Products results in the second quarter? And then you made a comment, Brett, about 2024 pricing. I didn't realize sort of most of that gets decided so early in 2023. Would you expect a further improvement relative, or are you sort of trending towards better condition for 2024 pricing you’re experiencing in the second quarter and looking to that third quarter?

Sam Lyon

This is Sam, Justin. The pricing, most of our major contracts are done in the second quarter-ish for next year, and then we got our raw allocations. And so that was my comment. The pricing that we're able to attain is in excess of inflation. Most of our major costs, raw materials, energy, transportation, they're all pass-throughs. And then we know what our wage inflation is going to be on all of the union contracts. And so, we're confident that we were able to cover--more than cover inflation there.

The pricing for Q3 and Q4 of this year are done. They were done, block last year. So the pricing would be similar or that--the pricing we will experience in Q3 and Q4 will be similar to Q2 of this year.

Justin Bergner
Okay. And so, the pricing for this year is more or less caught up with inflation as of Q2 and looking into the back half and then next year, you're expecting to get some pricing beyond your full set of inflationary pressures.

Sam Lyon
Yeah, that's correct.

Mike McAuley
Yeah, the pricing, I would say, is in line with the raw materials and energy and transportation costs this year but, potentially, not completely caught up with other inflationary items. Hence, the need to focus on pricing in 2024 and get that pricing raised in 2024, as Sam described.

Justin Bergner
Okay, that's good perspective. Thank you. I'll get back in the queue.

Mike McAuley
Thanks.

Operator
If you would like to get in the question queue, please press "*", "1".

And our next question comes from Greg Venit, who is a shareholder. Greg, please go ahead.

Greg Venit
Good morning. So, I guess my question for margin expansion for next year, you have these costs. You've negotiated the contracts and you have these cost pass-throughs, which I guess are variable. If costs go down, then you pass that through to your customer. So, for margin expansion this year it really comes down to this modernization program. I was wondering if you could give us more color on--I think you mentioned that you have four of the five pieces of equipment in place, and the first one was generating savings.

But about two years ago when you embarked on this, you were talking about quite a significant savings or productivity improvement. If you could tell us more about that, more color. Is that turning out the way you want?

Sam Lyon
Yes, this is Sam. Greg, the numbers that we're looking at are roughly in the $2.5 million to $3 million savings range and that expansion-there's two furnaces that we're putting in that allow us to increase our forge throughput and expand our non-roll business. And depending on volume, that'll be another $3 million to, say, $5 million worth of improvement.

Greg Venit
So, we would start to see this beginning in '24?

Sam Lyon
Yes.

Sam Lyon
Or during the third quarter or fourth quarter, any chance of seeing any improvement there or it's really more next year?

Sam Lyon
It's really more next year because we have some training costs and ramp-up costs. And then next year, by the end of Q4, everything will be up and running. And along with that, there's a little bit of a product shift, more product to be run in our Carnegie plant, which cuts on transportation costs between intercompany transportation. That's another piece of the savings. I would say it'd be more Q1 of next year.

Greg Venit
Okay. Most of the calls I've heard, recently, customers were looking for--used to look for just-in-time delivery than they were doing just in case and overordering. I'm wondering, are you finding that some of your customers are destocking now and don't want to take delivery of rolls? Or are you able to turn those rolls back to your customer as soon as you've manufactured them?

Sam Lyon
There's been very little of that. I mean, there's always some pushouts or pull-ins, but it's not any different than normal. So yeah, we're not seeing any significant pushouts of any kind. And one other thing that's unique to our business--well, I don't know if it's unique, but we get estimates for next year, what they want. But then before we start manufacturing, we get approval from them to start. And once we start, we have a very high success rate of them taking the product.

Greg Venit
One final question, I think. You touched--it was very quick, but you touched on with Air & Liquids this contract with the Navy. And I think you referred to it as additive manufacturing, but a lot of people refer to as 3D manufacturing where it's new technology for creating parts. What's the--is there a CapEx program for that, or is the Navy funding that? Or how is that working?

Dave Anderson
Greg, it's Dave, and thank you for the question. Right now, this is a Navy-funded program with Oak Ridge. And you're right, it's 3D or additive; they use either term for it. The Navy's intent is to go towards more of this additive because they see that as an answer to a lot of the supply chain issues that they've been having in recent years with the shipbuilders.

So for us, right now, we're committed to learning how to manufacture these parts, and we would expect to look at things like Navy funding in the future if we were to invest in the equipment. So right now, it's a 12-month program to learn how to design them and work with them, and then we make some determinations on what investments may or may not be needed at that point.

Greg Venit
So, if you go ahead with this, there will be a CapEx program, but that wouldn't be until 2025. Is that the way to think about it?

Dave Anderson
It would probably be around that. And there's really a couple of approaches that we could take upon developing these parts. We could, obviously, invest on our own equipment, we could request funding from the Navy to help pay for that equipment, or we could use other parties and contract out to use their equipment. So, that third option would not really require CapEx. So, it really depends, and we may end up using a variety of all three of those options.

Greg Venit
Do you know that you're the only one with this program with the Navy, or are there multiple companies that are participating in this?

Dave Anderson
There are multiple companies participating. This is an initiative that the Navy wants to really move towards.

Greg Venit
And is this technology transferable to outside of the Navy contract? Is it possible for you to produce other parts?

Dave Anderson
It absolutely is transferable, yes.

Greg Venit
You're the first company I've heard talking about additive manufacturing, which I think is the future, but thank you.

Dave Anderson
Yeah. Thank you. And I think you're right; I think it is part of the future, too.

CONCLUSION

Operator
And this concludes our question-and-answer session. I would like to turn the conference back over to Brad McBrayer for closing remarks. Thank you.

Brett McBrayer
Thank you. As I noted previously, the second half of 2023 will mark an important step forward in our transformation of Ampco-Pittsburgh. With the completion of our U.S. forged equipment modernization and our expanding production capacity in Virginia, we will position our company for a strong 2024 and beyond.

I want to thank our employees for their outstanding work. I also want to thank our shareholders and our Board of Directors for their continued support. Thank you for joining our call, this morning.

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