

Ampco-Pittsburgh Corporation

Second Quarter 2022 Earnings Results Call

August 11, 2022, 10:30 a.m.

CORPORATE PARTICIPANTS

Brett McBrayer - *Chief Executive Officer*

Michael McAuley – *Senior Vice President, Chief Financial Officer & Treasurer*

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

Sam Lyon - *President, Union Electric Steel Corporation*

PRESENTATION

Operator

Welcome to the Ampco-Pittsburgh Corporation Second Quarter 2022 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'll be an opportunity to ask questions. To ask a question, press star then one on your telephone keypad. To withdraw a question, please press star then two. Please note this event is being recorded.

I'd now like to turn the conference over to Michael McAuley, Chief Financial Officer. Please go ahead.

Michael McAuley

Thank you, Anthony, and good morning to everyone joining us on today's second quarter 2022 conference call. Joining me today are Brett McBrayer, our Chief Executive Officer, 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 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 risk 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 will turn the call over to Brett McBrayer, Ampco-Pittsburgh's CEO. Brett?

Brett McBrayer

Thank you, Mike. Good morning. As shared in our recent press release, Ampco-Pittsburgh recorded a net income of \$0.4 million in our second quarter of 2022. Although, we again recorded a positive net earnings quarter, we were negatively impacted by the lag in product surcharge coverage in our Forged and Cast Engineered Products segment as well as supply chain delays in our Air & Liquid Systems segment. We have recently seen commodity prices decline, which will help in cost recovery. However, the volatility of the energy prices in Europe continues to be a headwind for our operations, customers, and customers' end markets. Despite these challenges, net sales improved approximately 9% from the prior quarter and our backlog has grown 7% sequentially and 19% year-to-date.

The first installation of new capital equipment in our Forged and Cast Engineered Products segment is on track and will occur in the fourth quarter of this year. Completion of our North American fixed asset transformation will conclude in 2023.

From a safety and health perspective, we again saw positive progress in our injury rates during the quarter. The health and safety of our team members will remain a priority as we drive improvements in our businesses.

I will now turn the call over to David Anderson, President of Air & Liquid Systems for comments on his segment's performance.

Dave Anderson

Thank you, Brett. Good morning. At the end of the first quarter of 2022 Air & Liquid Systems' backlog was at a historic high. I am pleased to report that we have further increased our backlog in Q2 to a new record high. Backlog levels have increased 35% over the past six months and 46% over the past 12 months. We are seeing significant order activity as sales orders received in the first six months of this year exceed the orders received for the first six months of any year in the history of Air & Liquid Systems.

Sales in Q2 increased 7.5% compared to prior year, primarily due to higher shipments of heat exchangers. We continue to manage supply chain related issues including extended lead times on materials and customer-requested deferrals. While these supply chain issues have impacted our business, they are short-term in nature and do not impact the long-term strategic direction of the business. Operating income for Q2 increased 26% compared to the prior year due to higher sales, improved efficiencies, and favorable product mix.

At the beginning of 2022, Air & Liquid Systems began to implement our new multiyear strategic growth plan. We are now just six months into that plan, and we see very positive indicators. Record levels for orders received and backlog show the early success we have already experienced and provide positive momentum as we move forward with our growth initiatives.

Brett McBrayer

Thank you, Dave. I'll now turn the call over to Sam Lyon, President of our Forged and Cast Engineered Products segment.

Sam Lyon

Thanks, Brett, and good morning. The Forged and Cast segment's backlog increased another 6.6% sequentially in the second quarter of 2022 and is up nearly 15% this year. We are seeing strong activity in the US as there has been a shift toward a more local supply chain. Inflation continued to impact operations. Materials and energy prices have remained elevated, but we have begun to see a decrease in certain key raw materials over the last few months. If this trend continues, it should provide a tailwind for our operating income and cash in the second half of the year, as surcharge revenue will catch up to costs.

Energy prices in the UK, where we operate one of our cast roll plants, continues to be very volatile. Much of our order book has coverage for this volatility, but it's driving significant increases in costs and pass-through prices. While we have seen an increase in power costs in our Sweden plant,

the overall energy cost there is still only about 25% of the cost at our UK plant. We are working to shift more work to our Sweden operation. We continue to monitor developments in costs daily and react where possible to minimize the effect on our business.

We are well into our normal third quarter seasonal maintenance shutdowns. We kept our US plants down for an additional week to reduce some working capital from the system. We took advantage of this time to do some additional needed maintenance work on our forge presses and associated equipment.

As Brett stated, our expansion and modernization programs for our US plant assets continue on schedule. In the last month, we completed on-site acceptance testing for one of the new machine tools being built in Spain with positive results. We also achieved a key milestone as we received full approval from the Pennsylvania Department of Environmental Protection for the installation of four furnaces in our Burgettstown facility. These furnaces will allow us to increase our throughput and increase utilization of our melt and forge assets.

We are excited about these investments as they will provide a lower cost structure in the roll business and further growth in the non-roll business, which is currently at capacity. We are still on target to complete this CapEx program in 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 details regarding our financial performance for the quarter.

Michael McAuley

Thank you, Brett. Ampco's net sales for the second quarter of 2022 were \$102.6 million, an increase of 11% compared to net sales for the second quarter of 2021, led by 12% sales growth in the Forged and Cast Engineered Products segment, driven by higher pricing, including surcharge revenues, and higher shipment volumes of forged engineered products to the oil and gas and steel distribution markets. Net sales for the Air and Liquid Processing segment for the second quarter of 2022 were 7% higher than the prior year period due to higher shipments of heat exchange coils.

Loss from operations for the second quarter of 2022 was \$0.3 million. This compares to income from operations in the prior year quarter of \$0.5 million.

The Forged and Cast Engineered Products segment's operating results declined for the second quarter of 2022 compared to prior year. The decrease primarily reflects the inflationary impact of higher operating costs in excess of recovery through product pricing and surcharges and the impact of a \$0.7 million reserve recorded for the refund of certain excess COVID-19 subsidies received in 2020, but to be returned in 2022. Air and Liquid Processing segment's operating results improved for the second quarter of 2022 compared to prior year, primarily due to improved mix and lower employee-related costs.

Excluding the reserve for the excess COVID-19 subsidies, Ampco's non-GAAP adjusted income from operations was positive for the second quarter of 2022 and approximately comparable to the prior year quarter.

Other income expense net benefited from higher foreign exchange transaction gains but declined overall for the second quarter of 2022 when compared to the prior year quarter, primarily due to the timing of dividend income from one of the corporation's Chinese joint ventures. That dividend income was \$1 million in the prior year second quarter.

At the bottom line, the corporation reported net income attributable to Ampco-Pittsburgh of \$0.4 million, or \$0.02 per diluted share for the second quarter of 2022, compared to net income of \$1.1 million or \$0.05 per diluted share for the second quarter of 2021.

Backlog at June 30, 2022, of \$348.8 million, increased 7% sequentially and increased 19% year-to-date, and rose 37% from a year ago. Backlog for the Forged and Cast Engineered Products segment improved nearly 7% sequentially. The increase is principally a result of an increase in orders for forged rolls due to improved demand from the segment's flat-rolled steel and aluminum customers and improved pricing. Backlog for the Air and Liquid Processing segment is at a record high and increased 6% sequentially.

Net cash flows used in operating activities was approximately \$6.7 million for Q2 2022, due to an increase in trade working capital associated with the higher level of business activity, and in the case of inventories, higher costs associated with inflation and supply chain disruptions.

Capital expenditures for the second quarter of 2022 were \$2.9 million and are now \$6.3 million year-to-date, primarily in the Forged and Cast Engineered Products segment.

At June 30th, 2022, the corporation's balance sheet and liquidity position included cash on hand of \$7.4 million and undrawn availability on our revolving credit facility of approximately \$24.4 million.

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

QUESTION AND ANSWER

Operator

We will now begin the question-and-answer session. To ask a question, you may press star then one on your telephone keypad. If using a speakerphone, please pick up your handset before pressing keys. To withdraw your question, please press star then two. At this time, we will pause momentarily to assemble our roster.

Our first question will come from David Wright with Henry Investment Trust. You may now go ahead.

David Wright

Good morning, everyone.

Brett McBrayer

Good morning, David.

David Wright

I have a question for Dave. You – can you characterize the areas whether it's all health care or additional areas where demand for Air & Liquid Systems products is coming from? And then part B of the question is what kind of tension, if any, are you seeing between demand for delivery and a willingness or not to pay more?

Dave Anderson

Well, thank you, David. We are seeing demand in health care for sure, but it is not just health care. We are seeing demand really across most of the industries we serve. As far as willingness to pay more, we usually are pretty successful in passing along pricing. Everyone knows the inflationary market is out there and we're generally pretty successful in getting that pass through.

David Wright

I'm curious on this because it's a little counterintuitive, if you think while the economy is slowing down and this and that, and you hear nothing but problems, but you can find pockets of demand, things forging ahead, and it sounds like you're benefiting from being in one of those pockets?

Dave Anderson

Yes, we are definitely seeing strong demand.

Sam Lyon

David this is Sam. One thing that we heard repeatedly on our customers' earnings calls in the US is that nonresidential construction remains very strong. So, it is a pocket of, I'll call it, higher demand in the US for sure.

David Wright

And then Dave do you have any comment on trends in Buffalo Pumps' business, maybe with respect to Navy? There's been a lot of interest over the last many months about delays in the various shipbuilding programs. And I'm just wondering, what you're seeing there?

Dave Anderson

There are certainly some delays due to supply chain customer pushouts. It's not a significant problem for us in the long term, but there's been some short-term issues with shipyards pushing out. But we still see good demand coming from the US Navy. And I think if anything it's started to get a little stronger actually.

David Wright

Great. And then I just have a comment for Mike. Appreciate the good disclosure in the MD&A, and your breakout of kind of the pluses and minuses affecting the results from Sam's sector. That's appreciated. So, thanks very much and good luck over the balance of the year.

Brett McBrayer

Thank you, David.

Dave Anderson

Thanks, David.

Operator

Again, if you have a question, please press star then one.

Our next question will come from Justin Bergner with Gabelli Funds. You may now go ahead.

Justin Bergner

Good morning, Brett. Good morning, Mike.

Brett McBrayer

Good morning, Justin.

Michael McAuley

Hi, Justin.

Justin Bergner

First question would be on Forged and Cast Engineered Products. And in the forged engineered products you mentioned, you were at capacity. Is that sort of a hard line? And how much additional capacity will sort of the first major installment of new equipment in the latter part of this year add on the forged engineered products side?

Sam Lyon

Yes. The – we're really furnace constrained, Justin. And so there – the DEP approval for the four furnaces, which will take six to nine months to install. So, mid to a little bit later in the year next year is when those would go in. And that would increase our capacity roughly 40% on non-roll product.

Michael McAuley

Right. So forged products other than rolls.

Sam Lyon

Yes.

Michael McAuley

Rolls are not capacity constrained, it's the other forged products.

Sam Lyon

Correct.

Justin Bergner

Okay. And until that point you'll sort of be capacity constrained at the current capacity there's not any sort of intermediate checkpoints where you get part of that 40%?

Sam Lyon

Well, the furnaces won't go in all at the same time. So, you put in two furnaces and we'll pick up 20%, and then put in the other two and you'll pick up another 20%.

Justin Bergner

Okay. Got it. Second question relates to just balance sheet. I mean, with commodity prices rolling over, how does that impact your projected free cash flow needs in the second half? And I mean, does -- do commodity prices rolling over indirectly give you a little bit more wiggle room versus the availability under your asset-backed facility, or are you still actively exploring additional financing alternatives?

Michael McAuley

I guess, Justin, you're referring to the recent decline in commodity prices that we've been seeing post June 30 quarter end that we've been seeing? Yes, that should provide some relief on working capital demand, because of the cost of raw materials should be coming down. So that's good news. It will also help us, on the earnings side and hence cash generated from the business, because our surcharge mechanisms will finally be able to catch up to and potentially exceed the current period inflation that would -- change in prices that would occur. So that should provide some relief in reduced borrowings.

We are seeing continued growth in the order book, though, which would go the other way. So, I think that in terms of the demand for working capital and use of the credit line, we are expecting it to kind of abate from its growth that we've seen in the first half and grow at a lesser extent in the second half, but demand is still a factor even if prices are coming down.

Justin Bergner

Okay. Understood. I don't know if you've spoken to this specifically before, but have you -- or do you want to quantify sort of the headwind from the price cost lag, as it relates to the surcharge mechanism for investors? I assume that's something that you keep tabs on internally?

Michael McAuley

We do. In fact, we've disclosed it in the MD&A for the 10-Q that was filed Monday evening, under the Forged and Cast Engineered Products segment. We did disclose -- we measured that estimate to be in the range of \$6 million for the quarter -- compared to the Q2 2021 quarter, of under-recovery relative to price inflation for raw materials energy and other operating costs.

Justin Bergner

Okay. And does all of that get recovered by the surcharge mechanism catching up, or is only the portion of it related to specific commodities get recovered?

Michael McAuley

A portion will be recovered when the material prices and inflation abate and start -- and material prices start to come down, then we'll recapture that, a portion of it. But there is a portion of our business that we don't have full protection of the surcharge mechanism.

Justin Bergner

Okay. But how about costs like energy and such? Are they part of the surcharge mechanism for that part of the business where you have a surcharge mechanism, or is that outside of that realm?

Michael McAuley

It's part of the surcharge mechanism. We have spent a fair bit of time adding that to the surcharge formulas for, I would say the majority of our contracts; it's not in for every single agreement, but it's in for most of them.

Justin Bergner

Okay. Thanks. That detail is very helpful.

Michael McAuley

Thanks.

CONCLUSION**Operator**

This concludes our question-and-answer session. I would now like to turn it over to Brett McBrayer, Chief Executive Officer, for any closing remarks.

Brett McBrayer

Thank you. Just recently, we faced significant headwinds from the global pandemic. We now face just as significant headwinds from input cost inflation exacerbated further by the war in Ukraine. Despite these obstacles, I'm encouraged by the proactive steps we're taking to improve profitability as well as the hard work and resiliency of our employees. I want to thank our employees for making a positive difference each and every day. 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.