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Q4 2018 Synalloy Corp Earnings Call

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Dennis M. Loughran *Synalloy Corporation - Senior VP & CFO*

CONFERENCE CALL PARTICIPANTS

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Synalloy Fourth Quarter Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded. I would now like to introduce your host for today's conference, Mr. Craig Bram, President and CEO. Sir, you may begin.

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

Good morning, everyone. Welcome to Synalloy Corporation's Fourth Quarter 2018 Conference Call. With me today is Dennis Loughran, our CFO. Dennis will provide a review of the Q4 financials, and then I'll provide some comments on our business segments and what we are seeing so far in 2019. We will then open the call to questions. Dennis?

Dennis M. Loughran ***Synalloy Corporation - Senior VP & CFO***

Hello, everyone. As usual, the financial results will be presented using 3 different methods: first, GAAP-based EPS; second, adjusted net income, a non-GAAP measure is defined in the earnings release; and third, adjusted EBITDA, a non-GAAP measure also defined in the earnings release.

Fourth quarter GAAP-based net income was $0.5 million or $0.06 diluted earnings per share, as compared to net income of $1 million or $0.11 diluted earnings per share in the fourth quarter of 2017. Significant differences in the year-over-year performance include:

Q4 of this year was negatively impacted by $2.1 million in mark-to-market valuation losses on investments in equity securities, compared to no such losses in the fourth quarter of last year.

Q4 of this year contained $0.2 million of inventory price change losses compared to the fourth quarter of last year, which incurred inventory price change losses totaling $1 million.

Q4 of this year includes the favorable net one-time adjustments and amortization of prior period manufacturing variances totaling $0.3 million, compared to no impact in the fourth quarter of 2017.

Q4 of this year included $0.8 million of reduced earn-out accrual compared to a net favorable earn-out adjustment of $0.5 million in the fourth quarter of 2017. The decrease in projected earn-out liability represents the present value of expected payouts under the Marcegaglia acquisition agreement, as a result of lowered prognosis for sales than previous projections over the remaining contract.

Fourth quarter non-GAAP adjusted net income was $2 million or $0.22 diluted earnings per share as compared with adjusted net income of $1.2 million or $0.13 diluted earnings per share for the fourth quarter of 2017.

Fourth quarter non-GAAP adjusted EBITDA totaled $5.9 million or 8.1% of sales compared to the prior year's fourth quarter adjusted EBITDA of $4.0 million or 7.5% of sales. Those comparable figures topped off a tremendous growth year for the company with full year adjusted EBITDA totaling $34.1 million compared to just $12.5 million for the full year 2017 based on incremental profits from the company's latest 2 acquisitions and strong performance across our core metals and chemical markets.

The combined adjusted EBITDA as a percent of sales for the operating businesses in the fourth quarter was 10.5%, up substantially from prior year's fourth quarter of 3.4%.

At the end of the fourth quarter, our outstanding borrowings against our ABL facility totaled $76.4 million, up $13.6 million from September 30, 2018 total, primarily related to working capital increases. The calculated ABL facility remaining availability as of December 31, 2018, was approximately $17.5 million.

I'll now turn the call back over to Craig.

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

Thanks, Dennis. 2018 was a record year on multiple fronts, record sales, record EBITDA and record adjusted net income per share.

In late summer, our share price at a 10-year high of over $24 and in December we nearly doubled our dividend from the previous year. On top of stellar operating results, we completed the purchase of Marcegaglia galvanized tube business on July 1, 2018 and followed that up with the acquisition of ASTI's assets on January 1, 2019.

In January, we provided our forecast for 2019 with targeted revenue of $340 million, up 21% from the records set in 2018, and adjusted EBITDA of $34 million. The adjusted EBITDA forecast for 2019 assumes no inventory profits for the year and represents a 24% increase over 2018's adjusted EBITDA on a comparable basis.

While, our share price finished 2018 up 24% over the prior year, we have seen a decline this year by as much as 23%. At our February Board meeting, the Directors authorized a share repurchase of up to 850,000 shares. It's the Board's belief that our share price does not reflect the value that's been created in recent years. At this year's low of $12.79, Synalloy was valued at an enterprise value to EBITDA multiple of only 5.4x. By comparison, the average historical multiple in a peak year of the cycle for Synalloy was 7.8x. The median multiple in our peer group recently exceeded 9x. While I'm pleased with the company's financial performance and the completion of 2 complementary acquisitions, we are certainly disappointed with the share price.

Let me make some general comments on Q4 of what we're seeing so far in Q1 of this year. At the corporate level, we took a mark-to-market valuation loss on investments in equity securities in the fourth quarter totaling $2.1 million. Small-cap and microcap equities were hit hard in the fourth quarter and our 2 holdings were no exception. Unlike Synalloy, however, both holdings have staged a strong rebound so far in the first quarter of this year.

Turning to the Metals Segment. Average selling prices continued to show a positive trend across all product lines in the quarter, as well as in our backlogs. We do anticipate price increases to moderate in 2019 and that is reflected in our forecast. Nickel prices and associated surcharges were under pressure in Q4, resulting in metal losses in the quarter, which will carry over into this year's first quarter.

While finishing the year with metals' profits of almost $5 million, all the gains occurred in the first 3 quarters of last year. Nickel prices and surcharges have started to rebound in 2019. Since the end of 2018, nickel prices were up 26%. Should this trend continue, then we would expect to start generating inventory profits in the second quarter of this year.

The integration of ASTI has gone smoothly so far, and we are targeting conversion to Synalloy's ERP system in May. Raw material savings are hitting assumptions and we began coordinating sales activities among our other stainless units within the Metals Segment. We are also working on several organic sales initiatives across the Metals Segment, including the possible addition of a new product line in the Specialty Pipe and Tube unit.

Looking at the Chemicals Segment. We returned to organic sales growth in 2018, and we see reason for more of the same in 2019. The demand for increased biocide volume at our CRI facility has created a need for additional equipment. We have approved a $450,000 capital project that should be completed in the second quarter. This project will have a payback period of less than 1 year and will support increased volume from 4 existing customers as well as 1 new customer. We're also focused on better utilization of excess nonreactor capacity at manufactures chemical. We have opportunities to bring on some new simple blend products that will require little-to-no additional labor. We recently installed a new horizontal grinding mill at CRI to manufacture a jet fuel additive for a well-known chemical company. The new grinding mill is being paid for by the customer over the length of the contract. This new mill will increase throughput by at least 4x over the previous method of production.

As noted in the earnings release, the level of business activity in the first 2 months of this year has exceeded our plan in both the Metals and Chemical segments. While early, signs continue to point toward another solid year of end-market demand. The M&A pipeline has some interesting prospects as well.

Dennis and I'll now open the floor to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Mike Hughes with SGF Capital.

Michael E. Hughes ***SGF Capital Management, LP - Principal & Portfolio Manager***

Just wanted to start with the Chemical division. I guess, that was the, in my opinion, the one disappointment for the year. I think the margins in the second half were shy of 7% and mid-year you were taking 12% to 13% at least that was implied from the full year guidance. So what happened there and then what's the outlook from a margin perspective for 2019 for Chemicals?

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

Yes, Mike, I would say a couple of things. We rate our product opportunities in different phases and we didn't see some of the products that we expected to ramp in production didn't happen in the latter part of last year. Some of those product lines have made good progress and we're actually seeing the benefits of that in the first couple of months of this year. So the Chemicals Segment is definitely running north of our plan in 2019 so far. And some of that, as I said, are these products that we had anticipated contributing some margin for us in the fourth quarter moving into the first quarter of this year. And in addition to that, we've gotten quite a few additional opportunities that have presented themselves, including the biocide volume that I mentioned, the nonreactor product lines that I mentioned at MC. So we're expecting that you'll see some significant improvement in the Chemicals Segment in the first quarter of this year.

Michael E. Hughes ***SGF Capital Management, LP - Principal & Portfolio Manager***

Okay. And then just 1 detail follow-up on that. Was there a bonus reversal, the bonus accrual in the Chemicals division in the fourth quarter just for modeling purposes, I was wondering?

Dennis M. Loughran ***Synalloy Corporation - Senior VP & CFO***

I don't know.

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

Dennis is looking at a couple of things here, Mike.

Michael E. Hughes ***SGF Capital Management, LP - Principal & Portfolio Manager***

Okay. You want me to jump to just the Metals division.

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

Yes, sure.

Michael E. Hughes ***SGF Capital Management, LP - Principal & Portfolio Manager***

Okay. Palmer, you had some labor issues. Can you just talk about where the margins, I'm not sure if you'll disclose this or not, but where the margins were in the second half of the year for Palmer? And if you've been able to address those issues and things are running more smoothly now?

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

Yes. I won't get into the specifics of the exact margins, but the margins for Palmer in the second half were definitely improved over the first half. They've been strong the last several months and to address your -- a question, the labor specifically, the turnover among our welders is much reduced from what it was in the first half of the year. So that's definitely had a positive impact on throughput. The last 3 months our production levels have been hitting targets. So we're pleased with what's going on there.

Michael E. Hughes ***SGF Capital Management, LP - Principal & Portfolio Manager***

Okay. And the backlog looks essentially flat. So are you -- sequentially, are you still seeing good demand levels from the Permian?

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

Yes. Historically what happens is, we get second and third quarter bookings are the highest booking quarters of the year. January is always little soft, and so we saw that again this year. February bookings picked up very nicely. Right now, we've got bookings as of March 1 that at current revenue run rate there is about -- a little more than 5 months' worth of work in our backlog. And we expect that will continue to kind of hold in that level, that's where we've been in the last 18 months.

Michael E. Hughes ***SGF Capital Management, LP - Principal & Portfolio Manager***

Okay. And then just one more for me. The galvanizing and ornamental steel business. I think in the third quarter it did roughly $6 million. If I did the math correctly, it did roughly $5 million in revenue in the fourth quarter. And I think the ornamental steel business was supposed to be ramping during the fourth quarter and you'd exist the year at a run rate of $25 million. So can you just give us an update on those 2 businesses?

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

Yes. The galvanized in the fourth quarter was probably one of the more significant reduction of the inventory that we saw from the customer base, meaning some of our customers were saying, "please don't ship that product to us right now". They were trying to maintain inventory levels at a target that was either internally down, maybe driven by their ABL lines. So we saw some more pressure in the galvanized area. So far, this year we have seen that volume pick back up. It's a little bit below plan, but not materially so. On the ornamental side, you may recall we've got high frequency mills up in our Munhall plant outside of Pittsburgh, and we're starting to ramp that up. At the same time, we completed the ASTI acquisition. That's a higher end ornamental product. That business has done very well the first couple of months of the year, and we're actually using that team to try and help us both on the manufacturing side at Munhall, but more importantly, doing some collaboration among their sales team and the what I'll call the commodity ornamental plate sales effort. So we are seeing some good, good benefits in that -- from that acquisition and we have also seen some positive things on the raw material side as well adding that volume into the Bristol Metals purchasing mix is actually at this point exceeded some of our projections on the raw material savings. So we're very pleased with ASTI 2 months into the acquisition.

Michael E. Hughes ***SGF Capital Management, LP - Principal & Portfolio Manager***

Okay. Just 2 followups, then I'll jump back in the queue. So it sounds like it is safe to assume that the ornamental steel business did not exit the fourth quarter at $25 million in annualized revenue. Is that correct?

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

No. Absolutely, not.

Michael E. Hughes ***SGF Capital Management, LP - Principal & Portfolio Manager***

Okay. And then the second question, I think, part of the reason that you're excited about the galvanized business was the opportunity to increase the IBC business, the chemical companies. Can you give us an update on that front?

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

Yes. We have signed 2 long-term contracts at volume commitments that are higher than what they were when we acquired the business, so we expect that to continue to be a positive development. And secondarily, we started doing some work in the road construction market as well.

Michael E. Hughes ***SGF Capital Management, LP - Principal & Portfolio Manager***

And if you have the accrual information, are you willing to provide that?

Dennis M. Loughran ***Synalloy Corporation - Senior VP & CFO***

This is Dennis. In the Chemicals business the total incentives for the fourth quarter were only off $20,000 lower than the average for the full year quarter. So no major reversal.

Before we have any other questions, I would like to correct one of my statements I found in my script, a typo that I'd like to correct. In the statement where I've mentioned the combined adjusted EBITDA of the operating units, the correct percentage for the fourth quarter 2018 was 10.75% and the fourth quarter of last year was 10.5%. So we have neglected to override script from the prior periods. So that's a correction to that statement. Please continue with the questions.

Operator

(Operator Instructions) Because I'm showing no further questions at this time, I'd like to turn the call back over to Craig Bram for any closing remarks.

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

Looks like we have 1 more follow-up from Mike, maybe.

Operator

Yes, sir, you're correct, sorry. we have a follow-up from Mike Hughes.

Michael E. Hughes ***SGF Capital Management, LP - Principal & Portfolio Manager***

Just want to go back to the Metals Segment. Could you give us the specialty alloy mix for the backlog at year-end?

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

Mike, I don't have that handy, but if you want to check back in with Dennis off-line, we could give you a breakdown on that.

Michael E. Hughes ***SGF Capital Management, LP - Principal & Portfolio Manager***

Okay. Just high-level, what are you seeing from a large project perspective, which tends to be, I think, more weighted towards specialty alloy?

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

Well, certainly, the shipments from the Bristol Metals out of the Bristol Tennessee facility is where the bulk of the special alloy is produced. And their mix has been very good in the first couple of months of this year from a shipment basis and that's a reflection of some of the bookings that occurred in the fourth quarter. I have not seen a significant uptick in project bookings so far. There have been a few. We have had a mining project that got booked in late January. And there is also a plastics company booking that occurred in early February. But those are the 2 primary projects that I have seen that we actually reported on in our most recent board meeting.

Michael E. Hughes ***SGF Capital Management, LP - Principal & Portfolio Manager***

Okay. And then I think that the Koreans were out of the market because they hit their quota at the middle of last year. I'm not sure how much market intelligence you have on this front, but are they more active in the first half, and is that an issue?

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

No. I wouldn't say. They are -- I mean, they are back in. In fact, they have been bidding on projects since the end of the fourth quarter. But I can tell you that Bristol Metals market share in January, which is the latest month that we have, we actually increased our market share among domestic producers by 120 basis points.

Michael E. Hughes ***SGF Capital Management, LP - Principal & Portfolio Manager***

Okay. And then do you happen to have the import statistics provided on the maybe the second quarter call of last year even though the tariffs were in place, the imports were still pouring in. Do you have those numbers from maybe the fourth quarter?

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

I know that without getting into where it's coming from, imports represented about 42% of North American consumption in -- for all of 2018.

Michael E. Hughes ***SGF Capital Management, LP - Principal & Portfolio Manager***

Okay. And then you made 1 comment about on the BRISMET business prices moderating. You're not actually envisioning a price decline this year, are you?

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

No. Our plan actually has a price increase. Obviously, a lot of that is dictated by the direction of nickel prices and the associated surcharges. So we -- if you go back and look at the nickel prices in -- really starting in September on a -- it really got double-digit decline starting in October of last year on a sequential month basis. And that carried through February, really through February of this year. I'm talking about surcharges and we have seen surcharges reverse. So at the end of last year, the surcharge on 304 was about $0.63 a pound. And in February, it was roughly $0.53 a pound. In March, we saw it jump to $0.58 and right now the projected for April is $0.61 pushing $0.62. So we had inventory losses in the fourth quarter. You'll see some inventory losses in January and February. But based on the nickel price and the current surcharge, we will have double-digit increases in surcharges starting in April. So as long as nickel prices are trending up or they don't lose ground, then we would expect our average selling prices to show some increase over 2018 and be consistent with the plan that we built and have shared going back earlier this year.

Michael E. Hughes ***SGF Capital Management, LP - Principal & Portfolio Manager***

Okay. And then can you just talk about where you would take the leverage to, I think, it's around, I don't know roughly a little less than 3x at this point to EBITDA. Would you take it above 3x?

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

No. That's not an area we would be comfortable with. If you look at -- during my tenure as CEO going back to 2011, our leverage has averaged about 1.75x. At the end of 2018, before we did the ASTI deal, it was about 2. Immediately following the ASTI deal, it was about 2.5. And if we don't do any more acquisitions this year, we are projecting that net debt would average roughly $55 million over the course of this year. And so if we hit our plan that would suggest that our leverage would fall back to about 1.5x. But 3x is not a level that we would be comfortable with. Again, recognizing that our businesses are cyclical, and while we don't see any signs at all of any softening in our end markets right now we certainly don't want to go out and be sitting over 3 and then have things start hitting south a little bit.

Michael E. Hughes ***SGF Capital Management, LP - Principal & Portfolio Manager***

Right. So you must be projecting fairly robust free cash flow for the year. So what are the -- what are your working capital assumptions. I think your cash conversion cycle is over 100 days because of the inventories you carry. So do you have working capital actually contributing this year to free cash flow?

Dennis M. Loughran ***Synalloy Corporation - Senior VP & CFO***

Mike, this is Dennis. As we mentioned in our commentary in the press release, working capital was up. We had all of our metal side of the business pursued up higher inventories in the second half of the year. Some of it related to SPT, long lead times, brought in metal in the fourth quarter, anticipating not being able to get it in the first half for sales. So we're looking at anywhere between $7 million and $14 million of free cash flow from reduction of working capital by year-end, moving back to sort of historical targets and just managing our working capital, obviously we had a great year and we're just trying to moderate that and make sure our cash flow is positive over the 2-year period.

Michael E. Hughes ***SGF Capital Management, LP - Principal & Portfolio Manager***

Okay. Good. And then have you put out a 2019 CapEx number?

Dennis M. Loughran ***Synalloy Corporation - Senior VP & CFO***

No. We have not.

Michael E. Hughes ***SGF Capital Management, LP - Principal & Portfolio Manager***

Would you be willing to put a range out for us?

Dennis M. Loughran ***Synalloy Corporation - Senior VP & CFO***

So not acquisition, base would be in the $4 million to $6 million range.

Michael E. Hughes ***SGF Capital Management, LP - Principal & Portfolio Manager***

$4 million to $6 million. Okay. And then the 2 equity investments. What would they total right now, I don't think they're broken out on the balance sheet, they're probably in the 10-K, but I haven't looked at that yet.

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

As we sit right now, let me see.

Dennis M. Loughran ***Synalloy Corporation - Senior VP & CFO***

Hold on a second.

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

You had a calculator handy in here...

Dennis M. Loughran ***Synalloy Corporation - Senior VP & CFO***

Yes, at current market item.

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

Yes, looking at the current markets, so...

Dennis M. Loughran ***Synalloy Corporation - Senior VP & CFO***

At the end of the year, it was about $3 million, like while he is calculating that number...

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

Just shy of $4 million right now.

Michael E. Hughes ***SGF Capital Management, LP - Principal & Portfolio Manager***

Okay. Okay. And then my final question. Did you put out where the BRISMET backlog is right now. I know at year-end, you said it was $31.2 million. I assume it's higher right now?

Dennis M. Loughran ***Synalloy Corporation - Senior VP & CFO***

BRISMET, it's about $28 million.

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

BRISMET, right now, it's about $28 million.

Michael E. Hughes ***SGF Capital Management, LP - Principal & Portfolio Manager***

Does that include Munhall?

Dennis M. Loughran ***Synalloy Corporation - Senior VP & CFO***

BRISMET -- yes, Bristol and Munhall.

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

Yes. Bristol and Munhall.

Dennis M. Loughran ***Synalloy Corporation - Senior VP & CFO***

Mike, I did go -- I looked at those stats, for BRISMET, for both facilities excluding galvanized backorder or backlog, the special alloy is about 15% on a pounds basis, which is a pretty good number historically.

Operator

Thank you. And I'm showing no further questions in the queue at this time. I would like to turn the call back to Craig Bram for any closing remarks.

Craig C. Bram ***Synalloy Corporation - President, CEO & Director***

As always, we appreciate your support, and again, we are looking forward to a strong 2019. Thank you.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This does conclude your program, and you may all disconnect. Everyone, have a good day.