Ampco-Pittsburgh Corporation

Third Quarter 2021 Earnings Results

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CORPORATE PARTICIPANTS

Melanie Sprowson – *Director of Investor Relations*

Brett McBrayer – *Chief Executive Officer*

Michael 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 Third Quarter 2021 Earnings Results conference call. Today, all participants will be in a listen-only mode. Should you need assistance during today's call, please signal for 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. Additionally, during the Q&A please limit your initial questions to one plus one follow-up. If you do have additional questions please reenter the question queue. Please note that today's 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, Chris, and good morning to everyone joining us on today's Third 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 statements 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.

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 McBrayer
Thank you, Melanie. Good morning and thank you for joining our call. As shared in today's press release, Ampco-Pittsburgh recorded our first quarterly loss since the third quarter of 2019. This loss is a net result of our planned extended equipment outages as well as two unplanned outages due to equipment failures during the summer and under recovery of inflationary costs in our Forged and Cast Engineered Products segment.

To address these continuing cost pressures on our business, the Forged and Cast Engineered Products segment has commenced price increases across all products. The broad range of increases is necessary to address the varying impact of input costs in our North American, European and Asian operations. The extended maintenance outages taken during the quarter have us well-positioned to meet the growing demand for our products. Our backlog has increased 16% since Q2 in the Forged and Cast Engineered Products segment and our backlog in the Air and Liquid Systems segment remains strong. Although we have been challenged with supply chain issues and vendor labor shortages, our capital improvement work is well underway, with targeted completion in the first half of 2023. Finalizing this work will significantly improve our cost structure and facilitate substantial topline growth for our businesses.

As always, safety and health of our employees, and being good stewards in the communities where we operate, continue to be priorities as we work to improve the performance of Ampco-Pittsburgh. The efforts of our employees to improve in these areas continues to be impressive.

As we look to the fourth quarter, we will continue to see headwinds from an inflationary cost standpoint. Our price increases during the quarter will not deliver their full effect until the first quarter of 2022. With a growing backlog and the strong demand for our products, we are optimistic as we move into 2022 and beyond.

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 segment's performance. Terry?

Terry Kenny
Thank you, Brett and good morning. As with most manufacturing businesses in the country, all three divisions that make up the segment have been experiencing supply chain challenges including inflationary pressures on virtually all purchase materials, supplies and services, availability shortages and rationing of certain key materials, extended lead times which have historically been measured in several weeks are now quoted in months, daily missed delivery commitments and reschedules from our suppliers as well as trucking shortages and delays at customs.

The teams at all three businesses have been working tirelessly to overcome all obstacles and have to date successfully navigated the majority of these hurdles while delivering third quarter operating results that exceeded the prior year third quarter results and trailed year-to-date results by 5%. I want to thank all Air and Liquid Processing segment employees for their hard work and dedication through these challenging times. We have been able to pass through much of the cost increases in the form of price increases throughout the year. Our backlog remains strong, at $56.4 million, and we remain focused on sustainable growth at each of the three divisions.

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

Sam Lyon
Thanks, Brett and good morning. Operating conditions in the UK and Sweden in the wake of the Delta variant of COVID have proven challenging. Absenteeism is running two to three times' normal rates. This is attributed to societal reopening, the lifting of restrictions and the return to schools. As more of the population gets vaccinated and the initial spread through the school aged children exhausts, this absenteeism has started to improve.

From a sales perspective, our backlog is up 21% from the low point of the pandemic and 16% since the end of quarter two. This is the segment's highest level backlog since May of 2020. Our first quarter is very strong in the non-Forged Engineered Product segment. We are anticipating increased large roll sales starting in Q2 of 2022 and continuing into 2023. Our melt shop at our Burgettstown facility in Pennsylvania is at capacity through Q1 of 2022, and we are adding Forged personnel to increase output as early as January once training is complete.

Until a few months ago, our view was that material and natural gas prices would moderate, but the reality has proven much different. In the United States, natural gas has more than doubled. Key alloys such as ferrochrome and moly oxide are up 40% and 70%, respectively. In the UK natural gas has increased over 300%. All costs, including refractory, transportation and labor, are up. As I stated previously, our surcharge mechanism has some lag when compared to actual costs. Our surcharges in most cases only cover raw materials, leaving us exposed to these other inflationary costs. This has necessitated a recently announced price increase in our non-roll forged engineered products for new orders placed after October 25th.

In the past, we offered firm pricing at the time of order. We also implemented an alloy and energy surcharge on all orders shipping after December 31st. Extended lead times and the volatile energy prices have necessitated the implementation of the surcharge to capture costs at time of melt. Yesterday we also announced a price increase for our roll products effective November 3rd. These increases will vary by customer depending on individual surcharge mechanisms in place.

Our previously discussed expansion and modernization programs for our US assets continues to make progress. These investments will support further growth in the non-roll business and a lower cost structure in our roll business. Approximately 85% of the project has been scoped and approved and we expect to reach full completion by the middle of 2023.

I will 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?

Michael McAuley
Thank you, Brett. Good morning. Ampco's net sales for the third quarter of 2021 were $81.2 million, an increase of 7% compared to net sales for the third quarter of 2020 of $75.7 million. In the Forged and Cast Engineered Products segment, Q3 2021 net sales increased approximately 12% versus prior year, primarily due to higher shipments of Forged Engineered products to the steel distribution and energy markets and higher shipment of cast rolls for hot strip mills.

Net sales for the Air and Liquid Processing segment in the third quarter of 2021 were approximately 6% lower than the prior year period due to delays in availability of trucking and certain parts due to supply chain issues. Gross profit as a percentage of net sales was 16.3% for the third quarter of '21 versus 21.4% for the third quarter of 2020. The decline is mainly attributable to the Forged and Cast Engineered Products segment, which was impacted by higher net raw material and energy costs and higher repairs and maintenance spend as well as unfavorable changes in product mix.

Selling and administrative expenses of $10.9 million, or 13.4% of net sales for the third quarter of 2021, were down compared to $11.4 million or 15.1% of net sales for the third quarter of 2020. Lower employee-related costs and lower spend on research and development were partly offset by the impact of the higher exchange rates and additional sales commissions on higher forged engineered products sales during the current year.

Depreciation and amortization expense of $4.3 million for the third quarter of 2021 was approximately comparable to prior year. Loss from operations for the third quarter of 2021 was $2.4 million. This compares to income from operations in the prior year quarter of $0.2 million.

The Forged and Cast Engineered Products segment's operating results declined for the third quarter of 2021 compared to prior year, primarily due to under recovery of the inflationary effects of production costs as well as higher repair and maintenance spend associated with extended machine outages, which more than offset the effect of higher sales and improved cost absorption from higher production levels this year.

The Air and Liquid Processing segment's operating results improved for the third quarter of 2021 compared to prior year due to higher pricing and productivity improvements. Investment-related income declined for the third quarter of 2021 when compared to the prior year quarter, primarily due to the timing of dividend income from one of the corporation's Chinese joint ventures recorded one quarter earlier this year and hence remains comparable on a year-to-date basis.

Interest expense for the third quarter of 2021 decreased principally as a result of lower average borrowings on the revolving credit facility, while other net improved primarily due to higher pension income and foreign exchange transaction gains in the current quarter. Period-over-period change in the income tax provision was driven by the effects of changes in the pretax income of the corporation's profitable operations. At the bottom line, the corporation reported a net loss attributable to Ampco-Pittsburgh of $1.6 million or $0.08 per share for the third quarter of 2021, which compares to net income of $1 million or $0.07 per share for the third quarter of 2020.

Backlog at September 30, 2021, of $278 million increased approximately 10% from June 30, 2021. Backlog for the Forged and Cast Engineered Products segment improved approximately 16% sequentially. The increase is principally due to higher order intake for forged rolls and for forged engineered products due to improved demand.

Although the backlog for the Air and Liquid Processing segment declined approximately 9% sequentially because of reduced order intake for heat exchange coils and air handlers, it still remains at a historically high level. Net cash flows used in operating activities was approximately $1.4 million for Q3 2021, the result of an increase in trade working capital associated with a higher level of business activity.

Capital expenditures for the third quarter of 2021 were $5.5 million and are now $12.2 million year-to-date, primarily expended in the Forged and Cast Engineered Products segment. The corporation's balance sheet and liquidity position continues to remain strong, with cash on hand at September 30, 2021, of $12.3 million and undrawn availability on a revolving credit facility of approximately $42 million.

Operator, at this time we would like to open the line for questions.

QUESTIONS AND ANSWERS

Operator
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. If at any time your question has been addressed and you would like to withdraw it, please press star then two. As a reminder, we ask that you limit your initial questions to one plus an additional follow-up. Please reenter the question queue if you do have additional questions. At this time, we will pause momentarily to assemble our roster.

Today's first question comes from David Wright with Henry Investment Trust. Please proceed.

David Wright
Good morning, everyone.

Brett McBrayer
Good morning.

David Wright
Does anybody have non-roll engineered products revenue for Q3 and year-to-date?

Brett McBrayer
We do, David. Just give us a minute.

David Wright
Sure. And in the meantime, then a question for Sam and then I'll have one for Terry. In past calls you've talked about from time-to-time the annual order patterns for mill rolls, and I'm wondering do you have any update there on how that has gone or have the ordering patterns of the steelmakers changed such that that kind of order pattern is not carrying forward?

Sam Lyon
Yes, David. They're not ordering as far in advance, but we have seen an increase in finalizing allocations for 2022, which is the reason why our backlog has increased in the last quarter. So, it's sitting at roughly $220 million now against the total—you know, it's a pretty decent percentage of our plan for next year. So, it has improved, but it's still closer to real time than it was in the past.

David Wright
Okay.

Sam Lyon
And that's attributed to the fact that the lead times are shorter across the entire industry, so there's not as much of a need for them to order as far out.

David Wright
Got it. Right, okay.

Michael McAuley
David, to answer your question about non-roll Forged Engineered Products sales, for the year-to-date period through September is $17.6 million.

David Wright
And do you have the Q3 number?

Michael McAuley
And for Q3, $7.4 million.

David Wright
Okay, super. Thank you. Then a quick one for Terry. Terry, in terms of new construction business that you would be asked to bid on, can you characterize the level of activity versus six or nine months ago?

Terry Kenny
Hi, David. Yes. The new construction activity and bid activity is down very slightly from what we saw at the beginning of the year, but the quality of bids remains high.

David Wright
Okay. Thanks, everyone.

Operator
As a reminder, if you do have a question please press star then one. Our next question comes from Justin Bergner with Gabelli Funds. Please proceed.

Justin Bergner
Oh. Good morning, everyone.

Brett McBrayer
Morning, Justin.

Justin Bergner
In terms of the sort of profit bridge, either on a year-on-year or sort of sequential basis for Forged and Cast Engineered Products, are you able to sort of share how much of that decline is due to price cost versus some of this maintenance activity? I think you mentioned a mix component. I don't know if you've disaggregated that or have and can share that with the investment community.

Michael McAuley
Yes, we can talk about that. For the current quarter—we're going to get into the MD&A when the Q comes out next week, but roughly speaking, and what we're talking about mainly is the Forged and Cast Engineered Products that has the larger change in income. If we look at that area, we saw that for the change in sales for pricing, we're talking about maybe $1 million price mix kind of effect Q3 versus prior year.

Justin Bergner
Okay. That's helpful. Then so if $1 million is price mixed, does that mean the remainder of the decline year-on-year is mainly due to these unplanned outages?

Michael McAuley
Yes. We had some higher maintenance expense for this year versus prior year for a couple reasons. We had some unplanned outages, that Brett described, but we also this year during our annual maintenance turnarounds, we focused more on preventative and predictive maintenance and spent more this year, when last year our plants were shut down just because of lack of demand and it was all about the COVID situation and preserving liquidity. So, we weren't really spending much maintenance spend during shutdowns last year. It was more about shutting down to manage supply and demand. This year we called up on that maintenance and we wanted to make sure that we were prepared for the heavier production expectations going forward.

Justin Bergner
That makes sense. Are there any other factors that you would highlight in that profit bridge for Forged and Cast Engineered Products that were material besides planned and unplanned maintenance and price cost?

Michael McAuley
No. We got improved contribution from higher sales, a bit on the mix side that we talked about, higher maintenance expense and then the under recovery. The major driver was the under recovery of cost inflation. That was by far the largest driver in the quarter, and that's what we're addressing with our pricing actions and we're also going to be looking at our cost structure going forward and things that we're going to be doing there. But the price actions are the main focus right now at the moment.

Justin Bergner
Okay. Just to make sure I understand, the profit in Forged and Cast Engineering Products was down close to $4 million, but I think you said the price cost component was only about $1 million, or did I miss something?

Michael McAuley
That selling price is mixed. It's primarily a kind of a mix issue, whereby we're seeing lower sales of larger rolls year and so the mix of sales on the roll side is less favorable than average, so that's really a driver there. But when we talk about the cost inflation, that's net of surcharges. So yes, we're passing through higher raw material costs and surcharges and that does drive revenues, but if you compare the cost changes in raw materials energy and other factors against the surcharge recovery, we are under recovering and that's the reason for trying to address that through the pricing actions that we've talked about.

Justin Bergner
Okay. So, I think I get it now. So, the $1 million was price mix and the actual cost inflation element was separate from that in terms of the year-on-year bridge.

Michael McAuley
Right.

Justin Bergner
Okay. And then in Air and Liquid—sorry, were you going to add one thing?

Michael McAuley
The under recovery effect is multiples larger than the price mix effect for the quarter.

Justin Bergner
Okay. In Air and Liquid Processing, you guys talked about a number of supply chain headwinds, but it looks like profitability was actually up sequentially in Air and Liquid Processing. Was there anything idiosyncratic about that or is that sort of representative of margins that you're realizing the business on an ongoing basis?

Terry Kenny
Justin, it's representative of the margins that we're able to achieve in these certain businesses. Mix was favorable in the quarter and the price increases throughout the year have assisted in that effort.

Justin Bergner
Great, thanks.

Operator
The next question is from George Melas-Kyriazi with MKH Management Company, LLC. Please proceed.

George Melas-Kyriazi
Thank you. Good morning, gentlemen. On the backlog for the Forged and Cast Engineering Products, is all of that contracted with the cost recoveries in the surcharges, or is some of it still sort of under older contract terms?

Sam Lyon
Well, the price increases are on top of the contract terms, so I guess they're outside of the contract, is the best way to say it. So, we have base pricing plus surcharge that mainly covers raw materials in the current situation and we're just going out with an inflationary cost increase to cover the other costs.

George Melas-Kyriazi
Okay. But I'm not sure I understand if that covers the entire $220 million of backlog.

Sam Lyon
What's the question? Could you repeat that?

George Melas-Kyriazi
The backlog right now is roughly $220 million at the end of the quarter. The surcharges, for example, that you're putting in in November, does that impact the contract—the backlog that was there prior to that?

Sam Lyon
It does. The only small delay would be just talking with the customers to get the administration side of it so that the PO and the invoice actually match so that we don't have a problem getting paid. But other than that, it applies to all existing backlog.

George Melas-Kyriazi
Okay, okay. Very good. Thank you.

CONCLUSION

Operator
At this time, we are showing no further questions in the queue, and this concludes our question and answer session. I would now like to turn the conference back over to Brett McBrayer, CEO, for any closing remarks.

Brett McBrayer
Thank you, Chris. Despite the challenging quarter, I'm encouraged by our growing backlog as well as the progress in our capital improvements for our Forged and Cast Engineered Products segment. We will continue to take whatever actions are necessary to offset the inflationary pressures all businesses are facing, both now and in the future.

I again want to thank our employees for their hard work and dedication as we continue to transform Ampco-Pittsburgh. I also want to thank our shareholders and our Board for your continued support of our turnaround efforts. Although the global pandemic supply chain issues and inflationary costs have muted our efforts over the last 18 months, we continue to take actions that we expect to result in much improved performance for our businesses going forward. Our near-term target of $450 million of revenue and double-digit EBITDA margins remains a realistic objective as our capital improvement work concludes in 2023.

Thank you again for joining our call this morning.

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