Ampco-Pittsburgh Corporation

Fourth Quarter 2020 and Full-Year 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 day and welcome to the Ampco-Pittsburgh Corporation Fourth Quarter and Full-Year 2020 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 touchtone phone. 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, Carrie, and good morning to everyone joining us on today's Fourth Quarter and Full-Year 2020 Conference Call. Joining me today are Brett McBrayer, our Chief Executive Officer, and Mike McAuley, Senior Vice President, Chief Financial Officer, and Treasurer. Also joining 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 various 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.

On this call today we are not addressing the potential proxy contest. The background is set forth in the preliminary proxy statement we filed with the Securities and Exchange Commission on March 12, 2021.

A replay of the 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'll turn the call over to Brett McBrayer, Ampco-Pittsburgh's CEO. Brett?

Brett McBrayer
Thank you, Melanie. Good morning and welcome to our call. While we have aggressively pursued our goal of improved shareholder return, there's been nothing more important than protecting our employees' health, safety, and well-being and protecting the environment where we operate. We are intently focused on eliminating injuries and incidents in the workplace. Identifying and correcting potential hazards before an incident occurs is everyone's responsibility in all Ampco-Pittsburgh locations worldwide. With the onset of the global pandemic, we found ourselves confronted with new and unexpected threats. The response of our employees to these new challenges was, and continues to be, outstanding. We have successfully altered how we conduct business in our facilities and how we engage with our suppliers and customers.

I am proud of our employees' hard work to protect their teammates, themselves, and their communities where we interact and live. All this was achieved, while still honoring our commitments to our customers, which I'm very proud of. Despite the challenges we faced, our employees continued to demonstrate their dedication to continued improvement by reducing our lost work day rate by 6 percent in 2020 versus the prior year and our recordable injury rate by 26 percent. As we have in previous years, we've focused on identifying and eliminating high-risk hazards that could permanently alter an employee's life. I am encouraged by our progress to date. This effort will continue to be a primary objective for our businesses in 2021.

On the financial front, our businesses achieved an operating income of $6.4 million in 2020 compared to a loss of $10.9 million in 2019. This $17.4 million improvement was achieved despite the global pandemic's significant impact on our customers and their end markets. The restructuring activities and efficiency improvements the team has been engaged in over the past two years positioned us to face these challenges and deliver our first profitable year since 2015. Consequently, net income of $8 million was a $29 million improvement compared to our loss last year of $21 million. The net result for our shareholders was the achievement of an earnings per share of 56 cents in 2020 versus an earning-per-share loss of $1.67 in 2019.

As we ended 2020, we marked our fifth consecutive quarter of positive earnings. Through our process efficiency improvements, we delivered free cash flow from continuing operations of $33.6 million in 2020. These improvements, coupled with our successful equity raise of a little over $19 million, positioned us to reduce our total debt by approximately $44 million, or 47 percent, during 2020. Not only did we use our enhanced liquidity to improve our balance sheet, but we are now in a position to pursue our equipment upgrade initiatives, allowing us to further reduce our total cost structure, grow our topline, and meet the needs of our customers now and well into the future.

Regarding 2021, we are cautiously optimistic that order activity levels will increase moving into the second half of the year as the lingering impacts of the pandemic subside. For further comments on our businesses, I'd like Terry Kenny, President of Air & Liquid Systems, and Sam Lyon, President of Union Electric Steel, to share some of the highlights in their segments' performance. Terry?

Terry Kenny

Thank you, Brett. I would like to start off with acknowledging the AEROFIN Division for having zero OSHA-recordable injuries in 2020. Every employee at AEROFIN deserves recognition for their efforts. Thank you for a great job. The segment experienced a decrease in the recordable rate from 4.16 to 2.87 in the fourth quarter. The health and safety of our employees remains our priority as we continue to take every safeguard to limit their exposure to COVID-19.

During the pandemic, all three businesses that make up this segment continued to operate three shifts per day, six days per week, without interruption. This would not have been possible without the personal sacrifices and dedication of all of our employees. A sincere thank you to all.

I would be remiss without thanking our customers for their loyal support through these unprecedented times. Thank you to them as well.

The fourth quarter revenue and operating income before asbestos expense outpaced the previous quarter. The pump business had a strong showing in the quarter. The heat exchanger business has been adversely impacted by lower activity in the commercial and industrial OEM markets. The air handling business continues to be under pressure with competitive pricing.

Our material costs have been increasing for the last several months. The businesses are able to incorporate these increases for the most part in our pricing. Orders received for the fourth quarter were below that of the third quarter, with softness experienced in the heat exchanger business and the air handling business. The segment backlog remains strong at $54.2 million, which is 7.1 percent above that at the end of 2019. We remain optimistic that as certain of our markets continue to rebound and in-person customer access improves, our topline opportunities will expand.

We continue to concentrate our efforts on improving our efficiency in all areas of the business while providing quality products at competitive prices to our customers.

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

Sam Lyon
Good morning. First, I'd like to recognize our Slovenia and Valparaiso, Indiana operations for achieving zero loss-time incidents in 2020. These locations also had our lowest recordable rates in the Forged and Cast Engineered Product segment, with zero and 2.38, respectively. Compounded with the additional requirements that COVID-19 demanded, this is quite an achievement. Our overall recordable rate for the fourth quarter reduced from 4.16 to 2.82 when compared to the prior quarter. Our number one focus will always be the safety and well-being of our team members.

Liquidity continues to be a strong focus for us, and we have had great success here. Mike McAuley will cover this in more detail shortly. We have challenged our teams and reduced our inventory to levels not seen in many years. Working hard to maintain these gains has resulted in shorter lead times and the ability to react to orders sooner. We continue our weekly team meetings to review our inventory positions, receivables, and payables. All of these actions have resulted in the segment generating strong cash flow in 2020.

In Q4, our operations continued to run on a reduced schedule. Government programs in the UK have been extended again through September, allowing us to be flexible with our workforce. Currently, we are bringing people back in the UK to support increasing customer demand in the Q3 and Q4 timeframe of this year.

As stated on the last call, in the U.S., we adjusted our work schedule to align with demand by taking out full weeks of production rather than reducing staff and operating at a lower daily output. We shut down our Harmon Creek, Pennsylvania melt facility for the first week of this quarter for maintenance work and will continue to monitor order intake and adjust operations accordingly in the second quarter of 2021.

The rising cost of raw materials and scrap is a significant headwind we are facing in Q1. While the majority of our business is covered by a surcharge mechanism that addresses these increases, there is a one- or two-quarter lag in realizing price increases tied to raw materials.

Switching to sales, we continue to see more upside potential than downside. Most of our customer sentiment is strong for 2021. We currently expect 2021 revenues to come in around the midpoint of 2019 and 2020. We also anticipate roll sales to increase going into 2022.

Following up on the new oil and gas orders I mentioned on the last call, we have shipped initial product and continue to receive new orders. Our shipments and backlog of non-roll product are already equal to our shipments for non-roll product in 2020. We are targeting and resourcing this product segment for growth over the next three years.

I want to close by thanking the entire Union Electric global team for their hard work and commitment to deliver in 2020.

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

Michael McAuley
Thank you, Brett, and good morning. I'd like to focus my comments on the current quarter's results today. Commentary on our full-year results is available in our earnings press release issued this morning and will also be included in our forthcoming Form 10-K.

With EPS of 12 cents per share for the fourth quarter of 2020, Ampco-Pittsburgh continued to remain profitable on a net basis for the fifth consecutive quarter and sequentially higher than Q3 2020 EPS, despite the continued negative impact of the COVID-19 pandemic on our end markets.

I would also like to point out that the corporation's capitalization is significantly improved versus a year ago. At December 31, 2020, Ampco's total debt was nearly half the amount we opened the year with, given the free cash flow generation of the business in 2020 and the initial use of the proceeds from the equity offering completed in Q3 2020. Ampco's $87 million in net sales from continuing operations for the fourth quarter of 2020 declined 10 percent from $97 million in the fourth quarter of 2019 as a direct result of the pandemic.

Net sales in the Forged and Cast Engineered Product segment of $64.2 million for the fourth quarter of 2020 declined nearly 14 percent compared to the prior-year quarter, principally driven by a lower volume of shipments from customer deferrals in the flat-rolled steel and aluminum markets, along with the reduced demand for other forged engineered products, primarily for the oil and gas market.

Net sales for the Air and Liquid Processing segment for the fourth quarter of 2020 of $22.9 million increased marginally compared to the prior-year period, as Terry described, despite the pandemic.

Selling and administrative expenses of $12.1 million for the fourth quarter of 2020 declined $1.4 million compared to the prior year. We were able to deliver approximately a 10 percent year-over-year reduction in SG&A expense for the quarter.

Depreciation and amortization expense of $4.7 million for the fourth quarter of 2020 was approximately comparable to the prior-year amount. Excluding the $0.3 million charge associated with the potential insolvency of an asbestos-related insurance carrier, which is recorded in the current-year quarter, and excluding the $1.8 million in proceeds from a business interruption claim and the restructuring-related cost of approximately $0.7 million, both recorded in Q4 of 2019, adjusted income from continuing operations, which is a non-GAAP measure, improved from $1.9 million last year to $2.3 million this year. This was despite the pandemic-driven effects of the lower shipment volumes, net unfavorable absorption due to plant downtime in the Forged and Cast Engineered Product segment. A reconciliation of GAAP to non-GAAP adjusted operating results is included in the non-GAAP financial measures reconciliation schedule included in today's earnings release.

Other income expense net for the fourth quarter of 2020, when compared to the prior year, improved primarily due to lower interest expense given the lower debt balance. At the bottom line, the corporation reported net income attributable to Ampco-Pittsburgh of $2.2 million, or 12 cents per share, for the fourth quarter of 2020 compared to net income of $3.1 million, or 24 cents per share, for the fourth quarter of 2019, which included a net loss from discontinued operations of 1 cent per share.

Here are some highlights regarding business segment results. For the Forged and Cast Engineered Product segment, Q4 net sales of $64.2 million declined approximately 14 percent versus prior year, primarily due to a lower volume of shipments of mill rolls as a result of customer deferrals in response to the pandemic and reduced demand for other forged engineering products. Operating results for the Forged and Cast Engineered Product segment declined in the fourth quarter of 2020 when compared to prior year, which included a $1.8 million amount in proceeds from a business interruption insurance claim.

The unfavorable effects of lower sales volumes, pricing, and product mix were more than offset by the favorable effects of reduced cost structure from the segment's restructuring efforts and the restructuring-related costs recorded in the prior-year quarter, which were one time in nature.

In the Air and Liquid Processing segment, net sales of $22.9 million in Q4 2020 were comparable to the prior-year period, despite the pandemic. The Air and Liquid Processing segment's operating income in the fourth quarter of 2020 was approximately equal to prior year, despite the asbestos-related charge recorded in the current quarter. The segment successfully mitigated the negative impact on revenue and income from the pandemic.

Backlog at December 31, 2020 approximated $246 million, a decline of 23 percent from the $321 million in backlog at December 31, 2019. The decrease is principally due to the lower backlog for forged and cast rolls as a result of customers postponing order placement, given the uncertainty surrounding the pandemic. Air and Liquids Processing backlog improved over this period, driven by centrifugal pumps.

Next, I'd like to cover a few balance sheet and cash-related items for continuing operations. Accounts receivable of $60.2 million at December 31, 2020 decreased by $21.6 million compared to December 31, 2019, primarily attributable to lower sales in the latter part of 2020 versus 2019 and improved collections. Receivables increased $4.1 million compared to September 30, 2020 due to higher sales in the current quarter.

Inventories of $73.2 million at December 31, 2020 decreased by $9 million compared to December 31, 2019 and decreased by $5.2 million compared to September 30, 2020. Accounts payable of $26.7 million at December 31, 2020 decreased by $6.6 million compared to December 31, 2019 and decreased by $2.2 million compared to September 30, 2020.

Capital expenditures for the fourth quarter of 2020 were $2.5 million and were $8.5 million for the full-year 2020, primarily expended in the Forged and Cast Engineered Product segment. Cash and cash equivalents for continuing operations of $16.8 million at December 31, 2020, increased $9.9 million compared to December 31, 2019 and it decreased $1.4 million compared to the September 30, 2020 balance.

Cash provided by operating activities for full-year 2020 was $33.6 million. In Q4 2020, we made cash contributions to our defined benefit pension plans of approximately $5.4 million, principally funded by our revolver. As such, drawings on the Ampco revolving credit facility were $6 million at December 31, 2020, which is down by $28.3 million compared to the balance at December 31, 2019. The reduction in revolver borrowings for the year reflects improved operating results and lower investment in trade working capital through the year as well as the initial use of the net proceeds from the equity offering.

Total debt at December 31, 2020 of $37.2 million decreased $33.6 million, or 47 percent, from December 31, 2019, and increased $4.6 million or approximately 14 percent from September 30, 2020.

At December 31, 2020, in addition to our cash balance, the corporation also had remaining availability on the revolver of approximately $48 million, an improvement of approximately $21 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. I am incredibly proud of the results our team achieved in 2020, and I want to personally thank every employee for their hard work, dedication, and resilience as we faced the many challenges and opportunities that the year presented. We are not satisfied with where we are and we have much more work to do, but I am confident our efforts will be reflected in continuing improved performance as we move forward. Thank you.

We will now take questions.

QUESTIONS AND ANSWERS

Operator
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. We do ask that you limit yourself to one question and a single follow-up. After that time, you may rejoin the question queue. At this time, we will pause momentarily to assemble our roster.

The first question will be from Justin Bergner of G Research. Please go ahead.

Justin Bergner
Good morning, Brett and Mike.

Brett McBrayer
Good morning.

Michael McAuley
Good morning, Justin.

Justin Bergner
Two quick ones and then two more substantive ones. The quick ones — I'm not sure I heard the gross cash balance at December 31st, and then the second quick one would be any comment on sort of pension sensitivity to a move in the discount rates, given what's transpired since year-end?

Michael McAuley
Yeah, Justin, I can handle that. The cash balance at December 31, 2020 was $16.8 million consolidated. And then this will be in our 10-K, but from a pension sensitivity standpoint, a 25-basis point change in the discount rate will move the calculated liability for pension and OPEB plans by $10.9 million for Ampco, in total.

Justin Bergner
Great. Then on the more substantive side, how much in temporary cost reductions should we see as returning back into the business in 2021? And were temporary cost reductions, you know, outside of, I guess, those directly related to manufacturing utilization, still in play in the fourth quarter, or were they — those mainly out of the system?

Sam Lyon
Well — this is Sam — Justin, I can say that we're having to flex down our costs. The majority of the cost takeout were hourly people or blue-collar workers, and so — and we flex those regularly with the business, so as we ramp up, they come back, and as we ramp down, they go down. The only difference in that would be in the UK and Sweden, where it's more difficult to do that, but we're still able to do that this year up through September as I had mentioned in the UK through government support.

So the other, I guess, substantial — not substantial, but the other cost savings that we've seen is nobody's traveling, of course, but I would expect us to start traveling again but not to the same amount that we were before, as we've learned to do things differently in the new world. So some of that will stay, you know, probably — I don't want to put a number on it, but I could imagine us having a third less travel going forward or something like that.

Justin Bergner
Okay. And I guess my final question would relate to the Forged and Cast Engineered Products and sort of the non-roll opportunity. I guess Ampco-Pittsburgh has fairly ambitious goals there over a multi-year period. Any sort of update on how you're seeing that progress or the trajectory of orders interest, whatever metrics might be meaningful?

Brett McBrayer
Sure. I mean, the big changes there are on the oil and gas side of the business. There was really no business up until last year. This year we've seen that come back, and we're selling to a higher tier than we were. We were selling to lower-tier customers, so that should be more stable going forward, but I stated that we've already shipped and booked product equal to what we shipped in all of last year, and so we see a pretty good growth rate, as much as double what we shipped last year, potentially for this year.

Justin Bergner
Okay. All right. That's helpful. I wasn't sure I followed it, the shipped comments. You're saying in two and a half months you've shipped, what you shipped —

Brett McBrayer
Yeah, I shipped plus backlog. So what was shipped and what we're going to ship over the next few months is equal to what we shipped all of last year. So we — it's more of a transactional business. We don't have orders out in Q3 and Q4 at this point in time, but the order activity in the first half of this year is significantly higher than last year.

Justin Bergner

Oh, okay, so it refers to shipped and sort of planned-to-be-shipped orders?

Sam Lyon
Yes.

Justin Bergner
Okay, equivalency. All right. Thank you. I'll hop back in the queue.

Brett McBrayer
Thank you, Justin.

Operator
The next question will be from David Wright of Henry Investment Trust.

David Wright
Good morning. Question for Terry. At Buffalo Pumps, how much of your improvements might be U.S. Navy end-user business?

Terry Kenny
I'm sorry?

Michael McAuley
Could you repeat that, David. We're getting a little audio trouble here.

David Wright
I'm sorry. Can you hear me better?

Terry Kenny
Yeah, that's good.

David Wright
Terry, the — at Buffalo Pumps, what's the impact of Navy busines on the recent results?

Terry Kenny
The Navy business in 2020 was strong and was relatively flat between 2019 and 2020, but activity remains strong.

David Wright
Okay. And, Sam, in your prepared remarks, I missed your full comment on Harmon Creek's shutdown.

Sam Lyon
Oh, I just said we were down the first week of the year at Harmon Creek, just for maintenance work, and then in the second quarter, we'll evaluate order intake, whether or not we need to take a week or two out at the end of the quarter, but just in — relative to last year, we had six weeks out in the fourth quarter of last year.

David Wright
Okay. And then just lastly, any — gee, can you give us any expanded detail on where you are with the equipment upgrade initiatives?

Brett McBrayer
Yeah, so we have been working our final kind of layout, David, is what this is going to look like and how we're going to deploy the capital needs. We are at the point now of placing orders and aggressively trying to move these expenditures — or make these expenditures happen as quickly as possible. Obviously, we're pretty excited about the transformation that's going to occur in the Forged and Cast Engineered Product segment, and we have little patience for delaying those improvements. And so we're trying to push and expedite this equipment into our facilities as soon as possible.

We're obviously doing some heavy negotiation with our equipment suppliers, trying to see what we can do to shorten their lead times to us, but that program in process is well underway and we'll look forward to being able to share the results with you, David, and the rest of our shareholders hopefully here in the very near future.

David Wright
Okay. Well, congratulations on the continued improving results and thanks for the great job you're doing for all of the stockholders.

Brett McBrayer
Thank you, David, very much.

Operator
Once again, if you have a question, you can press star, then 1 on your telephone keypad. The next question is a follow-up from Justin Bergner of G Research.

Justin Bergner
Thanks for the follow-up. Just one quick one here. Could you elaborate a bit more on some of the headwinds you're seeing in heat exchangers and air handling systems? And obviously the backlog was up year on year, but it's being tempered by some of the comments you made, and any comment on sort of the relative profitability of those three product lines, just from a Air and Liquid Processing, if you're able to share that?

Terry Kenny
Justin, thank you for the question. The headwinds that we've experienced has been — for the heat exchanger business specifically is the lack of — or the reduced replacement business opportunities, the capacity, the occupancy in office buildings that we've experienced as well as not being able to reach out in person to maintenance people in various facilities. So that has been the headwind on the heat exchanger business.

The air handling business has been impacted slightly with the reduction of capital spending in some of our markets, specifically in the university market.

Justin Bergner
Okay.

Brett McBrayer
And, Justin, I'll just — this is Brett — I'll just add to Terry's comments. You know, a big factor, I would say, for those two businesses for Terry has been the fact that limited — actually field activity where we have our salespeople actually out in the field and that's where a lot of our transactional work occurs, and it's been learning a new way to do the dance, if you will. Still there's some

barriers that make it difficult, and so Terry and his team have worked, I think, extremely well around those challenges, but it's been one that's been very apparent to us.

Justin Bergner
Okay. And then just one, I guess, clarifying question. With respect to heat exchangers, you mentioned industrial and commercial headwinds. Are the heat exchangers sort of split fairly evenly between the industrial and commercial markets, or is it much more commercial than industrial

Terry Kenny
It's probably 60 percent commercial, Justin.

Justin Bergner
Okay. Thank you for the follow-up.

CONCLUSION

Operator
And this concludes our question-and-answer session, and this also concludes our conference call for today. We want to thank you all for joining. Feel free to disconnect at this time. Have a great day.