Ampco-Pittsburgh Corporation

Third 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 of Investor Relations*

Sam Lyon, *President of Union Electric Steel Corporation*

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

PRESENTATION

Operator
Good morning and welcome to the Ampco-Pittsburgh Corporation Third Quarter 2019 Earnings Results 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. 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 now like to turn the conference over to Melanie Sprowson, Director of Investor Relations. Please go ahead.

Melanie Sprowson
Thank you, Brandon, and good morning to everyone joining us on today's third quarter conference call. I'm 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 & 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 McBrayer
Thank you, Melanie. Good morning and welcome to our call. Our CFO, Mike McAuley, will review our financial results in more detail momentarily, but, first, I'd like to point out some of the key takeaways of our third quarter performance.

The highlight of the quarter was the completion of the sale of both of our cast roll manufacturing facility in Avonmore, Pennsylvania, and our Canadian specialty steel subsidiary, ASW Steel. The divestiture of these assets significantly improves our cost structure without compromising our ability to serve current and future customers in our Forged & Cast Engineered Product segment. Based on our current order book, we anticipate these actions will result in positive operating profit for our company beginning immediately.

During the third quarter, we also launched the next phase of our operational and efficiency improvements at our European cast roll facilities. These actions are expected to deliver a reduction of approximately $3 [million] to $4 million in operating costs in 2020. Sam Lyon,

President of our Forged & Cast Engineered Products segment, will provide more color on our progress in Europe shortly.

When compared to quarter two, the third quarter also reflects the impact of pre-scheduled seasonal plant shutdowns in our U.S. and European roll manufacturing locations. These shutdowns are used to maintain and improve our asset health. Despite the plant shutdown and the significant downturn in our frac block sales to the oil and gas industry, adjusted income from continuing operations, which is a non-GAAP measure, was approximately breakeven for the quarter. As for year to date, adjusted income from continuing operations yielded an improvement of $2½ million, more than double compared to last year. September was as particularly strong month for the quarter as we were able to efficiently wind down production at Avonmore during the month and harvest operational efficiencies through targeted actions.

I will now turn the call over to Sam Lyon, Union Electric Steel President, who will discuss the Forged & Cast Engineered Product segment activities for the third quarter. Sam?

Sam Lyon
Thanks, Brett. In the third quarter, we have continued our focus on safety, cost reductions in the U.S. plants, and, as mentioned by Brett, restructuring and cost reductions in the European plants. We concluded negotiations with our workforce represented by the United Steelworkers at our Carnegie, Pennsylvania plant, resulting in a four-year contract. The previous contract was set to expire this month.

During the third quarter, we also had planned outages in the U.S. and Europe, where we took the time to work on critical equipment to ensure reliability. Our safety performance continues to show improvement. As stated in the previous call, we will be relentless when it comes to safety as our goal is a zero-injury workplace.

During the quarter, we achieved two major milestones with the divestitures of Avonmore and ASW. Excluding impairment charges, these actions are expected to improve Ampco's net income by approximately $16 [million] to $18 million compared to our last 12-month run rate ended September 30, 2019. I'm pleased to say that the work planned for the Avonmore facility prior to its sale in order to finish product for our customers, was completed two weeks early. This is a testament to the leadership and workforce at Avonmore. I would like to thank them for this effort through this time of uncertainty.

All new production has been absorbed by the European cast plants. At our forged plants in the United Sates, we continue to take costs out of the system. Our tiered daily management system, where meetings are held at the department, plant, business, and corporate levels, continues to evolve and improve to expose issues and drive problem solving. Year to date, our efficiencies have improved in our U.S. facilities by 7 percent. This improvement has held steady from Q2 to Q3.

For our European assets, we are currently in the middle of a restructuring initiative to lean out our overhead costs, including the consolidation of some sales offices. Our focus on quality has already yielded benefits. We expect annualized savings of approximately $3 [million] to $4 million from these activities starting in Q4.

Finally, from a bookings' perspective, we have a solid backlog for our roll business, with some specialty, grade, and size combinations being sold out for the next year.

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

Terry Kenny
Thank you, Brett, and good morning. As Brett and Sam discussed, one of our major focuses is the safety of our employees. The Air & Liquid Processing segment has experienced significant improvement in OSHA-recordable accidents, which have decreased by more than 50 percent when compared to prior year. This is a segment-wide effort, and every employee is responsible for this success and the success of the safety program, and I thank them for their efforts.

Net sales for Air & Liquid Processing segment for the third quarter ended September 30, 2019, were 3 percent below that of the prior year as a result of changes in customer-required delivery dates. The operating income for the quarter, when compared to prior year, was negatively impacted by the lower sales and a shift in product mix.

The segment's backlog as of September 30, 2019, approximated $53 million, which compares favorably to approximately $44.4 million at December 31, 2018. The backlog at each of the three businesses which make up the Air & Liquid Processing segment have increased when compared to December 31, 2018. We are now seeing positive results of our process improvement efforts in increased productivity and material utilization improvements. We are pleased with the results to date and confident that the success we have experienced will continue to grow.

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 for the quarter in more detail. Mike?

Michael McAuley
Thank you, Brett. Good morning and thank you for joining our call today. My commentary today contains the use of certain non-GAAP measures. 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'd like to focus on our Q3 results this morning. A discussion of year-to-date results is included in today's earnings release. Ampco's net sales from continuing operations for the third quarter of 2019 were $90.9 million. This compares to net sales from continuing operations for the third quarter of 2018 of $98.8 million. Net sales in the Forged & Cast Engineered Product segment declined approximately 10 percent compared to the prior-year period, primarily due to lower sales of forged engineered products to the oil and gas industry.

Net sales for the Air & Liquid Processing segment for the third quarter of 2019 were relatively comparable to prior year. I'll comment more on segment-level results momentarily.

Gross profit as a percentage of net sales was 16.9 percent for the third quarter of 2019 and was approximately flat with the third quarter of 2018. Higher pricing for mill rolls and operating efficiencies within the domestic forged operations were offset by the effects of weaker pricing for forged engineered products and changes in product mix for the Air & Liquid Systems Processing segment.

Selling and administrative expenses of $12.4 million, or 13.6 percent of net sales, for the third quarter of 2019, were down compared to $14 million, or 14.2 percent of net sales, for the third

quarter of 2018. 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 this year, lower professional fees associated with restructuring activities, as well as lower volume-driven commissions expense.

Depreciation and amortization expense of $4.5 million for the third quarter of 2019 was down compared to $5.4 million for the third quarter of 2018, due in part to the sale of our Vertical Seal Division last year and the cessation of depreciation at the Avonmore facility beginning in Q2 in connection with the write-down of certain assets to their estimated net realizable value.

Loss from continuing operations on an as-reported GAAP basis for the third quarter of 2019 was $1.3 million. This compared to a loss from continuing operations in the prior-year quarter of $2.8 million, the improvement being driven in part by lower losses at the Avonmore facility as operations were curtailed in anticipation of its sale and the year-over-year reduction in SG&A I just described.

Excluding the restructuring-related costs and estimated temporary excess costs of the Avonmore facility, as defined in the earnings release this morning, non-GAAP adjusted loss from continuing operations was approximately $0.1 million for the quarter. This reflects an improvement of $0.6 million compared to the prior-year quarter on the same basis. This improvement is primarily attributable to higher pricing for mill rolls, manufacturing efficiencies in our domestic forged operations, and lower overhead costs, partially offset by lower sales of forged engineered products to the oil and gas industry and the effect of a shift in product mix in the Air & Liquid Processing segment.

Other income declined slightly for the third quarter of 2019 when compared to the prior-year quarter. Although we recorded a net gain of $2.3 million on the curtailment of the defined benefit pension and post-retirement plans and recognition of special termination benefits associated with the divestiture of the Avonmore facility in the current-year quarter, this was offset by higher transaction losses on foreign exchange, higher interest expense, and the timing of a dividend received from one of our cast roll joint ventures in the prior-year quarter.

At the bottom line, the Corporation reported a GAAP net loss from continuing operations of $1.2 million, or $0.10 per common share, for the third quarter of 2019 compared to a net loss of $3 million, or $0.24 per common share, for the third quarter of 2018.

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 third quarter of 2019 compared to a net loss of $3.4 million, or $0.28 per common share, for the third quarter of 2018. With the divestiture of this business at September 30, 2019, we will no longer be carrying this discontinued operation going forward.

With respect to results of our business segments, in the Forged & Cast Engineered Product segment, despite approximately a 10 percent decline in sales in Q3, mainly to a drop in forged engineered product demand in the oil and gas industry, the segment's operating results improved from a year ago by $1.1 million, primarily due to lower losses at the Avonmore facility as operations were curtailed in anticipation of its sale. The effect from lower forged engineered product sales was offset by better pricing for our mill rolls. Manufacturing efficiencies for our domestic forged operations were partially mitigated by unabsorbed costs primarily at our European operations due to seasonal summer maintenance shutdown activity.

Net sales for the Air & Liquid Processing segment for the third quarter of 2019 were down slightly, approximately 3 percent compared to prior year, whereas, the segment's operating income for the second quarter of 2019 decreased by 23 percent, or $685,000, versus prior year, principally due to changes in product mix and some shipment timing issues as Terry described earlier.

Now I will review a few cash-related items for continuing operations. Capital expenditures for the third quarter of 2019 were $3.4 million for continuing operations and are at $7.2 million year to date. Cash and cash equivalents for continuing operations of $9.8 million at September 30, 2019, decreased compared to the December 31, 2018 balance of $19.7 million. As I explained on prior calls, cash from our domestic customer remittances are now swept daily 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.

Drawings on the Ampco revolving credit facility are $38.4 million at September 30, 2019, which is down versus the $41.3 million at June 30th. The change reflects the proceeds from the two divestitures which closed on September 30th, which were used to pay down the revolver, but this was partly offset by having drawn on the revolver to fund operations earlier in the quarter. The increase in revolver borrowings compared to December 31, 2018, balance of $14.3 million, reflects the use of the credit facility as planned to repay the promissory notes and interest which were retired in the first quarter of 2019. At September 30, 2019, in addition to the cash balance, the Corporation also has remaining availability on the revolver of approximately $21 million.

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

Brett McBrayer
Thank you, Mike. I'm excited and encouraged by the progress our team has made thus far. While we've made substantial improvements, we're not finished. We will continue to push for topline growth and operational efficiencies across our core businesses.

During the fourth quarter, we expect improved operating income as a result of the projects and initiatives that we've discussed this morning. Our employees remain focused and committed to building a sustainable and profitable future for our businesses. I have great confidence as we move forward.

Thank you again for joining us for Ampco-Pittsburgh's conference call today. At this time, we will open up the lines for questions.

QUESTIONS AND ANSWERS

Operator
We will now begin the question-and-answer session. We ask that you please limit yourself to one question and one follow-up. 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. At this time, we will pause momentarily to assemble our roster.

Our first question comes from Marco Rodriguez with Stonegate Capital. Please go ahead.

Marco Rodriguez

Good morning. Thank you for taking my questions. I was wondering if you could talk a little bit more in regard to initiatives to improve your operating efficiencies. Obviously, you've made a couple significant divestures. If you can just put some more color and some more metrics as far as what we should be expecting as you guys move into fiscal '20 for those types of initiatives.

Sam Lyon
This is Sam. On the European side, I mentioned we initiated a restructuring and cost improvement program there, that is mainly some overhead redundancies that we're negotiating through and getting reduced, and most of that is completed, and some sales office consolidation, which will be completed by the end of Q1. So we expect to see a $3 [million] to $4 million improvement out of that activity. Also included included in that is a scrap-reduction program where we've already captured the benefit there, starting in Q4, so $1.0 million of that is done and 80 percent of the restructuring has been completed at this point. That's the main thing that's occurred in this quarter.

In the U.S. side, we continue to perform strong compared to last year. There will be more opportunity, but I think we've switched our focus to Europe.

Marco Rodriguez
Understood. And then in terms of the Air & Liquid business, you mentioned on the call that there were some timing issues and switches in the mix. If you could just provide some more detail in regard to that.

Terry Kenny
Yes, this is Terry. At the end of the third quarter, a few customers requested…construction projects were delayed. They asked us to delay some shipments, so we had no choice but to accommodate that, and the switch the shift in product mix was to some lower-margin business from our air handling business to some lower-margin business at our air handling business from some more profitable business from our centrifugal pump business.

Marco Rodriguez
And those delayed shipments, are they going to be completed in Q4, or are they pushed out into fiscal '20**?**

Terry Kenny
They will be shipped in Q4 if they haven't already been shipped by now.

Marco Rodriguez
Okay, and can you quantify the dollar amount?

Terry Kenny
No, I — it's —

Michael McAuley
We're down about 3 percent [inaudible].

Terry Kenny
We're down about 3 percent. Exactly, approximately 3 percent of the quarter of shipments were delayed.

Marco Rodriguez

All right. Thanks a lot. Appreciate your time.

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

Justin Bergner
Sorry for the company mispronunciation — GDOT Research. Good morning, guys.

Michael McAuley
Hi, Justin.

Brett McBrayer
Good morning.

Justin Bergner
So the mix in Air & Liquid Processing, is that dynamic supposed to continue, or will that be sort of sorted out once these delayed shipments take effect?

Terry Kenny
It will be sorted out once the delayed shipments occur.

Justin Bergner
Okay, great. And then could you just remind us what the proceeds are from the combined sales of the Avonmore facility and the ASW Canadian specialty steel operation?

Michael McAuley
Yeah, this is Mike, I can fill you in on that, and you'll see we didn't disclose it when we announced the deals, but you'll be seeing it in our Q which will be coming out shortly. Combined, after consideration of the purchase price adjustment mechanism for changes in networking capital, the combined proceeds from the divestitures was in the range of $8 million, and we used those proceeds to pay down the line on the day the proceeds came in.

Justin Bergner
Okay. Thank you.

Operator
Our next question comes from David Wright with Henry Investment Trust. Please go ahead.

David Wright
Hi, good morning. Sam made a comment in his remarks about the $16 [million] to $18 million of operating profit swing from having completed the two divestitures. I just wanted to make sure I understood that. Could you go over it again?

Michael McAuley
Yeah, David, hi, it's Mike. He didn't say operating profit, he said net income, number one, because we're talking about ASW, which is a discontinued operation. So if you look at our P&L and you look at our earnings release this morning, you see that results from discontinued operations, which is below loss from continuing operations, that's all ASW, and it's $9 million year to date. We were looking and he was making a reference to the impact of losing that compared to kind of an annualized run rate, by looking at our last four finished quarters. And if you go back in time and do that math, that's a big chunk of it.

And then he was also including the Avonmore temporary excess costs, which if you look at the attachment to our press release, we've identified the nine months' worth of that piece on our non-GAAP financial measures disclosure. And if you go back and look at our four quarter run rate on that and you're excluding things like impairment and so forth, one-off items, you can get these numbers that he cited, something in the range of $16 [million] to $18 [million] combined at the net income level.

David Wright
So that's what it would have been if you hadn't had these two things, essentially?

Michael McAuley
Theoretically, yes. And there's another item in there as well, David, where I mentioned on my remarks that we recorded a $2.3 million net gain on the curtailment of certain pension and post-retirement benefit plan numbers that's in other income expense. That's where it resides geographically in the P&L. So we netted that down, that $2.3 million gain as well.

David Wright
All right. Well, that's great. It seems like so far, the things that you said you were going to execute on, you have executed on, so I wanted to acknowledge that and to wish you continued good luck.

Michael McAuley
Thank you very much.

Brett McBrayer
Thank you.

Operator
Our next question is a follow-up question from Justin Bergner with GDOT Research. Please go ahead.

Justin Bergner
Oh, thanks again. I just want to understand, within the breakeven adjusted results for this quarter, how much was Avonmore still weighing that down to whatever direct or indirect costs were incurred after whatever you adjusted back out.

Michael McAuley
Yeah, it's Mike again — on the table attached to the press release, we've kind of spiked that out, that we think the excess cost of Avonmore in the third quarter, about $685,000. It's lower than we had been seeing in prior quarters because we started the wind down earlier, so we started seeing the benefit already of getting out of it in the third quarter.

If you look at that same value, if you pull up the last quarter's press release, you know, it was $1.7 million; the prior press release, $2.2 million, so as we started winding down operations, we're started to already harvest some of the benefit, but when we said it was a $9 [million] to $10 million benefit we were talking about a run rate from around the earlier part of the year when it was more in the range of $2 [million] to $2.2 million, kind of a quarterly value, which if you annualize that, that's how we got to the impact versus that prior run rate.

Justin Bergner

Okay, got it, yeah. So it seems like all the Avonmore costs are backed out when you get to that breakeven number. Okay, I just wanted to make sure that was the case. All right. Thank you again.

Michael McAuley
Okay.

Operator
As a reminder, if you would like to ask a question, please press star, then 1.

CONCLUSION

Operator
At this time, I'm seeing no further questions. This concludes our question-and-answer session as well as today's conference. We thank you for joining. You may now disconnect.