Ampco-Pittsburgh Corporation

Fourth Quarter 2022 Earnings Results Conference Call

Tuesday, March 21, 2023, 10:30 AM

CORPORATE PARTICIPANTS

Kim Knox – *Corporate Secretary*

Michael McAuley – *Senior VP, CFO and Treasurer*

Brett McBrayer – *CEO*

Dave Anderson – *President of Air & Liquid Systems Corporation*

Sam Lyon – *President of Union Electric Steel Corporation*

PRESENTATION

Operator
Welcome to the Ampco-Pittsburgh Corporation Fourth Quarter 2022 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 “*” key, followed by “0”.

After today’s presentation there will be an opportunity to ask questions. To ask a question, you may press “*”, then “1” on a touchtone phone. To withdraw your question, please press “*”, then “2”.

Please note, this event is being recorded.

I would now like to turn the conference over to Kim Knox, Corporate Secretary. Please go ahead.

Kim Knox
Thank you, Betsy, and good morning to everyone joining us on today's fourth-quarter 2022 conference call. Joining me today are Brett McBrayer, our Chief Executive Officer and Mike McAuley, Senior Vice President and Chief Financial Officer. Also joining 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 risk 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, Kim. Good morning and thank you for joining our call.

As shared in today’s press release, Ampco-Pittsburgh recorded an operating income of $0.9 million in the fourth quarter of 2022 and a full-year 2022 operating income of $2.8 million with a full-year EPS of $0.18 per share. Our fourth quarter sales improved by 11% over the prior year quarter and full-year 2022 sales were up 13% from 2021.

As of the end of 2022, our backlog is up 26% versus the prior year and 11% versus the prior quarter. Successful pricing actions continue to be taken in the Forged and Cast Engineered product segment to combat core inflation. Energy and transportation has been added to our surcharge mechanism and now covers over 80% of our backlog.

The exciting transformation of our North American fixed assets in the Forged and Cast Engineered Products segment continues to progress with our first piece of new equipment installed this quarter. We are on track to complete the new equipment installations this year.

The impact of the war in Ukraine and a softness in the European market continues to be a headwind for our foreign assets in the Forged and Cast Engineered Products segment. We are encouraged by domestic demand for our products, which remains robust.

Our Air & Liquid segment's growth strategy continues with record profits and backlog achieved in 2022.

Suppliers to the naval shipyards continue to struggle, resulting in a continuation of delays for our fluid pump products. We believe these bottlenecks will be resolved as we progress through the year.

Recordable and lost time rates improved dramatically in 2022, across our global operations. The engagement of our workforce and their actions to improve our work environment have been impressive, as we continue to pursue a goal of zero injuries in our workplaces around the globe.

David Anderson, President of Air & Liquid Systems will now discuss his segment's performance in more detail. Dave?

Dave Anderson
Thank you, Brett. Good morning. As I have discussed on previous calls, 2022 was the launch of our new multi-year strategic growth plan. The results of the first year of the plan were extremely positive and I would like to thank the Air & Liquid employees for all the work they've done to implement our new growth strategies.

In 2022, we achieved the highest level of sales orders in our history. We also achieved the highest backlog in our history. We increased our internal and external sales force and, as a result, our sales orders increased 40% compared to the prior year.

In 2022, every quarter resulted in a new record backlog, as our backlog ended the year $48 million higher than 2021. That represents a 69% increase and means we entered 2023 in a significantly stronger position than a year ago.

Along with our increase in sales orders, we also increased our manufacturing capabilities by finding new ways to hire and retain quality employees.

Sales in Q4 increased 20% compared to prior year, while full year sales increased 7% versus prior year. Increased sales were primarily due to higher shipments of heat exchangers and custom air handling units.

Full-year operating income for 2022 was $13.7 million versus an income of $2.6 million in the prior year; $8.9 million of the improvement was related to asbestos expenses and credits.

Full-year operating income, excluding asbestos, was $11.5 million versus $9.3 million in the prior year. The primary reason for the improvement was the higher sales levels in 2022.

Air & Liquid entered 2023 with a record backlog, a significantly stronger sales organization, and the increased manufacturing capabilities to allow us to continue to move forward with our growth plans.

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

Sam Lyon
Thanks, Brett, and good morning. Full-year operating income in the Forged and Cast Engineered Products segment declined for Q4 and full year 2022 compared to the prior year. Although our pricing initiatives for surcharge and base price increases were successful, 2022 results were impacted primarily by general core inflation exceeding the base price increases and lower volume in the European Cast Group.

The fourth quarter was also affected by an equipment outage in our forged large roll work cell, deferring approximately $3 million of sales into 2023 and causing unfavorable cost absorption in Q4.

As discussed in prior calls, our Europe plants experienced significant headwinds with unprecedented instability of energy price in the face of the Russia- Ukraine conflict.

We began to see some relief in the latter part of 2022, which continues into 2023, as energy prices have retracted significantly due to government controls and a warm winter. Our sales team was successful in negotiating energy and transportation surcharges in 2022. As a result, over 80% of our backlog has surcharges for raw materials, energy and transportation.

Energy hedges were executed to mitigate the risk for the remaining 20%. In response to the general inflation under recovery outside of surcharged items, we announced in February further base price increases of 10% to 15% for Forged and Cast rolls.

Our capital revitalization program in the U.S. continues to progress. We have completed factory acceptance testing on four of the five machines with the last scheduled for late April. The first machine is nearing final assembly in our Burgettstown, Pennsylvania facility, and the second machine has hit the U.S. shores. Factory test results have gone better than expected.
Site acceptance of the first machine is scheduled for April, with all machines commissioned by year's end.

The forged and cast segment's backlog increased by 11% over the third quarter of 2022 and 13% over the fourth quarter of 2021.The backlog reflects a strong roll market, especially in the U.S. as customers increasingly favor a domestic supply chain in light of the geopolitical tensions in Europe.

Partially offsetting the strong roll demand is the FEP backlog, which has softened over prior periods due to distributors working through high year-end inventories, increased imports and a two-year low in frac fleets.

We have recently seen an increase in quoting activity for oil and gas and distribution bar. The carbon steel flat rolled industry boasts positive market outlooks, as evidenced by recent announcements of restarts of vital blast furnaces, across multiple steel manufacturers.

Across North America and Europe, we're seeing an increase in hot roll coil prices, indicative of a strengthening market. Furthermore, U.S. Steel, Nucor, Steel Dynamics, and others have announced multi-billion-dollar investments in new site construction, opening up new avenues and opportunities for our product.

We have just received -the initial mill fill order for the new Aluminum Dynamics plant that is being built in Columbus, Mississippi.

In summary, our backlogs are increasing, pricing actions are holding and our customers are more bullish than in 2022.

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. As shared in the press release, Ampco-Pittsburgh recorded net income for the twelve months ended December 31, 2022, of $3.4 million dollars or $0.18 per diluted share. This compares to a net loss for the twelve months ended December 31, 2021, of $3.9 million or $0.20 per diluted share.

Now, I'd like to discuss a few special items that are important to understanding the reported results. First, effective December 31, 2022, the Corporation changed its method of accounting for the cost of its domestic inventories from the LIFO method to the FIFO method.

At December 31, 2021, approximately 35% of the Corporation's inventories were accounted for using the LIFO method and at December 31st 2022, approximately 42% of the Corporation's inventories would have been accounted for using the LIFO method had the Corporation not changed.

The Corporation believes the change to the FIFO method of inventory valuation is preferable, as it provides a better matching of cost with the physical flow of goods, standardizes the Corporation's inventory valuation methodology among the locations, and improves comparability with industry peers.

A change from the LIFO method to the FIFO method is considered a change in accounting principle, requiring all prior periods to be restated as if the Corporation had used the FIFO method to value its domestic inventories for those periods and with a cumulative adjustment recorded to retained deficit, net of tax, of the earliest year presented, in this case, January 1, 2021, as it relates to our forthcoming Form 10-K.

This change reduced net loss for the three and twelve months ended December 31, 2021, by $4.9 million and $8.8 million, respectively, and the cumulative change to opening retained deficit on the 2021 balance sheet net of tax was an improvement of $11.5 million.

More details on this change, including quarterly restatements of prior periods presented will be included in the Corporation's 2022 Form 10-K, which we expect to file this evening, or soon thereafter.

In terms of other significant items affecting comparability, the corporation recorded a $2.2 million benefit in the fourth quarter 2022, related to a reduction in the estimated long-term defense cost portion of our asbestos liability.

In contrast, the Corporation recorded a $6.7 million charge in the fourth quarter of 2021 in connection with last year's revaluation of the total asbestos liabilities and related insurance receivables. Both of these items are reflected in the Air & Liquid Processing segment’s results.

Ampco’s net sales for the fourth quarter of 2022 were $93.5 million, an increase of approximately 11% compared to net sales for the fourth quarter of 2021. Net sales from the Air & Liquid Processing segment grew 20%, driven by higher shipments of air handling units and heat exchange coils, which more than offset declines in sales for centrifugal pumps from project delays associated with the ongoing supply chain issues at U.S. Navy shipbuilders.

Net sales for the Forged and Cast Engineered Product segment in the fourth quarter of 2022 were approximately 8% higher than the prior year period, primarily due to higher pricing and variable-index surcharges as a result of higher raw material, energy, and transportation costs, offset in part by an unfavorable currency translation effect.

Income from operations for the fourth quarter of 2022 was $0.9 million. This compares to a loss from operations in the prior year quarter of $7.7 million. The three months ended December 31, 2022, include the asbestos-related benefit of $2.2 million I previously mentioned. The primary change items are the asbestos-related items I mentioned earlier.

Air & Liquid Processing segment’s operating results also improved, primarily due to the higher volume of shipments. The Forged and Cast Engineered Product segment’s operating results declined for the fourth quarter of 2022, compared to prior year, primarily reflecting higher cost of production not being fully offset by the effects of price increases.

Interest expense for the quarter increased compared to the prior year, as a result of the rise in total debt and interest rates. And other income net declined for the fourth quarter of 2022 when compared to the prior year quarter, primarily due to larger foreign exchange transaction losses.

At the bottom line, the Corporation reported a net loss attributable to Ampco-Pittsburgh of $0.5 million or $0.02 per diluted share for the fourth quarter of 2022, compared to a net loss of $7.4 million or $0.39 per diluted share for the fourth quarter of 2021.

Backlog at December 31, 2022, of $369 million increased approximately 11%, sequentially, and rose 26% from a year ago. As Sam and Dave indicated, backlog for the Forged and Cast Engineered Product segment increased approximately 11%, sequentially, and approximately 13%, year-over-year, while backlog for the Air & Liquid Processing segment continues to be at record highs and has increased 69% versus prior year.

Net cash flows used by operating activities was approximately $7.5 million for Q4 2022, primarily in support of working capital.

Capital expenditures for the fourth quarter of 2022 were $3.7 million and were $16.7 million for the year, primarily for the Forged and Cast Engineered Product segment.

At December 31, 2022, the Corporation’s balance sheet and liquidity position included cash on hand of $8.7 million and undrawn availability on our revolving credit facility of $28.4 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 “*”, then “1” on your touchtone phone. If you are using a speaker phone, please pick up your handset before pressing the keys. If at any time, your question has been addressed and you would like to withdraw your question, please press “*”, then “2”.

At this time, we will pause, momentarily, to assemble our roster.

The first question today comes from David Wright with Henry Investment Trust. Please go ahead.

David Wright
Good morning, everyone.

Brett McBrayer
Good morning, David.

Michael McAuley
David.

David Wright
I think I’ve got one for Mike, one for Sam and—I’ve got two for Mike, one for Sam and, I think, one for Dave. On the balance sheet, Mike, with the K not out yet, can you tell us what was long-term debt at year end?

Michael McAuley
David, the long-term debt is $105.5 million.

David Wright
I'm sorry?

Michael McAuley
Sorry, total debt is $105.5 million.

David Wright
And that includes current portion?

Michael McAuley
That includes current portion.

David Wright
Okay. And then on the, on the LIFO to FIFO, effective--the 2022 operating numbers, is that all FIFO and clean, what you're reporting for 2022?

Michael McAuley
Yes. And the comparative 2021 has been restated.

David Wright
Right.

Michael McAuley
It's all--everything is on a FIFO basis.

David Wright
Okay. So, 2022 is clean.

Michael McAuley
Yes.

David Wright
And all of the adjustments will be put back to the 2021 year?

Michael McAuley
Well, 2022 is, as you say, clean with respect to being reported on a FIFO basis. The comparative 2021 will likewise because we have to restate all periods on the same method that are presented in the 10-K and because we do a comparative for 2021 for income statement, for example. That income statement will likewise be, like you say, clean for total FIFO basis.

And then, what we do is, for all periods prior, a cumulative effect, as though all the history would have been on FIFO, is reported in opening retained earnings on the 2021 balance sheet.

David Wright
So, if I went back and took, say, the second quarter of 2022 and looked at that gross margin and that cost of sales, those numbers are the numbers--you don't have to change those?

Michael McAuley
We will restate all quarters, and it'll be out later today in the K.

David Wright
Okay. A question for Sam. On these--on the price increases given that the lag time between the customer's order and the rolls for delivery sometime down the road, when roughly is the income statement going to start seeing the effect--I guess, I should say the benefit of the base price increases?

Sam Lyon
We got a base increase going into this year of approximately 5%, and for the new 10% to 15%, the majority of that will be 2024. So, it will be a transactional business in 2023 but mostly long-term contracts with Arcelor Mittal, U.S. Steel, Nucor, still David, that's all for 2024.

David Wright
Okay. And then a question for Dave. How much of Buffalo Pumps business overall, roughly, is Navy, U.S. Navy?

Dave Anderson
It's a little more than half, David, slightly over 50%.

David Wright
Okay. And then, how much of that business is affected by shipyard building delays?

Dave Anderson
I would say 80% to 85% of that is shipyard business.

David Wright
Wow. Okay. All right. Those are my questions. Thanks for taking them.

Dave Anderson
Thank you.

Operator
As a reminder, if you would like to ask a question, please press "*" then "1" to be joined into the question queue. The next question comes from Gordon Fain with Retail. Please go ahead.

Gordon Fain
Good morning, gentlemen. Thank you for the nice report. I did make a small purchase of a long time, small investor or retired employee, federal employee, not Ampco-Pittsburgh. So, my question is, if the financial people were to do an estimate of the effect on cash and earnings of a $0.02 a share dividend payable in the third or fourth quarter, a one-time dividend to bring us into a dividend stock category, which many mutual funds want, how would that--would that be feasible? Thank you.

Michael McAuley
I can answer that.

Gordon Fain
Yes sir.

Michael McAuley
Thank you for your question. We stopped paying dividends in 2017 when the liquidity position needed attention.

Gordon Fain
Right.

Michael McAuley
A return to dividend paying stock, that's certainly on our future agenda. At the moment, we have significant investment plans, and we're focused on profitability improvement, which means cash flow improvement.

So, for 2023, I think it would be difficult to consider a restoration of the dividend. But I think as we go forward in the future, I think that's definitely on the long-term thinking. It's not--I don't think it's a near-term realistic possibility.

Gordon Fain
Thank you, that helps.

Operator
The next question comes from Dennis Scannell with Rutabaga Capital Management. Please go ahead.

Dennis Scannell
Yes, thank you. Just a couple quick things for me. I'm kind of interested, particularly in Europe, in demand on the on the roll business and maybe push backs that, well, if customers are giving you push backs in pricing, what's happening from a competitive standpoint in that market in terms of, are your customers looking for suppliers outside of the European region that aren't as affected by the high and volatile energy prices? And then I have a couple of follow-ups. Thank you.

Brett McBrayer
Okay, the demand in Europe was mostly down because the steel demand and steel manufacturing in Europe was down. So, those rolls go into the European market, strip mostly, as well as the U.S. market. So, we just saw an overall decline in demand from that.

Most of our competition on the roll side is in Europe. There's 10 to 15 suppliers of cast rolls that reside in various countries inside of Europe.

Our position, and I think we addressed this on the last call, particularly in our UK plant, we were disadvantaged from an energy perspective, and some of our competition had hedges in place that made them more advantageous. Those are expiring and in conjunction with that is the state of the energy prices have retracted most of the way back to where they were, prior to the escalation from the war.

So, we believe we're on a much more level playing field with where our competition was. The other competition that sometimes shows itself would be Japan or China. But the acceptance of Chinese rolls in the western market is still very, very limited. Did that answer your question?

Dennis Scannell
Yeah, absolutely, absolutely. So, maybe just to stick on Europe for a bit. Would you say your market share in 2022 was stable, or did you lose some share as--just relative to the competition?

Brett McBrayer
I'd say in '22, we lost a bit of share in, particularly out of the UK. The Sweden plant was stable, and now we are negotiating essentially 2024 volumes. Most recent--commit anything, but most recent outlooks look more positive, going forward.

Dennis Scannell
Excellent. Good. Good. And then, I think this would be for Mike. But can you talk a little bit about the capital spending for 2023 and then 2024, kind of what the what the budget looks like?

Michael McAuley
Yeah, sure, we can talk about that. Now, we're--for the year, I think, I quoted that in the script, for the year, CapEx for the total Corporation, we finished the year 2022--

Brett McBrayer
$16.7 million.

Michael McAuley
Yeah, I think, $16.7 million; 2023 will be a bit heavier, especially on the kind of the strategic domestic machining assets that we're putting in, in some of the heat treat furnaces. We're going to see higher levels of CapEx in the next, particularly Q2 and Q3 of this year, I predict. So, we're

going to see that bounce around between the quarters and be a bit elevated for 2023, relative to 2022.

We didn't really give an outlook as far as that granular level of detail, but I think we'll see, probably, maximum CapEx in '23 and a tapering '24, '25.

Dennis Scannell
So, I mean, are we talking like $30 million in 2023? Or can you put a range on that?

Michael McAuley
Yeah, we're not. No, it's not going —'to be that high.

Dennis Scannell
Okay—okay.

Michael McAuley
What we're doing is, we're managing sustaining CapEx with more of the replacement, the machinery that we're focused on putting in is replacing the older machinery. So, we're trying to spend less on sustaining to afford our way through this program.

Dennis Scannell
Right-right. And then, thinking about, once this capital spending, this strategic capital spending is done by year end '23, can you give a sense of kind of where CapEx shakes out for '25 and beyond—I'm sorry, for '24 and beyond?

Michael McAuley
We're probably going to be in the $15 million range.

Dennis Scannell
Okay. Yeah, that's helpful. And then, go ahead, I'm sorry.

Michael McAuley
That's, you know globally.

Dennis Scannell
Yeah, right. No, absolutely good. No, that's helpful. And then, I'm not sure. So, again, without having the K in front of me, so for the full year 2022, our operating cash flow, I think you gave for the fourth quarter, but for the full year, where would that have shaken out?

Michael McAuley
Cash flow from operating activities?

Dennis Scannell
Right.

Michael McAuley
It was a use of $27 million.

Dennis Scannell

And as we look into ’23, we’ve got heavy capital spending. Do you have any guidance in terms of how operating cash flow will look? I mean, again, we’re hoping to have some improved profits. Hopefully, working capital won’t be as much of a drag. Hopefully, raw material prices?

Michael McAuley
Right, 2022 was definitely a big working capital growth year, and we all know inflation really added to that. But as we look to 2023, if we just focus on operating cash flow and because we already talked about CapEx--

Dennis Scannell
--Great--

Michael McAuley
--We should not be in that range. We will see higher sales and it depends on the timing of those sales if fourth quarter winds up being a larger quarter, we may end the year with maybe a little-a little bit on accounts receivable. But our game plan is to kind of control inventory through the year, and we don't really predict a large inventory growth.

So, we expect a much more moderated working capital position in 2023, as compared to 2022. So we're not, we're not projecting a big use like that in ‘23.

Dennis Scannell
But would you go out on a limb to say that we're going to have positive operating cash flow in 2023?

Michael McAuley
I think it'll be a challenge.

Dennis Scannell
Okay.

Michael McAuley
We do have higher sales.

Dennis Scannell
Yeah. Right-right-right.

Michael McAuley
And no--and it depends on the outlook for ‘24, for inventory, because it would--because long cycle times in the roll business, especially, you’ve got to build ahead. So I think it depends on where ‘24 is shaking out as we get through the year. But our challenge is to control the working capital.

Dennis Scannell
Absolutely. Good. Excellent. Okay, great. Thank you very much.

Michael McAuley
Okay. Thanks, Dennis.

Operator
Once again, if you would like to ask a question, please press “*” then “1” to enter the question queue.

CONCLUSION

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

Brett McBrayer
Thank you, Betsy. I'm encouraged by our progress over the past year toward our goal of $450 million in revenue and double-digit EBITDA margins. The completion of our capital equipment investment in the U.S. this year will be a significant enabler, as well as the growth initiatives we have underway in Air & Liquid Systems.

I want to thank our employees for their tremendous 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 efforts. We are confident in the actions we are taking and our expectations for much-improved performance in our businesses. Thank you for joining our call this morning.

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