Ampco-Pittsburgh Corporation

First Quarter 2019 Earnings Results Conference Call

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CORPORATE PARTICIPANTS

Brett McBrayer, *Chief Executive Officer*

Michael McAuley, *Senior Vice President, Chief Financial Officer and Treasurer*

Melanie Sprowson, *Director, Investor Relations*

Sam Lyon, *President of Union Electric Steel Corporation*

Terry Kenny, *President of Air & Liquid Systems Corporation.*

PRESENTATION

Operator
Good day and welcome to the Ampco-Pittsburgh Corporation First Quarter 2019 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 1 on your telephone keypad. To withdraw your question, please press star, then 2. Please note this event is being recorded.

I would like to now turn the conference over to Melanie Sprowson. Please go ahead.

Melanie Sprowson
Thank you, Allyssa, and good morning to everyone joining us on today's first quarter conference call. I'm joined today by 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 Terry Kenny, 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 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 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 and remain available for two weeks following the conclusion of the call. To access the earnings release or the webcast replay, please consult the Investor section of our website at ampcopgh.com.

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

Brett McBrayer
Thank you, Melanie. Good morning. Welcome to our call. As Melanie mentioned, with us today are Sam Lyon and Terry Kenny.

Sam joined Ampco-Pittsburgh as Union Electric Steel Corporation President in February of this year, and he runs our Forged & Cast Engineered Product segment. He brings over 28 years of experience in LEAN manufacturing operations and process improvement leadership to the organization, and we are pleased to have him as part of the Ampco-Pittsburgh leadership team. Sam and his team have been instrumental in driving the improvements we are beginning to see in our UES business.

Terry has been with Ampco-Pittsburgh for 35 years. Terry has held his current position as President of Air & Liquid Systems Corporation for ten years. His knowledge and leadership are invaluable in the execution of our strategic plan. Terry has challenged his business leaders and is engaged with his team to further improve the profitability of this group.

This morning we issued our earnings press release for Ampco-Pittsburgh's first quarter of 2019. There are a couple of key items I'd like to speak to you first and foremost. We announced today our plan to sell our U.S. cast roll manufacturing facility located in Avonmore, Pennsylvania, to an affiliate of WHEMCO Inc. We expect the transition will close in the second half of this year once remaining customer commitments have been fulfilled.

Excess capacity and high operating costs in our cast roll system have made operation of the Avonmore facility untenable. The annualized impact on operating results following the sale, is currently expected to improve income from continuing operations by approximately $9 [million] to $10 million.

Also during the quarter, we implemented a first phase reduction in force. These actions are key steps in the corporation's continued overall restructuring, helping to further reduce our overhead costs and right-size our business to meet current and future customer demands. We expect both actions to improve our operating results from continuing operations by approximately $1 million per month on a full run-rate basis once the sale is complete. We are beginning to see the benefits of our operational improvement initiatives and are currently engaged in additional asset restructuring opportunities which should facilitate further overhead reduction actions and increase efficiencies in our business.

Mike McAuley will review our financial results in more detail later in the call. I will now turn the call over to Sam Lyon, who will discuss the Forged & Cast Engineered Product segment activities for the first quarter. Sam?

Sam Lyon
Thanks, Brett. Throughout my first 90 days with the company, we have focused on a few key initiatives. The first is the ramp-down of our Avonmore site. We are moving products to our assets in the UK and Sweden, where there is capability and capacity and managing the remainder through our North American assets. As previously stated, this action alone is expected to improve income from continuing operations in the range of $9 [million] to $10 million per year, once complete.

Secondly, we are focused on taking costs out of the system. We are continuing to implement a tiered daily management process based on the Toyota production system. This is a simple yet effective way to understand what is happening on the shop floor daily and allows management to apply resources to the most pressing issues. It also provides a goal that is measurable on a real-time basis. We are seeing very good results from this process.

Q1 '19 versus Q1 of '18, we have improved efficiencies 10 percent across our U.S. forged plants, and we are just in the early innings. At our Harmon Creek facility, we have reduced the total time to process the heat or melt by 8 percent year over year. In addition, we've improved the cost of our melts through raw material management by 3 to 4 percent. This has been accomplished through opportunistic scrap purchases and diligent scrap management.

From a market perspective, our forged engineered product sales to the oil and gas industry are down 60 percent from the prior year, almost entirely offset by higher sales of both forged and cast rolls. In spite of this slowdown in our non-roll product sales, which generally carry a higher margin than our roll product, Q1 of '19 was one of our best quarters for the U.S. forged products division in years. The cost improvements that I have discussed has allowed us to improve our operating income compared to Q1 of 2018. We will aggressively leverage these improvements through the remainder of our processes and facilities for the balance of the calendar year.

Brett McBrayer
Thanks, Sam. I'll now turn the call over to Terry Kenny, Air & Liquid Processing segment President.

Terry Kenny
Thank you, Brett, and good morning. Net sales for the Air & Liquid Processing segment for the first quarter ended March 31, 2019, increased when compared to the same period last year. Sales of air handling units benefited from a higher opening backlog and increased market penetration, while sales of centrifugal pumps improved as a result of increased demand from the U.S. Navy. Sales of heat exchangers continue to be negatively impacted by declines in the nuclear and fossil fuel power generation markets.

The segment's backlog as of March 31, 2019, approximated $53.7 million, which compares favorably to approximately $44.4 million at December 31, 2018, and approximately $46.3 million at March 31, 2018. This is the highest the segment's backlog has been in ten years. The increase over prior periods is primarily attributable to increases of orders for centrifugal pumps for the U.S. Navy.

The segment is focused on several key objectives. We are improving the manufacturing process in each operation to increase productivity in order to maximize capacity of the segment's existing resources. Each operation is in the process of conducting in-depth reviews of our current processes and identifying opportunities for improvement. We are also focused on improving the segment's share of key markets currently serviced while entering new markets for our products.

Brett McBrayer
Thank you, Terry. With that, I'd like to hand the call over to our CFO, Mike McAuley, to review our financial results in more detail. Mike?

Mike McAuley
Thank you, Brett, and good morning to everyone listening on the call today. Today's conference call commentary contains the use of certain non-GAAP measures. I refer you to our disclosures regarding non-GAAP measures and related non-GAAP financial measures reconciliation schedule included in this morning's earnings release.

I will start off today by highlighting a few key items which had an impact on our financial statements for Q1 2019. First, in connection with today's announcement of the anticipated divestiture of our Avonmore, Pennsylvania cast roll manufacturing facility, we recognized a $10.1 million non-cash impairment charge, which represents the write-down of certain assets of the facility to their estimated net realizable value associated with the asset sale.

Second, included in our Q1 2019 financial statements, are costs of $0.9 million, representing professional fees associated with the corporation's overall restructuring plan and employee severance costs due to a reduction in force.

Ampco's net sales from continuing operations for the first quarter of 2019 were $107.5 million. This compares to net sales from continuing operations for the first quarter of 2018 of $106.4 million. Net sales in the Forged & Cast Engineered Products segment were comparable to prior year. Forged and cast roll sales increased; however, sales of forged engineered products to the oil and gas industry offset the improvement.

Net sales for the Air & Liquid Processing segment for the first quarter of 2019, increased approximately 5 percent compared to prior year, led by higher sales of air handling units and centrifugal pumps. I'll comment more on segment results in a moment.

Gross profit as a percentage of net sales was 16.1 percent for the first quarter of 2019, versus 17.6 percent for the first quarter of 2018. The decline is primarily due to lower production volumes for forged engineered products, particularly to the oil and gas industry, and product mix for our cast roll operations. Improved pricing helped to offset these impacts.

Selling and administrative expenses were $13.9 million, or 12.9 percent of net sales, for the first quarter of 2019, which is down compared to $14.9 million, or 14 percent of net sales, for the first quarter of 2018, due to lower employee-related costs, lower commission expense, and lower R&D spending.

Depreciation and amortization expense of $5.3 million in the first quarter of 2019, was down slightly compared to $5.6 million for the first quarter of 2018.

Loss from continuing operations on an as-reported GAAP basis for the first quarter of 2019 was $12 million. This compares to a loss from operations in the prior year of $1.8 million, the decline being driven primarily by the $10.1 million impairment charge and the $0.9 million restructuring-related costs. However, the corporation incurred approximately $2.2 million in estimated excess costs from the Avonmore cast roll facility, which will be exited in the second half of this year. Therefore, excluding the impairment charge, the restructuring-related costs, and the estimated excess costs of the Avonmore facility, the corporation had positive adjusted income from continuing operations of $1.8 million in the first quarter of 2019. This reflects an improvement of $0.7 million compared to the prior-year quarter on the same basis and is reflective of the operational improvement initiatives Sam described to you earlier.

Other expense net decreased for the first quarter of 2019 when compared to prior-year quarter, due primarily to a favorable contract settlement with a third party which occurred in the first quarter of 2018 of $2.4 million.

The income tax provision for the current-year quarter includes income taxes associated with our profitable operations, whereas we continue to record valuation allowances against the deferred tax assets of the majority of the corporation's operations. By comparison, in the prior-year quarter, we recorded an income tax benefit driven by several factors — the release of a valuation allowance previously established against the deferred tax assets of one of our foreign subsidiaries on the basis that it was more likely than not that the deferred tax assets would be realized; the benefit of certain carrybacks and refunds recorded last year, and this was partially offset by the impacts of the recognition of a one-time tax on deemed repatriation of previously untaxed foreign earnings associated with tax reform in the prior-year quarter.

As a result, the corporation reported a GAAP net loss from continuing operations of $12.6 million, or $1 per common share, for the first quarter of 2019, compared to a net income of $1.6 million, or 12 cents per common share, for the first quarter of 2018. The net loss from continuing operations for the first quarter of 2019 includes the $10.1 million impairment charge and the $0.9 million in restructuring-related costs I previously described.

The corporation also reported net loss from discontinuing operations, reflecting the operations of ASW, of $2.2 million, or 18 cents per common share, for the first quarter of 2019, compared to a net loss of 1 cent per common share for the first quarter of 2018. The higher loss compared to

prior year is due to lower sales volumes as a result of tariffs imposed by the U.S. on imports of primary steel and lower ingot demand used as feedstock for the production of forged engineered products for the oil and gas industry.

And here's a bit more color for you on our business segment results. As I mentioned earlier, net sales from Forged and Cast Engineered Product segment for the first quarter of 2019 were flat compared to prior year. While shipments of forged and cast rolls improved, sales of forged engineered products decreased. Specifically, sales of frac blocks to the oil and gas industry decreased from a year ago as the market decline continued through the first quarter of 2019. The segment reported an operating loss for the quarter ended March 31, 2019, driven by the $10.1 million impairment charge. Otherwise, results for the segments were generally comparable to prior year.

Net sales for Air and Liquid Processing increased for the first quarter of 2019 versus prior year. Sales of air handling units benefited from improved demand, while sales of centrifugal pumps improved due to higher volume shipments to U.S. Navy shipbuilders. The segment's operating income for the first quarter of 2019 was approximately flat with prior year as the higher shipment volumes were approximately offset by unfavorable product mix. Backlog at March 31, 2019, approximated $349 million, which was slightly higher than the backlog at December 31, 2018 and at March 31, 2018.

The impact from ongoing softening of demand for our forged engineered products in the oil and gas industry was offset by improved order intake for rolls and additional orders for U.S. Navy shipbuilders. Approximately $74 million of the current backlog is expected to ship after 2019.

Now I will review some cash-related items. Please note that this discussion excludes discontinued operations. Accounts receivable at March 31, 2019 increased by $17.1 million compared to December 31, 2018, primarily attributable to higher first quarter 2019 sales when compared to the fourth quarter of 2018. Inventories were approximately stable overall with December 31, 2018 levels. Accounts payable at March 31, 2019 increased by $6.9 million compared to December 31, 2018. Capital expenditures for the first quarter of 2019 were $1.4 million for continuing operations. Cash and cash equivalents for continuing operations of $10.4 million at March 31, 2019, decreased compared to the December 31, 2018 balance of $19.7 million, for a specific reason.

During the quarter and following the payoff of the notes, we instituted a springing lockbox feature whereby domestic customer remittances are swept regularly against the credit line to minimize borrowings. As a result, we are maintaining minimal domestic cash, and the reported cash balance reflects primarily foreign cash. The balance sheet reported cash balances for the near-term future are therefore expected to remain approximately in the range of the March 31, 2019 balance, while we keep this practice in place.

Drawings on the Ampco revolving credit facility are $40 million at March 31, 2019. This reflects an increase compared to the $14.3 million at December 31, 2018. As we had planned, the increase was due to additional borrowings being used to repay the promissory notes and interest which was retired on March 4, 2019. At March 31, 2019, in addition to the cash balance, the corporation also has remaining availability on the revolver of approximately $39 million.

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

Brett McBrayer

Thank you, Mike. As discussed on the call today, we have taken several actions over the course of the first quarter that are key steps in the corporation's overall restructuring, and we are just getting started. We will stay the course with our restructuring plan with a pace and urgency to fully demonstrate our earnings power. I am confident that the steps we are taking today will lead to the generation of sustainable profitability and improved performance.

Thank you for joining us for Ampco-Pittsburgh's conference call this morning. At this time, we will open up the line for your questions.

QUESTIONS AND ANSWERS

Operator
Thank you. We will now begin the question-and-answer session. To ask a question, you may press star, then 1 on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star, then 2. Just as a reminder, in the interest of equal access to all participants, please limit yourself to one question and one follow-up. If you have any additional questions, feel free to jump back in the queue. At this time, we will pause momentarily to assemble our roster.

The first question today comes from David Wright with Henry Investment Trust. Please go ahead.

David Wright
Good morning, everyone.

Brett McBrayer
Good morning, David.

David Wright
Hi. On the Avonmore sale, what are the gating issues that determine when you close that transaction?

Brett McBrayer
Yeah, this is Brett, David. Basically, we are working through the completion of customer commitments, and that's what is the timing from a closure standpoint. So we've made a commitment to finish up what we've said we'd do for the customers, and as soon as that is complete, we will be done with that operation.

David Wright
Do you internally have any vision of when in the second half you'd like this thing to close or think the thing can close?

Sam Lyon
Yeah, this Sam. We're targeting the end of September.

David Wright
Okay. On the ASW pending sale, any update there?

Mike McAuley
Yeah, David, it's Mike. On the sale of ASW, we are currently in due diligence with parties, and that's about all I can say about that.

David Wright
Okay, I'll get back in line. Thanks very much.

Mike McAuley
Thank you.

Operator
Our next question comes from Justin Bergner with G Research. Please go ahead.

Justin Bergner
Oh, hi, good morning, Brett. Good morning, Mike.

Brett McBrayer
Good morning.

Mike McAuley
Good morning, Justin.

Justin Bergner
On the sale of Avonmore, should I assume that the cash proceeds will be deminimis, and are there any cash outlays that you will need to undertake, outside of winding down the operations to get to completion?

Mike McAuley
Justin, we did not disclose the proceeds from the sale. I will say it's not a large amount, but with regard to, future cash outlays associated with winding down the facility, there will be some unusual one-time costs that we'll accrue that will become cash costs as they're incurred, associated with labor issues, and we will also see some non-cash items that will be hitting P&L, associated with pension and retiree healthcare adjustments to the pension and the OPEB that will flow through P&L. And so there will be some unusual items in addition to some continuing, lagging excess operating costs until the transaction does close.

Justin Bergner
Okay, that makes sense. With respect to the buyer, do they currently have a cast rolls business, and will they be sort of operating the plant as a cast roll operation after the completion of the sale?

Male Speaker
[Inaudible]

Brett McBrayer
This is Brett. They do have a cast roll business. What we can say is that when we will close the facility, and, at that point, it's really WHEMCO Inc's —their view of what they'll do going forward is really up to them to communicate. So we're focused on the closure, and the ramp-down as expeditiously as possible. We're working on ways to make that timeline even faster, but I think I'll leave it to WHEMCO to express their intentions going forward.

Justin Bergner
Okay, and just to clarify the approved profitability for the actions you're undertaking, the $1 million improvement per month in profitability, is that just associated with Avonmore, that is, the operating

impact and the reduction in the excess cost, or does that include the restructuring benefits, and, if so, where are those to fit in the operation on top of Avonmore?

Mike McAuley
Justin, in estimating the benefit of closing the facility, we looked at the impact on the total segment, but it's principally focused on getting costs out of Avonmore, which are essentially unabsorbed costs, so that's the basis, and then what was the other part of the question — restructuring?

Justin Bergner
Yes, the restructuring, I guess, improvements that are on top of that $9 [million] to $10 million to get to the $12 million, that don't relate at all to Avonmore. They're independent benefits.

Mike McAuley
Those are independent, correct. And I would go back to the question that you had regarding, are we going to see any other cash costs associated —down the line, and I did indicate that there are some labor-related costs. I will say that we are currently estimating those to be not very significant and less than the proceeds from the sale.

Justin Bergner
Okay, that's helpful. And then, lastly, it seemed like it was a good quarter for forged and cast rolls. Maybe we could just delve into a bit as to what made the quarter positive. Was it demand or sort of efficiency of operations or other factors?

Sam Lyon
Yeah, this is Sam. Demand was strong, particularly for our larger-size rolls. As stated, we did have a negative on the non-roll product that offset that demand, but it's really the improvements that were made in the operations, particularly in the U.S. We've seen that 10 percent efficiency improvement, and that's really just going right to the bottom line. It's a twofold improvement that helps us ship more, and it also lowers the costs.

Justin Bergner
Great. Thank you.

Operator

Our next question is a follow-up from David Wright with Henry Investment Trust. Please go ahead.

David Wright
Sam has talked about some of these improvements in forged and casting in the U.S., and can he talk about, are you doing anything in Europe, do you need to improve efficiencies there, et cetera?

Sam Lyon
Yeah, well, we have not started in Europe yet. We're focused here right now, but certainly that will come in the short near future.

David Wright
So that would infer the greater urgency was in the U.S.

Sam Lyon
We had demand, we have backlog for our large roll product that goes up fairly far, so the biggest bang for the buck was to start here.

David Wright.
Okay. And can anyone put any details around the first quarter reduction in force?

Mike McAuley
Yeah, it was focused on primarily U.S. population, David, and I would say it was not massive, but it was the first step of cost cutting. And, as we indicated, we had about $900,000 of costs associated with restructuring and activities for professional fees, plus the reduction in force reserve. I would say that the reserve was the smaller portion of that number.

David Wright
Okay. And when are you planning to file the 10-Q?

Mike McAuley
Today.

David Wright
Okay. Thanks very much.

Brett McBrayer
Thanks, David.

CONCLUSION

Operator
Again, if you have a question, please press star, then 1.

As there are no further questions, this concludes our question-and-answer session. The conference is now also concluded. Thank you for attending today's presentation. You may now disconnect.