Ampco-Pittsburgh Corporation

Second Quarter 2020 Earnings Results

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CORPORATE PARTICIPANTS

Melanie Sprowson – *Director of Investor Relations*

Brett McBrayer – *Chief Executive Officer*

Mike McAuley – *Senior Vice President, Chief Financial Officer and 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 2020 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. After today's presentation, there will be an opportunity to ask questions. Please note this event is being recorded.

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

Melanie Sprowson
Thank you, Allyssa and good morning to everyone joining us on today's Second Quarter 2020 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. To access the earnings release or the webcast replay, please consult the Investor 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 very proud of our employees' performance in our Second Quarter of 2020. We faced tremendous obstacles during this unprecedented time. However, the team met these challenges head on and delivered positive results.

The health and safety or our employees are at the forefront of everything we are doing. We have taken extraordinary steps to safeguard their well-being during this challenging period. At all times we have continued to seek guidance from our local, state and federal authorities where we operate to ensure we meet or exceed safety and health guidelines during this pandemic.

From an injury perspective, we've reduced our recordable injury rate by over 30% compared to 2019. Unfortunately our lost time rate increased by 15% during this same period. We are keenly focused on addressing this gap as we target zero injuries in the facilities where we operate. As the global economy took a pause, we initiated plant shutdowns and furloughs to meet the reduced customer demand experienced in the forged and cast engineered product segment. Our Air & Liquid processing segment continued to operate without interruption during the quarter and continues to experience a strong order book. Despite the challenges we faced, we continued to progress in our efficiency and cost improvement efforts. I want to thank all of our employees for their dedication, diligence and hard work during this time.

We reported a positive earnings per share of $0.05 per common share for the second quarter despite significant headwinds. As a result, our return to profitability extended through the second quarter with a positive trailing 12-month EPS for the first time in many years. Our liquidity position improved through effective measures taken during the quarter to respond to the pandemic and we used our improved position to pay down debt. I was also pleased that we extended our credit agreement in Q2.

Looking ahead to the third quarter, we are electing to take proactive outages in many of our facilities to perform planned maintenance to further improve our long-term performance. I'd now like Terry Kenny, President of Air & Liquid Systems and Sam Lyon, President of Union Electric Steel to share the improvements in their segments' performance. Terry?

Terry Kenny
Thank you, Brett and good morning. Second quarter sales for the Air & Liquid processing segment increased slightly when compared to the same period last year, an increase by 9% when compared to the first quarter. Increases in sales of custom air handling equipment and centrifugal pumps were partially offset by a decrease in sales of heat exchangers.

Segment Operating Income for the second quarter was modestly lower when compared to the second quarter last year and showed an increase when compared to the first quarter. On a year-to-date basis, sales and operating Income displayed an increase when compared to the prior year. The favorable results reflect the impact of increased sales prices, an improved product mix and the savings generated by the process improvement efforts at all three divisions.

The Air & Liquid processing segment backlog is $52.4 million which compares favorably to the $50.5 million to start the year. As Brett mentioned earlier, the operations at all three businesses that make up the segment have continued to work without interruption through the pandemic. I would like to thank all of the employees because this would not be possible without their hard work and dedication.

In addition, I would like to thank our customers for their loyalty and support throughout these difficult times. The focus for all three businesses is to continue to keep our employees safe, service our customers and build on our process improvement successes.

Brett McBrayer
Thank you, Terry. I will now turn the call over to Sam Lyon. Sam?

Sam Lyon
Good morning. Throughout the second quarter our focus was on the well-being of our employees, the safe operation of our facilities, liquidity, maximizing cost savings and staying close to our customers to understand their needs. From a safety perspective, I would like to congratulate and recognize our Slovenia, UK and Valparaiso, Indiana operations for having zero lost time incidents year-to-date. Our recordable rates are also at a five-year low. The team has remained focused during this unprecedented time.

From a liquidity perspective, we took every opportunity to conserve cash as in late March and early April the future was quite uncertain. We shut down operations in the US, Europe and China for one to six weeks depending on the demand for each business and government guidelines. Sweden did not shut down however, but we reduced operations by 40% to 50%.

In response to the pandemic, we took the opportunity to optimize inventory and prioritize capital expenditures. Combined with expense reductions, we expect to reduce cash outlays significantly in Fiscal Year 2020. During our last call I discussed the cost savings initiatives on maintenance and quality in the United States, the reorganization in Europe and the initiatives on raw material process improvements and the cost of quality in Sweden. All of these initiatives are progressing on or ahead of plan helping to mitigate the effects of the pandemic.

As we look to the third quarter, we are taking our seasonal European shutdowns of three to four weeks. In the US we will adjust plant production based on demand. We will also use this time as Brett mentioned to perform planned maintenance to further improve our performance.

Brett McBrayer
Thank you, Sam. At this time Mike McAuley will share more detail regarding our financial performance for the quarter. Mike?

Mike McAuley
Thank you, Brett and good morning, everyone. As Brett mentioned with EPS of $0.05 per share for the second quarter of 2020, Ampco-Pittsburgh did extend its return to profitability with its trailing 12-month EPS now positive. Ampco's net sales from continuing operations for the second quarter of 2020 were $74.8 million. This compares to net sales from continuing operations for the second quarter of 2019 of $102.5 million.

Net sales in the forged and cast engineered product segment of $50.5 million for the second quarter of 2020 declined approximately 36% compared to the prior year quarter, principally attributable to the lower volume of shipments due to customer deferral of deliveries in the flat-rolled steel and aluminum markets, primarily in response to the global pandemic and reduced demand for other forged engineered products.

Net sales for the Air & Liquid processing segment for the second quarter of 2020 of $24.3 million increased slightly compared to the prior year period. Gross profit as a percentage of net sales was 19.8% for the second quarter of 2020 versus 17.5% for the second quarter of 2019. The improvement is primarily attributable to the forged and cast engineered product segment which is benefiting principally from improved pricing and product mix, a lower-cost structure due to the sale of the Avonmore facility last year and lower raw material costs. The improvement was partly offset by the impacts of lower shipment volumes and net unabsorbed costs from the temporary idling of capacity caused by the pandemic. For the Air & Liquid processing segment, gross profit was comparable between the periods.

Selling and Administrative Expenses of $10.2 million for the second quarter of 2020 declined $3.7 million compared to the prior year. The prior year quarter included a bad debt expense of $1.4 million for a cast roll customer who filed for bankruptcy. The remaining decline was driven principally by lower employee related expense due to the completed reduction in force actions in 2019, lower professional fees and employee severance costs associated with the corporation's restructuring efforts, as well as ongoing cost containment initiatives.

Depreciation and Amortization expense of $4.7 million for the second quarter of 2020 was flat compared with the second quarter of 2019. The corporation recorded a nearly breakeven income from continuing operations for the quarter which compared favorably to the $0.7 million loss from continuing operations in the prior year quarter. The prior year quarter included approximately $1.7 million in excess carrying costs of the Avonmore, PA cast roll facility divested in 2019, the bad debt expense I previously mentioned of $1.4 million and some restructuring related costs. Although the current year quarter benefited from improved roll pricing, the elimination of the excess costs of Avonmore and the lower SG&A expense, these impacts could not completely offset the pandemic-driven effects of lower shipment volumes and net unfavorable absorption due to plant shutdowns in the forged and cast engineered product segment.

Other income expense net improved for the second quarter of 2020 when compared to the prior year quarter which included dividend income of approximately $1.4 million from one of the corporation's Chinese joint ventures. Partial recovery of forward exchange rates in equity markets during the quarter following the pandemic-related market disruptions at the end of Q1 resulted in unrealized gains on FX and on rabbi trust assets in the current quarter which contributed to the period-over-period improvement. At the bottom line, the corporation reported net income attributable to Ampco-Pittsburgh of $0.7 million or $0.05 per share for the second quarter of 2020 compared to a net loss of $3.9 million or $0.31 per share for the second quarter of 2019 which included a net loss from discontinued operations of $0.27 per share.

Regarding business segment results in the forged and cast engineered product segment Q2 2020 net sales of $50.5 million declined approximately 36% versus prior year due to a lower volume of shipments of mill rolls both forged and cast as a result of customer deferral of orders in response to the pandemic and reduced demand for forged engineered products which is offset in part by more favorable pricing and product mix.

Operating results for the second quarter of 2020 were comparable to prior year. The segment was adversely impacted by the lower volume of shipments and net unabsorbed manufacturing costs due to the temporary plant idlings during the quarter. But these effects were largely mitigated by the elimination of the excess carrying costs of the now divested Avonmore plant, improved product pricing and lower SG&A expense including the bad debt charge recorded in the prior year quarter.

In the Air & Liquid processing segment, Net Sales of $24.3 million in the second quarter of 2020 were slightly higher than the comparable prior year period as higher shipments of air handlers and centrifugal pumps more than offset a decline in shipments of heat exchangers as Terry indicated. The Air & Liquid processing segment's Operating Income for the second quarter of 2002 was comparable to prior year.

Backlog at June 30, 2020 approximated $258 million, a decrease from $321 million at December 31, 2019. The decrease is principally attributable to lower backlog for forged and cast rolls and a decline in foreign exchange rates used to convert the backlog of the corporation's foreign subsidiaries into the US dollar although Air & Liquid's processing backlog improved slightly over this period due to higher order intake for centrifugal pumps.

Next, here are a few balance sheet and cash related items for our continuing operations. Accounts receivable of $63 million at June 30, 2020 decreased by $18.8 million compared to December 31st, 2019, primarily attributable to lower sales in the latter part of the quarter of 2020 compared to the latter part of the fourth quarter of 2019, improved collections and an increase in the corporation's allowance for doubtful accounts provision which is linked to the bad debt charge from the prior year. Receivables decreased $12.3 million compared to March 31, 2020 due to lower sales in the quarter. Inventories of $76.7 million at June 30, 2020 decreased by $5.5 million compared to December 31, 2019 and decreased $5.6 million compared to March 31, 2020.

Accounts payable of $27 million at June 30, 2020 decreased by $6.3 million compared to December 31, 2019 and decreased $9.2 million compared to March 31, 2020. Capital expenditures for the second quarter of 2020 were $1.4 million and are $3.3 million year-to-date primarily in the forged and cast engineered product segment. Cash and cash equivalents for continuing operations of $15.9 million at June 30, 2020 increased $8.9 million compared to the December 31, 2019 balance. Net cash flows provided by operating activities was robust, approximately $19.3 million for Q2 2020 and approximately $31.4 million year-to-date.

Drawings on the Ampco revolving credit facility were $15.8 million at June 30, 2020 which is down by $18.5 million compared to the $34.3 million balance at December 31, 2019. The decrease in revolver borrowing reflects improved operating results in a lower investment in trade working capital. Total debt at June 30, 2020 of $52.3 million decreased $18.6 million or 26% from December 31, 2019 which is in line with the revolver decrease and a decrease of $15.9 million or 23% from March 31, 2020.

At June 30, 2020 in addition to the cash balance the corporation also has remaining availability on the revolver of approximately $34 million, an improvement of approximately $7 million compared to availability at December 31, 2019.

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

Brett McBrayer
Thank you, Mike. As I had stated at the beginning of the call, I could not be prouder of the way our employees have responded to the pandemic while generating positive net income for Q2. We've taken extraordinary measures to maintain safe work environments and to protect our liquidity including extended plant shutdowns and cost containment efforts in the quarter to mitigate reduced customer demand in our roll business. Restructuring of our portfolio, cost reduction measures and production efficiency improvements over the past two years have helped position us to achieve positive results and to-date minimize the effects of the pandemic.

Thank you. We will now take 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 one 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 two. As a reminder, we ask that you please limit yourself to one question and one follow up. If you have additional questions you may reenter the question queue. At this time, we will pause momentarily to assemble our roster.

The first question today comes from Marco Rodriguez of Stonegate Capital Markets. Please go ahead.

Marco Rodriguez
Good morning. Thank you for taking my questions. I was wondering if maybe you could talk a little bit more in detail on the forging and cast segment specific to the deferrals you saw in the quarter. Was it a consistent flow of deferrals or can you discuss the cadence and then if there is any sort of color that you could provide in terms of is there a typical timeframe where those deferrals have been pushed towards?

Sam Lyon
Yes. Sure, Marco. This is Sam. We saw a decline from first quarter/second quarter of about 27% of our sales and it was much more pronounced in April as Europe had shut down much of the steel mills to contain the virus. Then we saw sales improve in May and then further in June. Many things were just moved a quarter or two quarters to the right.

One of the things about the business is the roll business is they keep several months of inventory on-hand. And so one, they shut down their mills for a period of time and then two, as they come back up and they're operating at a lower utilization rate, their inventory on-hand instead of having two months or three months on-hand, now they have three or four months on hand. That takes a little while to absorb but we're starting to see if you listen to Ford's call or GM's call, automotive is coming back up. There's a shortage of products actually on the dealer lots and we're starting to see some utilization rates come up in steel mills across the world. So we expect Q3 to be better than Q2 and Q4 to be better than Q3.

Marco Rodriguez
Understood. Thank you. And then on the call in your prepared remarks you had brought out a few different impacts to the quarter for the forged and cast. In terms of obviously volumes being down, you had to idle some plants but then you had some offsets in terms of just some improved pricing and the removal of excess cost. I wonder if you can sort of put it into sort of buckets if you can talk about the biggest impacts and the least impacts in the quarter. Then just kind of circling back on the removal of the costs, just trying to confirm that if I heard correctly that all the cost reduction initiatives that you guys had introduced in late Fiscal '19, they're all progressing on plan through this fiscal year.

Mike McAuley
Yes. I will take a shot at a couple and then pass it off to Sam. Just in terms of magnitude of impacts in the forged and cast segment, Marco, just looking and analyzing our numbers, the sales volume impact in the quarter versus prior year was about the same magnitude as the net unabsorbed cost impact roughly. Those two factors were about equal impacts to the reduction in operating income. Then we had some positives like we didn't have the bad debt charge recur that we had in Q2 of last year. Then the cost benefits are really showing through because those are the things that help keep the operating income stable in such a down environment from a sales and absorption impact. I will let Sam talk about those, but it manifests itself not only in cost of sales but also SG&A.

Sam Lyon
Yes. Just a couple comments. From last year just productivity improvements in the US are north of $1.5 million. Reduced repair and maintenance costs is a little bit north of $1.5 million year-to-date and that's really driven by a switch from reactive to proactive maintenance. That increased to about 80% proactive in Q2. We did have the opportunity as Brett said while the plants were down to make sure that any critical maintenance items were actually taken care of while the plant was down, so we took advantage of that. Our cost of quality both internal and returns is down year-over-year and that's trending almost $1 million and then we have the reduction in forces that we had which was about $1.5 million. Those are pretty much the big ones.

Marco Rodriguez
And if I could just put one more in here real quick. Some of the Air & Liquid processing, pretty strong growth sequentially. Just wondering if any sort of products got delivered earlier than expected. Thank you.

Terry Kenny
No. We had no delays but we did not have any equipment that was asked to be delivered sooner.

Marco Rodriguez
Thanks a lot, guys. I appreciate the time.

Mike McAuley
Thank you, Marco.

Operator
The next question today comes from David Wright of Henry Investment Trust. Please go ahead.

David Wright

Good morning. Great quarter. For forged and cast to be down 36% and still breakeven is really phenomenal, so just great job with Air & Liquid as well. I don't know a lot of businesses that are flat year-over-year in this environment.

Mike, couple questions for you. Absent any extraordinary events, do you have a target or at least a trend for net debt between now and the end of the year?

Mike McAuley
Yes, David. I would say on the cast side, just one of the things to note is that our US cash we had sweeping against the line. We keep US cash very fairly minimal. We target to keep about $10 million to $12 million globally on cash on the balance sheet for working fund needs. That would be like a kind of a projection to keep in mind.

Then on the debt, it all depends on the recovery. We will be using our credit line to support a rebound in trade working capital. That's what it's there for. With sales stepping up as Sam indicated that he believed in Q3 and then again in Q4 we're going to see the revolver grow a little bit further, but I am very pleased with our liquidity situation at the moment relatively speaking. With borrowings down to $15.6 million on the revolver, we have plenty of capacity on the revolver.

Oh, the other thing is that in July we had an industrial revenue bond of $4.2 million that we did retire. That was due July 1st, so it's not in these numbers but it is a piece of debt that's now gone, and the revolver balance didn't really go up that much because we've paid some additional down since then. If you're trying to project net debt, I would take out the industrial revenue bond and use the cash balance I kind of indicated there and then maybe a little something for working capital growth.

David Wright
Right. So in terms of the trend, it can obviously fluctuate, but it sounds like based on current business trends that you've seen the high for the year in net debt. Is that a fair statement?

Mike McAuley
Yes.

David Wright
Okay. And then on SG&A I know you have ongoing initiatives and you're down in last quarter to basically $10 million. Do you have any sense of what SG&A, absent again, anything extraordinary would be for the next couple of quarters?

Mike McAuley
We expect it to be flat.

David Wright
Okay. And then, Sam, just to put different words on something that you said to the previous questioner, in terms of roll shipments you would anticipate the unit shipments would be higher in Q3 than they were in Q2 and then higher in Q4 than they would be in Q3?

Sam Lyon
Yes, that's about right.

David Wright
Okay, great. Alright and thanks very much. Keep up the good work.

Mike McAuley
Thank you, David.

Brett McBrayer
Thanks, David.

Operator
Again, if you have a question please press star then one. The next question comes from Mr. Whitehead of TED Education and Lifeguarding. Please go ahead.

Mr. Whitehead
Good morning. I'm wondering if the successes of this quarter will be affecting the upcoming rights offering.

Mike McAuley
Well, thank you for your question. Regarding the company's rights offering, the company has filed a registration statement with the SEC and we did recently put out a press release indicating our calendar with our proposed timing, so that's out there. We're going to be offering common stock with warrants to purchase additional shares of common stock and we are expecting to try to raise gross proceeds of $20 million from the offering. But we'd like to refer you to our filings made with the SEC in regards to that which will be updated with additional information once available.

Mr. Whitehead
Okay. Thank you.

Mike McAuley
Thanks.

CONCLUSION

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