Ampco-Pittsburgh Corporation

Third Quarter 2023 Earnings Results Conference Call

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CORPORATE PARTICIPANTS

Kim Knox – *Corporate Secretary*

Brett McBrayer – *Chief Executive Officer*

Sam Lyon – *President, Union Electric Steel Corporation*

Dave Anderson – *President, Air & Liquid Systems Corporation*

Mike McAuley – *Senior Vice President, Chief Financial Officer and Treasurer*

PRESENTATION

Operator
Welcome to the Ampco-Pittsburgh Corporation Third Quarter 2023 Earnings Results Conference Call.

All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the "*" key, followed by "0". After today's presentation there will be an opportunity to ask questions. To ask a question, you may press "*", then "1" on your telephone keypad. To withdraw a question, please press "*", then "2".

Please note this event is being recorded.

I would now like to turn the conference over to Kim Knox, Corporate Secretary. Please go ahead.

Kim Knox
Thank you, Tony and good morning to everyone joining us on today's third 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 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 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 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 would like to now 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 reported in our press release and 10-Q filing, Ampco-Pittsburgh delivered a positive earnings per share for the third quarter of 2023, with improved performance from both business segments.

Our operating income of $1.7 million for the quarter and $7 million year-to-date is up significantly compared to last year. This improved performance was realized despite the significant negative headwinds we continue to experience in Europe.

The growth we are seeing in our Air & Liquid Systems segment is encouraging, and we again experienced record backlog in that segment for the quarter. We are excited about our capital equipment investments in the Forged and Cast Engineered Products segment, which is on track for completion at the end of this year.

I am now going to turn the call over to Sam Lyon, President of our Forged and Cast Engineered Products segment, for further comment on his group's performance. Sam?

Sam Lyon
Thank you, Brett, and good morning. Q3 of 2023 marked the fourth consecutive quarter of positive operating income for the FCEP segment. Despite the annual summer outages at our Europe plants and the planned maintenance outages for the U.S.-based melt and forge operations, we finished the quarter with a segment operating income of $1.4 million, an improvement of $1.2 million over Q3 of 2022.

Q3 revenues were $73.6 million versus the prior year of $75.5 million. The year-over-year decrease reflects our pass-through to customers of lower energy and raw material costs through lower surcharges and a decreased demand for FEP.

The cast roll market is soft but stable, while the forged roll market has strengthened and is approximately 13% higher than 2022.

FEP revenues continue to be depressed. However, we are starting to see increased activity for this non-roll business and anticipate some recovery in 2024.

In October, the World Steel Association modified a short-range outlook for global steel demand in 2023 and 2024 from its April projections. It cited a weakening in steel consumption and investment, reacting to high inflation, increasing interest rates, and ongoing global conflicts and uncertainties. In kind, our customer base has voiced expectations of a flat to declining North American market and continued softness in Europe.

This decrease in demand has resulted in some of our customers having a higher role inventory position relative to 2024 demand, impacting the overall market for cast and forged rolls in the short term. Our customers project roll demand to be down for the first half of 2024 and recover in the second half, as inventories correct and demand increases. Offsetting this decline, we have successfully increased base pricing and grown share with many of our larger customers.

The intermediate to long-term demand picture for steel remains strong, and we are well positioned to supply our customers as demand increases. Steel Dynamics, Nucor, U.S. Steel and others are all bullish on the next decade in North America and are all investing in new capacity. ArcelorMittal projects non-China demand to increase approximately 35% in the coming decade with an increase of 15% in the U.S. and Europe, where our share has increased. They believe India will double and Brazil will grow by approximately 30%.

In addition, the global aluminum market is expected to grow with estimates of a 5.8% compounded annual growth rate through 2031, according to Allied Market Research. Similar numbers were quoted by Next Market Research, Future Market Insights and SkyQuest.

In 2022, the construction of three new aluminum rolling mills was announced in the U.S. This domestic expansion opens new opportunities to broaden our footprint in the sector of the metals industry for which our roll products are well suited.

As Brett stated, our capital equipment improvement plan in the U.S. continues to progress. Two of the five machine centers were commissioned in Q3 and are performing as expected. The three remaining machine centers have been installed or in the process of being commissioned. We are very encouraged by these results and look forward to many years ahead with significantly reduced maintenance costs, allowing us to improve our service levels for our customers further.

Brett McBrayer
Thank you, Sam. Dave Anderson, President of Air & Liquid Systems, will now cover his segment's results. Dave?

Dave Anderson
Thank you, Brett. Good morning. Air & Liquid continues to see the positive results of our strategic plan with record level sales through the first nine months of this year. Sales in Q3 increased 18% versus prior year with year-to-date sales up 29%, 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.

We have now achieved a new record backlog for seven consecutive quarters and our backlog is now 107% higher than it was 21 months ago.

Segment operating income for the first nine months of 2023 was 15% above prior year, primarily due to the increased sales. The prior year income included $0.7 million in income recognized for a change in an employee benefit policy. Excluding this one-time item shows adjusted operating income growth of approximately 23% versus prior year.

The additive manufacturing project we are working on with the U.S. Navy at Oak Ridge National Laboratory continues to make progress toward the goal of using additive technology to make parts for the pumps we provide to the U.S. Navy. We are also pleased to share that Air and Liquid has received a funding grant from the U.S. Navy for the purchase of new manufacturing equipment.

The $1.6 million funding grant allows us to purchase new machining equipment, which will improve efficiencies and increase capacity for our U.S. Navy business. The new equipment is on order and is expected to be installed and operating in mid-2024.

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

Mike McAuley
Thank you, Brett. Good morning. As indicated in our press release issued last night and in the Corporation's Form 10-Q filed this morning, Ampco's net sales for the third quarter of 2023 were $102.2 million, an increase of 2.6% compared to net sales for the third quarter of 2022.

Net sales on the Air and Liquid Processing segment grew 18% year-over-year, driven by a higher volume of shipments in all three businesses.

Net sales for the Forged and Cast Engineered Product segment in the third quarter of 2023 declined 2.5%, compared to the prior year period, as Sam explained, driven primarily by lower demand for FEP products in the oil and gas and steel distribution markets and lower surcharge pass-throughs, offset, in part, by higher mill roll shipment volumes.

Income from operations for the third quarter of 2023 was $1.7 million. This compares to income from operations in the prior year quarter of $0.2 million. The improvement was principally led by higher pricing net of surcharges outpacing manufacturing costs in the Forged and Cast Engineered Products segment and the impact of higher shipment volumes in the Air and Liquid Processing segment.

Investment related income declined for the quarter due to a lower dividend this year from one of our Chinese roll joint ventures.

Interest expense for the quarter increased compared to prior year due to a rise in both interest rates and in total debt. This reflects interest on the sale and leaseback financing transaction and the equipment financing arrangement completed during the second half of 2022, the latter of which is funding the equipment modernization project in the U.S. forged business. It also reflects higher average borrowings under the revolving credit facility to support the growth in working capital in 2023.

Other income-net declined for the quarter primarily due to lower foreign exchange transaction gains in the current year quarter compared to the prior year quarter.

The income tax provision decreased for the quarter compared to prior year in part due to a $0.3 million discrete item recorded in the prior year quarter for the revaluation of certain deferred tax assets of the Air and Liquid Processing segment following new legislation enacted in 2022, which will decrease the Pennsylvania state income tax rate by 2031.

Net income attributable to non-controlling interest rose for the quarter due to higher operating results for our majority-owned Chinese joint venture. As a result, net income attributable to Ampco-Pittsburgh was $0.8 million, or $0.04 per share for the quarter.

Total backlog at September 30, 2023, of $403.2 million rose approximately 9% from the beginning of the year with the Air and Liquid segment backlog at a new record high and the Forged and Cast Engineered Products segment reflecting higher forged roll orders driven by U.S. demand and better pricing, offset in part by a decrease in orders for cast rolls and FEP products.

Net cash flows used by operating activities was approximately $3.2 million for Q3 2023, and was a use of $10.3 million year-to-date September 2023, primarily in support of working capital investment. This represents an 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 $4.1 million, primarily for the Forged and Cast Engineered Products segment, inclusive of the forged business‘ modernization capital program. We expect CapEx and usage of the equipment finance facility to increase in Q4 2023 with the completion of milestones expected for the machinery that are part of that key capital expenditure program.

At September 30, 2023, the Corporation’s liquidity position included cash on hand of $6.1 million and undrawn availability on our revolving credit facility of $21.7 million. In addition, the equipment financing facility has remaining capacity of $6.8 million as of September 30, 2023, and is sufficient to finance the remaining expenditures of the modernization program.

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

QUESTION AND ANSWER

Operator
We will now begin the question-and-answer session. To ask a question, you may press "*", then "1" on your telephone keypad. If you are using a speaker phone, please pick up your handset before pressing the keys. To withdraw from the question queue, please press "*", then "2".

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

Our first question will come from Justin Bergner with Gabelli Funds. You may now go ahead.

Justin Bergner
Hi, Brett, Mike, Sam, and Dave. How are you?

Brett McBrayer
Good. Good morning.

Justin Bergner
Good morning. With respect to Forged and Cast Engineered Products, this customer downtime that led you to take some downtime, does that pull forward from what I'm expecting would be downtime that's more concentrated towards the fourth quarter in the holiday season? Or is that additional downtime in the annual view?

Brett McBrayer
Maybe I wasn't clear. That's just our normal and Europe's normal downtime that happens in the third quarter. Now on top of that, Justin, there are many blast furnaces that have been idled to pull down supply and raise prices in the market in Europe. But the downtime wasn't necessarily pulled in. That was just our downtime that we normally take in the third quarter to align with the European vacations.

Justin Bergner
Got you. Okay. And with respect to cash flow, obviously used last year and this year. In the first half of next year when you expect volumes to be down should that lead to some harvesting of working capital?

Mike McAuley
Yes, whenever we expect a softness in production, for example, as Sam indicated like first half versus second half on the roll business, yes, that should release working capital. And then as production ramps up, working capital tends to ramp up with that, so with demand and hence, production.

Justin Bergner
Okay. And then just in terms of the modernization project. I think the detail came out a little bit fast in prepared remarks. So how many have been commissioned, how many have yet to be commissioned? And when do you expect the EBITDA benefit from the modernization to start showing up in the financials?

Brett McBrayer

Justin, two of the machines are commissioned and those are the roughing machines that are in our Harmon Creek plant--Burgettstown, Pennsylvania. The three remaining machines are in our finishing plant at Carnegie. They'll be finished commissioning this quarter, and then we have overlap of training that will continue through probably the first quarter of next year.

Justin Bergner
Okay. So after the first quarter, should we just begin to see a step up of EBITDA everything else being equal on the count?

Brett McBrayer
Yes.

Justin Bergner
Okay.

Brett McBrayer
That's correct.

Justin Bergner
All right. Thank you.

Brett McBrayer
Thank you.

CONCLUSION

Operator
And if you have a question, please press "*", then "1".

It appears there are no further questions. 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. I'm encouraged by our strengthening operational performance and the positive momentum we've seen across both business segments. I want to thank the hard work of our employees and the positive change they are delivering, each and every day. I also want to thank our shareholders for your continued support. Thank you for joining our call, this morning.

Operator
The conference is now concluded. Thank you for attending today's presentation. You may not disconnect.