Ampco-Pittsburgh Corporation

Second Quarter 2021 Earnings Results

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CORPORATE PARTICIPANTS

Melanie Sprowson - *Director, Investor Relations*

Brett McBrayer - *Chief Executive Officer*

Mike McAuley - *SVP*, *Chief Financial Officer, Treasurer*

Sam Lyon - *President, Union Electric Steel Corporation*

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

PRESENTATION

Operator
Good day, and welcome to the Ampco-Pittsburgh Corporation second quarter 2021 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 one on your touchtone phone. To withdraw your question, please press star then two. Please limit yourself to one question and one follow-up. Please also note that 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, Sarah, and good morning to everyone joining us on today's second quarter 2021 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 10K and subsequent filings with the Securities and Exchange Commission. We do not undertake any obligation to update or otherwise release publicly any revisions 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 investors 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 I want to thank everyone for joining our call this morning. I will begin with our safety performance where we saw a significant improvement for the quarter with a 61% reduction in our recordable injury rate and a 65% reduction in our lost time injury rate compared to our first quarter. The organization continues to push towards our goal of zero injuries in our workplace, and I want to thank our employees for their commitment to this effort.

Ampco-Pittsburgh continued our positive earnings trend, delivering earnings per share of $0.06 for the quarter. Our sales increased sequentially for the quarter by 6%, and our backlog is growing with order activity gaining momentum in our forged and cast engineered products segment. As steel and aluminum output continues to improve, and utilization rates strengthen, we expect a much stronger 2022 as business returns to pre-pandemic volume. Growth in our forged non-roll products continues to accelerate with robust sales and a growing customer base. Our air and liquid systems segment continues to see strong demand with a growing backlog.

During the quarter, we continued to execute our equipment modernization plans, which will further improve our cost structure and expand our topline capabilities. We also amended and extended our revolving credit facility during the quarter to support our capital improvements and anticipated working capital growth. Our liquidity position remains strong and is further strengthened through our new agreement.

Despite our positive performance for the quarter, we faced headwinds with rising raw material prices and logistical and supply chain delays. These headwinds continue to negatively impact our performance. Our surcharge to our customers lagged the rising price of raw materials and transportation. However, this gap will close as prices stabilize. Although we conduct annual outages each year to improve the reliability of our assets, we were conservative in our spending last year due to the uncertainty of the global pandemic and to protect our liquidity.

During the third quarter, we will address the items we deferred in 2020, as well as undertake our normal reliability improvement work. As a result, many of our factories will be idle for portions of the quarter as we do this critical work. For further comments on our businesses, I'd now 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, and good morning. I would first like to talk about our safety performance. We had one OSHA recordable accident during the second quarter. I am pleased to report that the employee received minor medical treatment and is back to work. I would like to acknowledge the employees at the Aerofin division for achieving 18 months without an OSHA recordable injury. All Aerofin employees should be proud of this significant accomplishment.

Orders received for the segment in the quarter increased 39% compared to the prior year's quarter. Orders for centrifugal pumps and custom air handling equipment were the primary reason for the increase. Orders for heat exchangers have increased and are exhibiting the expected growth as the country continues to reopen. As a result, the segment backlog increased 9.9% during the quarter.

Revenue for the quarter was down when compared to the prior year, principally due to customer requested delays and a lower beginning backlog of heat exchangers. The decrease in sales was the primary contributor to the lower operating income. As Brett mentioned, we have experienced rising material costs, combined with supply chain delays. Additionally, we have increases in material lead times and delays in purchased material delivery date commitments. To date, material availability issues have had minor impacts on the operations. The demand for the segment's products is strong, and we remain optimistic about the segment's future growth.

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

Sam Lyon
Thanks, Brett, and good morning. I would like to begin with safety. Brett already talked about our improvements in the rates. We continue to focus on potential hazards and identify the root causes and mitigation actions when an incident does occur. I would like to recognize our operations in Valparaiso, Erie, Carnegie, Austintown, Ohio, the UK, and Slovenia for being recordable free for the quarter. A remarkable accomplishment.

From a cost perspective, raw materials and scrap continued to be a headwind. Our surcharge mechanism lags actual cost by one to two quarters, depending on the customer. This has compressed our margins in the first two quarters of 2021 when compared to 2020 by approximately $1 million.

Both raw materials and scrap appear to be moderating. If this moderation continues, we will see improved margin in the second half of the year. We continue to control what we can, and our teams are delivering on managing maintenance and repair costs, as well as reducing the overall cost of quality for the entire business.

At the end of Q2 and beginning of Q3, our planned outages that Brett referenced in the United States were extended by one week to perform furnace rebuilds that were deferred as a result of the ongoing uncertainty of the pandemic last summer. This three-week outage was completed as scheduled. Our European plants will have their summer holiday shutdowns during Q3. In addition, our UK plant has seen lower production rates in Q3 as the COVID-19 Delta variant has resulted in significant absences, causing output issues which will reduce shipments by approximately $700,000 in the quarter. These absences are now abating.

From a sales perspective, 52% of our cast rolls and 38% of our forged rolls have been awarded. We still see overall sales activity recovering roughly to 2019 levels in 2022. While the flat rolled producers are making record profits, the capacity utilization in the United States just recovered to 2019 levels in Q2. The consensus of our customers is that pricing and demand should remain strong as inventories of both automobiles and steel at service centers are at historic lows.

Demand remains strong in the automotive, consumer packaging and white goods segments. Also, there is a pending infrastructure bill on the horizon, as well as the elimination of the tax rebate in China on exported hot rolled coil, cold rolled coil and hot dipped galvanized steel. All of these items support the demand for our customer base, as well as strong pricing for them. For our forged engineered products segment, which is our non-roll business, bookings increased 385% year-over-year for the first half of 2021. We’re excited about our prospects here.

Our expansion and modernization programs that I referenced on the last few calls are well underway. As Brett stated, these investments will further support growth in the forged and engineered products business and a lower cost structure in our rolls business. Approximately 70% of the project has been scoped and approved, and we expect the completion of the project by the middle of 2023. I’ll now turn it back over to Brett.

Brett 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?

Mike McAuley
Thank you, Brett. With sales up 24% versus the prior year quarter and up 6% sequentially, Ampco-Pittsburgh reported basic EPS of $0.06 per share for the second quarter of 2021. The corporation’s balance sheet and liquidity position continues to remain strong with cash on hand at June 30, 2021, of $13.3 million and undrawn availability on a revolving credit facility of approximately $47 million.

Total debt is down 22% compared to June 30, 2020, while total shareholder’s equity has risen 50%. Ampco’s net sales for the second quarter of 2021 were $92.4 million, an increase of 24% compared to net sales for the second quarter of 2020 of $74.8 million, and the forged and cast engineered product segment, Q2 2021 net sales increased approximately 41% versus prior year due to higher shipments of forged and cast mill rolls, as well as higher shipments of forged engineered products.

Net sales for the air and liquid processing segment in the second quarter of 2021 was approximately 12% lower than prior year, driven mainly by some customer requested delays. Gross profit as a percentage of net sales was 18.4% for the second quarter of 2021 versus 19.8% for the second quarter of 2020. The decline is mainly attributable to the forged and cast engineered products segment, which has been impacted by higher net raw material costs and unfavorable changes in product mix. In addition, the prior year quarter benefited from the receipt of $0.8 million in business interruption insurance proceeds.

Selling and administrative expenses of $12.1 million or 13.1% of net sales for the second quarter of 2021 were up compared to $10.2 million or 13.6% of net sales for the second quarter of 2020. The impact from higher exchange rates and additional sales commissions on higher forged engineered product sales during the current year quarter were the primary factors for the increase. Higher stock related compensation costs, due in part to the increase in share value of the corporation's common stock, was also a factor.

Depreciation and amortization expense of $4.5 million for the second quarter of 2021 was comparable to the second quarter of 2020. Income from operations for the second quarter of 2021 was $0.5 million. This compares to a loss from operations in the prior year quarter of $0.1 million. The forged and cast engineered products segment's operating results improved for the second quarter of 2021 compared to prior year due to the higher volume of shipments, higher production levels contributing to better cost absorption, partly offset by higher net raw material costs and less favorable mix of roll sales.

The air and liquid processing segment's operating result declined for the second quarter of 2021 compared to prior year due to the lower volume of shipments. Other income expense net improved for the second quarter of 2021 when compared to the prior year quarter, primarily due to the timing of dividend income of $1 million in the current year quarter from one of the corporation's Chinese joint ventures. Period over period change in the income tax provision was driven principally by the revaluation of certain deferred income tax net liabilities for a future rate change enacted in the UK during the quarter and for the restructuring of a foreign sales office. These unfavorable discrete tax items negatively impacted EPS in the quarter by $0.04 per share.

At the bottom line, the corporation reported net income attributable to Ampco-Pittsburgh of $1.1 million or $0.06 per share for the second quarter of 2021 compared to net income of $0.7 million or $0.05 per share for the second quarter of 2020. Backlog at June 30, 2021, of $254 million increased 6% from March 31, 2021. Backlog for the forged and cast engineered products segment improved approximately 4% sequentially. The increase is principally due to higher order intake for forged rolls and for forged engineered products due to improved demand.

Backlog for the air and liquid processing segment improved approximately 10% sequentially as a result of improved order intake for centrifugal pumps and heat exchange coils. Net cash flows used in operating activities was approximately $4.7 million for Q2 2021, the result of an increase in trade working capital associated with the higher level of business activity. Capital expenditures for the second quarter of 2021 were $4.3 million or $6.7 million year to date, primarily for the forged and cast engineered products segment.

Total debt at June 30, 2021, of $40.9 million is up 10% from December 31, 2020 due primarily to usage of the revolver to fund working capital growth. The total debt has decreased $11.4 million or 22% from June 30, 2020. The corporation has received $3.2 million in proceeds from warrants exercised as of June 30, 2021, representing an increase of approximately 559,000 common shares outstanding. I will now turn the call back over to Brett.

Brett McBrayer
Thank you, Mike. At this time, we'd like to open the line for questions.

QUESTION AND ANSWER

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. Also, please limit yourself to one question and one follow-up. At this time, we will pause momentarily to assemble our roster. Our 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
Question for Sam. In your remarks, Sam, you talked about certain percentage of the rolls being awarded. Could you reread that sentence? I have a question around it.

Sam Lyon
Yeah, it's really 52%. Let me find it. Hold on a second. 52% of the cast and 30% of forged rolls have been awarded. That's really--that's the amount of the customers that have given us their allocations for 2022.

David Wright
Right, okay. So, in the last call you commented that you were still in the negotiations with the company's two largest customers and thought those might be concluded in the coming weeks. Are you still in negotiations with those two?

Sam Lyon
No, we're finished with seven of the 10 largest customers that we have at this point in time.

David Wright
Okay, so when you say 38% of the rolls, or 52% of the rolls are awarded, just what's the definition of that?

Sam Lyon
Just from the total amount that, you know, we know what the customers--what they use, and then we negotiate with them, and then we get our allocations. So, for example, if the customer had 100 rolls to give, we have 40% market share, typically. If we get that award, we get 40%, and whatever that number equals, you know, that--for the year, if we're going to do two, for

example--I'm just making these numbers up--but if we're going to do 2000 rolls, 50%, we have roughly 1000 of them in our order book for next year, roughly.

David Wright
And thus, in backlog?

Sam Lyon
Yeah, but it's really, they're placeholders. They give us orders as the year goes, but they're pretty--they pretty well know as long as another pandemic doesn't occur or something like that, they sort of know what they're going to use based on their run rates and their usage and how much steel they plan to produce. So, it's pretty--it's pretty close. If anything, they allocate lower, and they add spot orders on top as the year goes.

David Wright
Okay, and then to follow up, how has, you know, unit pricing been relative to, say, last year?

Sam Lyon
It varies by customer, but I'd say flat to up several percentage points, and then we also have our surcharge mechanism, which accounts for the raw material pricing that goes up and down.

David Wright
Okay, that's it for me, and thanks very much.

Sam Lyon
Thank you.

Brett McBrayer
Thanks, David.

Operator
Our next question comes from Justin Bergner from Gabelli. Please go ahead.

Justin Bergner
Hey, good morning, Brett. Good morning, Mike.

Brett McBrayer
Good morning.

Mike McAuley
Good morning, Justin.

Justin Bergner
Just two quick sort of clarification questions. Can you restate what the impact of the sort of surcharge lag was and how much money and shares have been issued associated with the warrants?

Sam Lyon
Well, I'll take the surcharge one. This is Sam, Justin. It's roughly $1 million of margin compression in the first half.

Justin Bergner
Oh, it was the first half, not the second quarter? That's just--it's for the whole first half?

Sam Lyon
Correct, first half of the year, yes.

Justin Bergner
Okay.

Sam Lyon
It's fairly close, first quarter second quarter. The prices have been rising pretty steadily of the raw materials. They now have appeared to moderate, and on the Steel Dynamics earnings call, they project scrap to actually be flat to declining in the second half, which would be good.

Mike McAuley
And the second question, Justin, was about--was it about warrants, did you say?

Justin Bergner
Oh just--yeah, just before the warrants, just to make sure I understand, so without the surcharge lag, income from operations from forged and cast engineered products would have been about $4.5 million versus $3.5 million in the first half?

Sam Lyon
Yes.

Justin Bergner
Okay, and then the second question was just the warrant detail on the exercised. The amount raised came at me a bit quick. I was just wondering if you could repeat that, as well.

Mike McAuley
Sure, yeah. So, year to date we've got $3.2 million in on the warrants, and that's (INAUDIBLE) ever since the warrants have been outstanding and the exercised prices, you know, the trading prices exceeded the exercised price. We have had incremental exercises. We had--most of it was Q1. We had some additional incremental exercises in Q2. The total proceeds received by the corporation so far, $3.2 million. And that's about--that's worth about 559,000 additional shares in the share count.

Justin Bergner
Okay, and then my last question would be, you said that the unit pricing was flat to up a few percent. I think that with a sequential comment on top of the surcharge mechanism. Are you seeing an acceleration in pricing outside of the surcharge mechanism, sort of as you finish 2Q and get into 3Q, or has demand at the sort of steel producer level not yet reached a point to get accelerating price beyond the surcharge?

Sam Lyon
I think that's right, other than a little bit of, you know, inflationary pricing. Utilization, just looking at Steel Dynamics' earnings call, I mean it was 77% in Q1 for the U.S. versus the low, like 80% in 2019 and 81% in Q2. So, it's just recovered. Last few months is, you know, 84, 85. But they're still--you know, we're still in competition with all of our competitors on the roll side. So, we have been able to--it's really where your rolls perform, where you're a preferred supplier, you can--you have some ability to raise price, and then there's somewhere where you're trying to

get in and get some market share, or trying to get your rolls into the business for a trial. Then you know you have to be more competitive.

Justin Bergner
Great. Thank you for taking my questions.

Brett McBrayer
Thanks, Justin.

Operator
This concludes our question-and-answer session. I would like to turn the conference back over to Brett McBrayer for any closing remarks.

CONCLUSION

Brett McBrayer
Thank you. I continue to be extremely proud of the employees who work in our businesses that make up Ampco-Pittsburgh. I've shared my gratitude and support for their outstanding work personally, but I want to take this opportunity to again state my sincere thanks on this call. We remain optimistic as our market activity continues to accelerate and as we simultaneously execute on our business improvement actions. Thank you very much.

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