Ampco-Pittsburgh Corporation

Q2 2019 Results Earnings Conference Call

Friday, August 9, 2019, 10:30 A.M. Eastern

CORPORATE PARTICIPANTS

Melanie Sprowson - *Director, Investor Relations & Corporate Communication*

Brett McBrayer - *Chief Executive Officer*

Mike McAuley - *Senior Vice President, Chief Financial Officer & Treasurer*

Sam Lyon - *President, Union Electric Steel Corporation*

Terry Kenny - *President, Air & Liquid Systems Corporation*

PRESENTATION

Operator
Good day and welcome to the Ampco-Pittsburgh Corporation Second Quarter 2019 Earnings Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star (*) key, followed by zero (0). After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star (*), then one (1) on your touchtone phone. To withdraw your question, please press star (*) and then two (2). Please note this event is being recorded.

I would like to now turn the conference over to Melanie Sprowson, Director of Investor Relations and Corporate Communication. Please go ahead.

Melanie Sprowson
Thank you Jake and good morning to everyone joining us on today's second quarter conference call. I am joined 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 and 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 statements 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 Investors section of our website at ampcopgh.com.

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

Brett McBrayer
Thank you, Melanie. Good morning, and welcome to our call. I am excited to share the results of our second quarter performance. While we recorded a modest GAAP loss from continuing operations in quarter 2, we are beginning to see the initial impact of our improvement efforts.

These efforts have delivered an adjusted income from continuing operations, which is a non-GAAP measure of $2.5 million for the quarter and $3.8 million for the first six months of 2019, an improvement of more than 80% compared to last year's quarter and nearly double last year's adjusted performance on a year-to-date basis.

During the second half of the year, we will continue to right-size our assets to deliver sustainable profitability in our businesses. We are on target to close on the sale of our Avonmore facility by around September 30th. We also anticipate the completion of our ASW divestiture by the end of the year.

We expect a marked improvement in our earnings profile, beginning as early as the fourth quarter of this year. Mike McAuley will review our financial results in more detail later in the call.

Another area of importance that I would like to highlight is our performance from the safety, health and environmental standpoint. Across the globe, we begin every operational, daily management meeting, focused on the well-being of our employees and the stability of our environmental systems. With the introduction of new leadership in 2019 and a focus on disciplined daily execution, we have made some significant improvements.

Our continuing operations have reduced recordable injuries globally by over 11% and lost-time injuries by 17% compared to last year. We are far from where we want to be, but I am encouraged by the progress our team has made.

We also continue to operate our facilities incident-free from an environmental perspective. We will always strive to safeguard and enhance the wellbeing of the communities where we operate. These measures of success highlight our improved stability in people, processes and equipment.

I will now turn the call over to Sam Lyon, Union Electric Steel President.

Sam Lyon
Thank you, Brett. In the second quarter, we have continued our focus on safety, cost reductions in the U.S. plants, and reducing arrears in our European operations. We have also launched initiatives to further improve our European operations performance.

Earlier, Brett mentioned a reduction in lost-time injuries and recordable injuries over last year. Much of this progress was made in Q2 where globally, we reduced our recordable count from 16 to 11. While 11 people getting hurt to the point of requiring medical treatment is unacceptable, five more people went home to their families, safe and unharmed, in the first half of this year compared to prior year.

This improvement is being driven by two thrusts. Focused safety, observations on high-risk tasks, which many times result in a change to the tool method to minimize or eliminate the risks identified and behavioral safety observations. We will be relentless when it comes to safety as our goal is a zero-injury workplace.

From a cost perspective, our goals are the same as they were during our last call. The first item, as Brett mentioned, is the ramp down of the Avonmore site. We are on schedule to complete this sale by the end of September. We have absorbed the new production requirements and finishing back into our European operations and are working off the final work-in-process inventory at Avonmore.

As mentioned on our last call, we are expanding our capabilities in Sweden, which will triple our capacity at that plant for these large rolls where demand continues to be robust.

Secondly, we continue to take cost out of the system. We are continuing to implement a tiered daily management process based on the Toyota production system. We are driving improvement by understanding our shortfalls daily and applying resources to close those gaps. Year-to-date, our efficiencies have improved in our U.S. facilities by 7%.

The cost improvements, that I discussed a moment ago, have allowed us to offset the reduction in our non-roll product sales, which generally carry a higher margin than our roll product.

Moving forward, we will continue to drive operational improvements in our U.S. plants and complete planned maintenance outages to improve the reliability of several critical assets in Q3.

For our European assets, we are improving our process yield and restructuring our cast roll facilities, which we expect to generate an estimated $4 million in annual run rate savings starting by the end of Q4 of this year.

In our current backlog, we continue to experience softness from our non-roll products, but have a solid backlog for our roll business with some specialty grade size combinations being sold out through 2020.

Brett McBrayer
Thanks Sam. I will now turn the call over to Terry Kenny, President of Air & Liquid Processing Systems. Terry?

Terry Kenny
Thanks Brett and good morning. I am happy to report that we have continually reduced our OSHA recordable injuries on a year-to-date basis, achieving a 42% reduction in recordable injuries and a 100% reduction in lost-time injuries.

We have accomplished this principally by involving all employees in plant-wide safety programs. These programs include daily toolbox talks, plant stand downs when incidents occur and immediate investigations and corrective actions. The safety of our employees is our number one priority, and I am pleased with our progress.

Net sales for the Air and Liquid Processing segment for the second quarter ended June 30, 2019, were comparable to prior year. Net sales for the second quarter compared favorably with that of the first quarter. The 7.9% improvement quarter-over-quarter was led by increases in sales of custom heat exchangers and custom centrifugal pumps.

The segment's backlog as of June 30th, 2019, approximated $53 million, which compares favorably to approximately $44.4 million at December 31st, 2018 and approximately $50.2 million at June 30th, 2018.

The current backlog remains close to the highest level the segment's backlog has been in 10 years. The increase over the prior periods is primarily attributable to an increase in orders for centrifugal pumps for the U.S. Navy. The manufacturing process improvement initiative is moving forward at each operation.

Although, we are at the early stages of the implementation, we already can see and measure positive results in both labor efficiencies and material utilization. The hands-on engagement of all levels of employees at each operation is essential to the success and sustainability of this program.

We continue to focus on increasing revenues of the segment by growing our market share in existing markets and entering new markets while improving margins through increasing material utilization and labor efficiencies.

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

Mike McAuley
Thank you, Brett. Good morning everyone and thank you for joining our call today. My commentary today contains the use of certain non-GAAP measures. So, I refer you to our disclosures regarding non-GAAP measures and the related non-GAAP financial measures reconciliation schedule, included in this morning's earnings release.

I would like to focus on our Q2 results this morning, a discussion of the year-to-date results is included in today's earnings release and in our Form 10-Q filed yesterday. Ampco's net sales from continuing operations for the second quarter of 2019 were $102.5 million. This compares to net sales from continuing operations for the second quarter of 2018 of $118.4 million.

Net sales in the Forged and Cast Engineered products segment declined 16% compared to the prior year period, primarily due to a lower volume of sales of Forged Engineered Products to the oil and gas industry. Net sales for the Air and Liquid Processing segment for the second quarter 2019 were comparable to prior year. I will cover more segment level details in a moment.

Gross profit as a percentage of net sales was 17.5% for the second quarter of 2019 versus 16.5% for the second quarter of 2018. The 100 basis point improvement is primarily due to better pricing for mill rolls and operating efficiencies within the Forged and Cast Engineered Products segment, partly offset by the effects of lower production volumes for Forged Engineered Products and a shift in mix for the Air and Liquid Processing segment.

Selling and administrative expenses of $13.9 million or 13.6% of net sales for the second quarter of 2019 were down compared to $14.3 million or 12.1% of net sales for the second quarter of 2018.

Even though we recognized a bad debt expense of $1.4 million for a British customer who filed for bankruptcy during the quarter, and we absorbed some higher professional fees associated with our restructuring plans in Q2, we were able to show a year-over-year reduction in SG&A for the quarter, due in part to our reduction in force actions earlier in the year as well as some volume-driven lower commission expenses.

Depreciation and amortization expense of $4.7 million for the second quarter of 2019 was down compared to $5.4 million for the second quarter of 2018, due in part to the impairment charge recorded in Q1 to write the assets of our Avonmore, Pennsylvania facility down to their expected fair value.

Loss from continuing operations on an as-reported GAAP basis for the second quarter of 2019 was $0.7 million. This compares to a loss from continuing operations in the prior year quarter of $0.2 million, the decline being driven primarily by the current period bad debt expense.

In addition, the Corporation continued to incur excess costs for operation of the Avonmore cast roll manufacturing facility, which are not expected to continue after its sale as well as more restructuring-related costs incurred during the quarter.

Excluding the bad debt expense, the restructuring-related costs and the estimated temporary excess costs of the Avonmore facility, the Corporation had positive adjusted income from continuing operations of $2.6 million in the second quarter of 2019.

This reflects an improvement of $1.2 million compared to the prior year quarter on the same basis and is reflective of the manufacturing efficiencies, higher pricing and lower overhead costs in the underlying business.

Other income expense net improved for the second quarter of 2019 when compared to the prior-year quarter, primarily due to a dividend of approximately $1.4 million received from our cast roll Chinese joint venture during the quarter.

The income tax provision for the current-year quarter was comparable to the prior-year amount and 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.

As a result, the Corporation reported a GAAP net loss from continuing operations of $200,000 or $0.02 per common share for the second quarter of 2019 compared to a net loss of $1 million or $0.08 per common share for the second quarter of 2018.

Note that the net loss from continuing operations for the second quarter of 2019 includes over $0.12 per share for the impacts of both the bad debt expense and the $200,000 of incremental restructuring-related costs, I previously mentioned.

The Corporation also reported a net loss from discontinued operations, reflecting the operations of our Canadian subsidiary, ASW Steel, of $3.4 million or $0.27 per common share for the second quarter of 2019. This compares to a net loss of $1.7 million or $0.14 per common share for the second quarter of 2018.

The higher loss compared to prior year is due to lower demand of ingots used as feedstock for the production of Forged Engineered Products for the oil and gas industry, and the impact of tariffs imposed by the U.S. on imports of primary steel, which began in June 2019 and were not lifted until May 19th of 2019.

Now, here is a bit more color on our business segment results. In the Forged and Cast Engineered Products segment, despite a 16% decline in sales in Q2, the segment's operating results were comparable to the prior year.

Manufacturing efficiencies, better pricing and lower overhead costs helped to minimize the effect of the lower volume of Forged Engineered Product sales to the oil and gas industry and the bad debt expense recorded during the quarter. Net sales for the Air and Liquid Processing segment were comparable to the second quarter of 2019 versus prior year, whereas the segment’s operating income for the second quarter of 2019 decreased by 21% or $800,000 versus prior year, principally due to changes in product mix.

Backlog at June 30th, 2019, approximated $355 million, which is 2% higher than backlog at March 30th and 6% higher than prior year. We have seen higher order intake and improved pricing for mill rolls along with additional orders for U.S. Navy shipbuilders, offsetting the impact from the ongoing softening in demand for our Forged Engineered Products in the oil and gas industry. Approximately $157 million of the current backlog is expected to ship after 2019.

Now, I will review some cash-related items for continuing operations. Accounts receivable at June 30th, 2019, increased by $15.8 million compared to December 31st, 2018, primarily attributable to higher second quarter 2019 sales when compared to the fourth quarter of 2018, but receivables were about flat with March levels.

Inventories at June 30th, 2019, were approximately flat overall with December 31st, 2018, and with March 31st, 2019, levels.

Accounts payable at June 30th, 2019, increased by $3 million compared to December 31st, 2018, but decreased approximately $4 million compared to March 31st, 2019. Capital expenditures for the second quarter of 2019 were $2.2 million for continuing operations and are $3.6 million year-to-date.

Cash and cash equivalents for continuing operations of $6.5 million at June 30th, decreased compared to the December 31st, 2018, balance of $19.7 million for a specific reason, which, as I explained on the Q1 call, is because we instituted a springing lock box feature earlier this year, whereby domestic customer remittances are swept daily against the credit line in order to minimize borrowings. As a result, we are maintaining minimal domestic cash, and the reported cash balance primarily reflects foreign cash.

Drawings on the Ampco credit facility are $41.3 million at June 30th, 2019, which is up just slightly versus the $40 million at June 31st. The increase compared to December 31st, 2019, reflects the use of the credit facility as planned to repay the promissory notes and interest, which were retired back in the first quarter of 2019. At June 30th, 2019, in addition to the cash balance, the Corporation also has remaining availability on its revolver of approximately $33 million.

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

Brett McBrayer
Thank you, Mike. As we discussed on the call this morning, we continue to see the benefits of our operational improvement initiatives. We are aggressively pursuing additional restructuring opportunities to increase efficiencies in our business and facilitate further cost reduction actions. We are committed to continuing to right-size our business operations to deliver consistent improved profitability. Thank you again for joining us for Ampco-Pittsburgh's conference call today.

At this time, we will open up the line for your questions.

QUESTIONS AND ANSWERS

Operator
We will now begin the question-and-answer session. Please limit yourself to one question and one follow-up. To ask a question, you may press star (*), then one (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 addressed and you would like to withdraw your question, please press star (*), then two (2). At this time, we will pause momentarily to assemble our roster.

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

David Wright
Good morning everyone.

Brett McBrayer
Good morning David.

David Wright
Thanks for all the commentary about the focus on safety, and great to hear about it. Question for Sam. Can you clarify, in your remarks, you had a phrase, working to reduce arrears in Europe. What did that mean?

Sam Lyon
Yes, that is just a past due number of rolls in Europe and we are able to reduce those by over 20% from beginning of the year till now. It is just a delivery performance measure.

David Wright
Okay. So, that is a term for delayed shipments?

Sam Lyon
Correct.

David Wright
Okay. Two-parter for Mike. The dividend from the China subsidiary, was that an extraordinary thing, a regular thing? What was the circumstance behind it?

Then separately, the bankruptcy in the U.K. -- the AR write-down, do they have a similar system whereby creditors get in line and try to get some sort of a recovery? Thank you.

Mike McAuley
Yes, David, the dividend that we received is from our Chinese cast roll joint venture. It is one of our cost basis affiliates. So, it is not the one that we consolidate, but we have received consistent dividends, they have been about every other year, but they have not been this large. They have been lower than this. So, this is a function of the improved performance of that joint venture company. So, yes, it is a regular dividend every other year approximately, but larger this time.

On the customer bad debt expense, yes, there is a process of creditors. It is similar to U.S. bankruptcy. It is in the U.K. So, if you are familiar with U.K. Bankruptcy Law, we were writing off that receivable, David and it was a significant impact in the quarter, I mentioned at $1.4 million.

David Wright
All right, and do you have the possibility of getting a recovery of some sort down the road?

Mike McAuley
It is possible. They have to go through the process, but we were an unsecured creditor, and as I understand it, British deal is moving in to potentially liquidation or finding an alternate buyer. So, it is going to be a long process, I believe.

David Wright
Okay. Thank you.

Operator
Again if you have a question, please press star (*), then one (1).

The conference has now been concluded. Thank you for attending today's presentation. You may now disconnect.