Ampco-Pittsburgh Corporation

Fourth Quarter and Full Year 2021 Earnings Conference Call

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CORPORATE PARTICIPANTS

Melanie Sprowson - *Director, Investor Relations*

Brett McBrayer - *Chief Executive Officer*

Mike McAuley - *Senior Vice President, Chief Financial Officer, Treasurer*

Sam Lyon - *President, Union Electric Steel Corporation*

Dave Anderson - *President, Air & Liquid Systems Corporation*

PRESENTATION

Operator
Good day and welcome to the Ampco-Pittsburgh Corporation Fourth Quarter and Full-Year 2021 Earnings Results Conference Call. All participants will be in a 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 telephone keypad. And to withdraw your question, please press star then two. Please note this event is being recorded.

I would now like to turn the conference over to Ms. Melanie Sprowson, Director of Investor Relations. Please go ahead, ma'am.

Melanie Sprowson
Thank you, Chuck, and good morning to everyone joining us on today's Fourth Quarter and Fiscal Year 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 Dave Anderson, 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. A replay of this call will be posted on our Web site later today. To access the earnings release or the webcast replay, please consult the Investors section of our Web site 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 thank you for joining our call. As shared in today's press release, Ampco-Pittsburgh recorded a loss in the fourth quarter of 2021. This loss was driven primarily by the under recovery of inflationary headwinds, that began last July, and a non-cash asbestos liability adjustment. Despite these temporary setbacks, I'm encouraged by the ever-increasing demand for our products.

Full-year backlog has increased 19%, with continuing momentum as we have entered the New Year. The diversification of our Forged and Cast Engineered Product segment continues to go well, with open-die Forged Engineered Products backlog up over 300% at the end of Q4. As mentioned in prior press releases, we commenced price increases across all of our products to address negative inflationary costs, impacting, primarily, our Forged and Cast Engineered Product segment. These increases included new surcharges which capture the dramatic shifts in energy and transportation costs across our global operations.

The transformation of our North American fixed assets in our Forged and Cast Engineered Product segment is on track, with completion targeted mid 2023. Despite the challenges we have recently faced, we are confident our path forward will facilitate long-term consistent profitability for businesses. Although both segments have experienced supply chain constraints over the last six months, our Air and Liquid Processing segment's performance was impacted the greatest. Critical component lead times began to extend in the second-half of 2021, impacting shipments in the fourth quarter. The lead times have stabilized, and these deferred sales will be realized in 2022.

From a safety perspective, over the last 12 months, we conducted 18 high-risk assessments across our businesses. The goal of these assessments is to challenge our current work practices to ensure robust safeguards are in place for our employees. The engagement of our workforce and their actions to improve our work environment have been impressive.

Our previous Air and Liquid Systems President, Terry Kenny, retired at the end of 2021. His successor, David Anderson is joining the call this morning, and will discuss the segment's performance in more detail. Dave?

Dave Anderson
Thank you, Brett. Good morning. I would first like to talk about our safety performance. In the fourth quarter, we had zero OSHA reportable accidents for all Air and Liquid locations. I would like to thank all three business units for their continued focus on safety.

Our backlog continued to strengthen in the fourth quarter. At the end of 2021, our backlog was 28% higher than prior year, and 19% higher than the prior quarter. In January of 2022, our backlog continued to increase. Sales declined for both the quarter and the year, primarily due to lower shipments of centrifugal pumps and custom air handling units. We continue to experience supply chain-related issues, including extended lead time on materials and customer-requested deferrals. While these supply chain issues impacted our business in 2021, they are short-term in nature and do not impact the long-term strategic direction of the business.

Non-cash asbestos-related expense, of $6.7 million, drove the quarter to an operating loss of $5.4 million, compared to prior year income of $2.4 million. Full-year results declined due to the non-cash asbestos expense and lower sales compared to the prior year. As we move forward, all three business units have identified new growth opportunities, and we are moving forward with new market initiatives, both in the United States and abroad.

Brett McBrayer
Thank you, Dave. I will now turn the call over to Sam Lyon, President of Forged and Cast Engineered Products. Sam?

Sam Lyon
Thank you, Brett, and good morning. From a sales perspective, backlog is up 25% in the low point of the pandemic, and up sequentially since the end of Q3, the segment's highest level since May of 2020. Supply chain worries and supply stability are becoming more of a factor in our customers' ordering decisions. Although there were some supply of rolls to the market coming out Ukraine and Russia, reliability of these sources is uncertain. As a result, we have seen more inquiries and questions from our customers regarding our potential available capacity since the war in Ukraine has begun.

As stated in our last call, our first quarter is very strong for our non-roll Forged Engineered Product line. We also anticipate an improved roll sales mix with increased large, forged roll sales starting in Q2 of 2022 and continuing into 2023. Inflation continued to impact operations in Q4 of 2021 and continuing into Q1 of 2022. Materials and energy prices have remained elevated, and the volatility in Europe has been extreme.

In the United States, natural gas has remained elevated at more than double the previous levels from around the midpoint of 2021. Key alloys, such as moly oxide and ferrochrome, were up over 80% since Q2 of 2021. In the U.K., natural gas spot prices have increased over 300% in Q4, and between 300% and 800% in Q1 of 2022. All costs, including refractories, transportation and labor are higher. As I stated previously, our surcharge mechanism has some lag compared to actual costs.

In Q4, our sales team was very busy implementing new surcharge mechanisms to address the energy and transportation costs. In addition to surcharge expansion, price--base pricing has been increased to address other general inflationary pressures, with the typical increase ranging from 5% to 7% over 2021 base pricing. Our ability to work with our customers to implement these pricing mechanisms is a testament to our value to the market. These pricing mechanisms will allow better stability throughout commodity cycles.

Our previously discussed expansion and modernization programs for our U.S. plant assets continue to make progress. These investments will provide a lower cost structure in our roll business, and further growth in the non-roll business, which is currently at capacity. On this note, we have seen a resurgence in the oil patch and a strong order book resulting from the increase in fracking. We expect to reach completion of our CapEx program 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?

Mike McAuley
Thank you, Brett. I'll focus my comments on Q4, 2021 results. Commentary on our full-year results is available in our earnings release issued this morning, and will also be included in our forthcoming Form 10-K. There were a few large, unusual items recorded during the quarter, namely a non-cash net asbestos-related liability and insurance receivable revaluation charge of $6.7 million, as well as reorganization related costs, of $1.4 million aimed at reducing the corporation's long-term cost structure.

The reorganization-related costs included include early retirement incentives, a reduction in force charged for terminations at one of our cast roll manufacturing facilities, and cost associated with the closure of a foreign sales office entity. Please refer to the non-GAAP financial measures reconciliation table included in this morning's earnings release and the related footnotes.

Ampco's net sales for the fourth quarter of 2021 were $84.5 million, a decrease of approximately 3% compared to $87 million for the fourth quarter of 2020. In the Forged and

Cast Engineered Product segment, Q4 '21 net sales compared to the same quarter of the prior year, but comparable, as higher sales are forged engineered products offset lower sales of mill rolls. Net sales for the year of the Air and Liquid processing segment in the fourth quarter of 2021 were 13% lower than the prior year period due to customer requested deferrals and delays in receiving required components due to supply chain issues.

Selling and administrative expenses of $11.5 million, or 13.6% of net sales for the fourth quarter of '21 were down compared to $12.1 million or 13.9% of net sales for the fourth quarter of 2020. Lower employee related costs and lower spend on research and development activities were offset by the impact from higher exchange rates and additional sales commissions on higher forged engineered product sales during the current year quarter.

Depreciation and amortization expense of $4.4 million for the fourth quarter of '21 was down slightly compared to the prior year. Adjusted loss from operations for the fourth quarter of 2021, after the asbestos related charge and reorganization related costs, was $4.6 million. This compares to adjusted income from operations in the prior year quarter of $2.3 million. The Forged and Cast Engineered Product segment's operating results declined for the fourth quarter of '21 compared to prior year, primarily due to higher raw materials, energy and other operating costs, net of surcharges passed through to customers, as well as higher maintenance spending associated with some extended machine outages, which more than offset the effect of higher sales and higher manufacturing cost absorption.

Outside of the asbestos charge, the Air and Liquid Processing segments underlying operating results declined for the fourth quarter of 2021 compared to prior year primarily due to the lower volume of shipments, but it benefited from changes in product mix and savings generated from process improvements. At the bottom line, the corporation reported a net loss attributable to Ampco-Pittsburgh of $12.3 million, or $0.65 per share loss for the fourth quarter of 2021 compared to net income of $2.2 million, or $0.12 per share for the fourth quarter of 2020. Results for 2021 include the asbestos related charge and the reorganization related charge, which combined to increase the net loss by $8.1 million or $0.42 per common share. So about 65% of the current quarter EPS loss was driven by these two unusual items.

Backlog for the Forged and Cast Engineered Product segment improved 16% year-over-year. The increase is principally due to favorable product mix, surcharge and pricing for mill rolls along with increased demand for forged engineered products. In fact, the backlog for forged engineered products increased fourfold from a year ago. Backlog for the Air and Liquid Processing segment increased approximately 28% year-over-year, principally due to additional order intake for centrifugal pumps and higher on hand orders for air handlers. Net cash flows used in operating activities was approximately $11.5 million for Q4 '21, primarily due to an increase in trade working capital associated with the higher level of business activity. Capital expenditures for the fourth quarter of 2021 were $3 million and were $15.2 million year-to-date, primarily for the Forged and Cast Engineered Product segment.

At December 31st, 2021, the corporation's balance sheet and liquidity position included cash-on-hand of $10.3 million and undrawn availability on a revolving credit facility of $34 million. Despite the Q4 book loss, total shareholders' equity as of December 31st, 2021, grew by 8% or $6.8 million compared to December 31, 2020, and grew nearly 4% sequentially. This is driven by a significant improvement in the balance of employee benefit obligations, namely the higher funded status of our global pension plans from the rise in discount rates and good asset return performance during the year.

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

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. And to withdraw your question, please press star then two. Please limit yourself to one question and one follow up. And if you have further questions, you may reenter the question queue. And at this time, we will pause momentarily to assemble our roster.

And the first question will come from David Wright with Henry Investment Trust. Please go ahead.

David Wright
Hi, good morning. Can you--Brett, you talked about the mid-2023 target completion. Is it possible for anyone to walk us through what's going to happen between now and then, the new equipment, and so on?

Brett McBrayer
Sure. And I'll let Sam kind of weigh out kind of how the capital is going to be hitting the business, and kind of the path forward from an improvement standpoint. Sam, you want to get that?

Sam Lyon
Yeah, sure. Thanks, Brett. David, there's three aspects to it. There's a couple pieces of equipment for large roll processing, and that's our large backup rolls that have very good margin. And that's really stability of that product flow path. Those machines are being built as we speak, and will be, excuse me, installed in the next year, about 12 months from now.

If you go to the work roll machines, that's on a similar path. And then the forged non-roll improvement, which is really growth, we're waiting right now on the DEP to improve the permitting, which is in our plans to finish in 2023, and those furnaces to improve that growth will be installed beginning to mid 2023 to complete the capital.

David Wright
And what facilities are those for?

Sam Lyon
The furnaces for the non-roll will go into Harmon Creek, and then the other machines will--some of them will go into Harmon Creek, and some of them will go into Carnegie.

David Wright
Okay. Great.

Sam Lyon
So, the finishing machines go into Carnegie, and the roughing machines or the intermediate processing machines go into Harmon Creek.

David Wright
Okay. Thanks. And the--Mike, can you tell us, in the fourth quarter, how much of the forged and cast revenue was from non-roll, the Engineered Products revenue?

Sam Lyon
Probably (INAUDIBLE) nine out of--probably nine out of 75. Right, 12%, 14% something like that? (INAUDIBLE).

Mike McAuley
Yeah.

Sam Lyon
Yeah. We have to validate that, but that would be rough numbers.

David Wright
I'm sorry, I didn't hear. You were speaking very soft.

Sam Lyon
(INAUDIBLE) Mike will validate the numbers, so. Did you get that, Dave?

David Wright
No, I didn't hear a number.

Sam Lyon
Okay. It's roughly between 10% and 15%, but we're trying to get that number right now. So, it should be in the neighborhood of--we did rough--over $30 million, roughly 25% of that would have been in Q4, so $8 million to $9 million out of $75 million-ish, $70 million total.

David Wright
Got it. Okay. All right. Thank you very much.

Brett McBrayer
Thanks, David.

Operator
The next question will come from Justin Bergner with Gabelli Funds. Please go ahead.

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

Brett McBrayer
Morning.

Mike McAuley
Hi, Justin.

Justin Bergner

You mentioned that customers are less willing to rely on rolls coming from Ukraine and Russia. Could you elaborate a bit more there on how much of the overall market is supplied by facilities in those countries, and it primarily captive for those markets or are those being exported to European markets that now the customers need to find alternative suppliers for?

Sam Lyon
This is Sam, Justin. I can't really comment on the size or how much they're participating. They--or we do see them, particularly in Europe. And one of our larger customers in Europe has reached out to us and placed some orders to backfill some rolls for that region. And so, we're just--this is just starting. We're starting to see people look at where they have exposure and what they're going to do about it. I wouldn't call it not significant, but there is an opportunity for the western suppliers to pick up share.

Justin Bergner
Okay. Second question would be on the price increases that are being implemented in the first half of 2022 on the Forged and Cast Engineered Products side. Is it anticipated that those price increases will recover the entire set of inflationary forces to-date across materials, freight, energy, and labor?

Sam Lyon
A significant portion of it. So, we have two portions of the price increase. There's a base price increase to cover general inflationary pressures, and then there's a surcharge mechanism being implemented. That surcharge mechanism will reduce our exposure to roughly 20% of our customer base that will be non-covered. In those cases, we are going back and more regularly visiting the base prices. So, we're either getting it through base price, or we're getting it through surcharge mechanisms. The preferred method from our customer base and from us is the surcharge mechanism just because it's a lot easier and cleaner, but the anticipation is to capture those costs, yes.

Justin Bergner
Okay. But the base--sorry, the surcharge mechanism will not recover labor. So, it's more a question of for the customers that don't allow a full surcharge mechanism, you'll have a larger base price increase for those customers that do allow the full surcharge mechanism, right?

Sam Lyon
That's accurate. So yeah, there's a smaller base price increase when there's a surcharge mechanism, a larger base price increase when there's no surcharge mechanism. Correct.

Justin Bergner
Okay. And then, to the extent that certain inflationary forces are hard to recover, where would those be? Would that be more labor-oriented or any clarification there would be helpful?

Sam Lyon
More on the supply side, so your refractories or your tooling that you're purchasing, boxes, those kinds of things. But again, those are lesser. I mean by far, labor would end up in base pricing, but the energy and natural gas are--and transportation are a much bigger portion of our costs than the supply side.

Justin Bergner

Okay. And then, maybe one clarification question. The question on the CapEx project, just help me understand the difference between the finished machines and the intermediate machines? In terms of the key pieces of CapEx equipment, I'm not sure I followed there.

Sam Lyon
Well, the way, real briefly, the way the process works is we forge the roll, so it's a rough forged blank. And then, it goes to what we call an intermediate machine or a roughing machine. So that's to make the rough general shape for thermal processing. Then once the material is thermal processed at Harmon Creek, it goes to a finishing plant where the real fine detail is done. So, the finishing machines are doing the post heat treat work that makes the final product that the customer sees. The roughing equipment is just to get the material ready for heat treatment.

Justin Bergner
Got it. So, it's the second and third stages in the production process, where the CapEx is addressing, and those are where you'll be able to meaningfully expand capacity and address limitations for bottlenecks?

Sam Lyon
Correct, correct.

Justin Bergner
Got it. Thank you.

Brett McBrayer
And I think, Justin more significantly as well as take costs out of the process. If you look at--you know, we stated this before, but these are multipurpose machines, replacing multiple machines with one new one, which really accelerates the velocity through the manufacturing process as well as takes out costs. So, pretty excited about the opportunities we have here with this new capital.

Justin Bergner
Great. Thank you, again.

Operator
Again, if you have a question, please press star then one. This concludes our question-and-answer session. I would like to turn the conference back over to Mr. Brett McBrayer for any closing remarks. Please go ahead.

Mike McAuley
Just before we get to the closing remarks, just for the record, I wanted to respond to the question about Forged Engineered Products sales for the fourth quarter, just to get it in the record. There were $7.7 million in the quarter, and for the full-year, $25.3 million. And the change year-over-year is about $7.5 million for Q4 versus prior-year, David.

Brett McBrayer
Great. Thank you, Mike. Despite the challenges we faced in the second half of 2021, I'm encouraged by our progress over the past year toward our near-term goal of $450 million in revenue and double-digit EBITDA margins. I 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. We remain confident in the actions we're taking and our expectations for much improved performance in our businesses as we conclude our capital improvement initiatives. Thank you for joining our call this morning.

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