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EDITED TRANSCRIPT

Q1 2020 Synalloy Corp Earnings Call

EVENT DATE/TIME: MAY 05, 2020 / 1:00PM GMT

CORPORATE PARTICIPANTS

Craig C. Bram *Synalloy Corporation - President, CEO & Director*
Dennis M. Loughran *Synalloy Corporation - Senior VP & CFO*

PRESENTATION

Operator

Good morning, everyone, and welcome to the Synalloy Corporation's first quarter earnings conference call. (Operator Instructions)

During this call, management will be using certain non-GAAP financial measures. The company's earnings release and the Securities and Exchange Commission filings include information about these measures and the reconciliation to the most directly comparable GAAP financial measures.

Statements made during this call will include forward-looking statements and defined as Private Securities Litigation Reform Act of 1995. Management expectations and options reflected in the -- in those statements are subject to risks, and the company can give no assurance that they will prove to be correct. Those risks are described in the company's earnings release and the Securities and Exchange Commission filings.

Further, please be advised that the company, its directors and certain of its executive officers and participants in the solicitation of proxies from the company's shareholders in connection with the 2020 Annual Meeting of Shareholders. The company has filed a definite -- a definitive proxy statement with the SEC in connection with any such solicitation of proxies. Shareholders are strongly encouraged to read such proxy statements and all other documents filed with the SEC carefully and in their entirety as they contain important information.

Information regarding the identity of the company's participants and their direct or indirect interest or security holdings or otherwise can be found in the company's definitive proxy statement and other materials filed with the SEC. These materials can be obtained free through the company's website in the section titled Investor Relations or through the SEC's website.

Hosting today's conference will be Mr. Craig Bram, President and Chief Executive Officer; and Dennis Loughran, Senior Vice President and Chief Financial Officer.

I will now turn today's call over to Mr. Bram for opening remarks. Please go ahead, sir.

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

Good morning, everyone. Welcome to Synalloy Corporation's First Quarter 2020 Conference Call. Dennis Loughran, our CFO, will provide a review of the Q1 financials, and then I'll provide some comments on our business segments. 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 as defined in the earnings release; and third, adjusted EBITDA, a non-GAAP measure also defined in the earnings release.

First quarter GAAP-based income was a net loss of $1.2 million or $0.13 diluted loss per share as compared with a net loss of $0.9 million or $0.10 diluted loss per share in the first quarter of 2019.

First quarter non-GAAP adjusted net loss was $0.7 million or $0.08 adjusted diluted loss per share as compared with adjusted net income of $0.6 million or $0.07 adjusted diluted earnings per share in the first quarter of 2019.

First quarter non-GAAP adjusted EBITDA totaled $2.6 million or 3.5% of sales compared to the prior year's first quarter total of $4.8 million or 5.6% of sales.

As pointed out in the earnings release, inventory price change losses impacted results, totaled on a pretax basis $0.4 million in the first quarter of 2020 compared to a pretax loss of $3.4 million in last year's first quarter. This represents a $3 million improvement in the balance between the surcharges invoiced to customers and the cost of inventory passed through the income statement compared to the first quarter of 2019.

As a note regarding the current status of nickel and metal valuations, with nickel at today's level at the end of the first quarter of 2020, we had approximately $4.8 million of accumulated downward revaluation impact due to declines in alloy metal pricing over the prior 3 to 5 months. With order book pricing fixed on approximately half of current pipe and tube inventories, we would expect approximately $2.4 million of that total to pass through as metal pricing losses during the second quarter of 2020.

The combined adjusted EBITDA as a percent of sales for the operating businesses in the first quarter was 5.7% compared to the prior year's first quarter of 7.6%, the primary factors in the decline being the inventory price change differential mentioned above, the average pricing declines experienced in welded stainless pipe and galvanized tube operations compared to prior year's level.

The company had $77.8 million of total borrowings outstanding with its lender as of March 31, 2020. Since March 31, 2019, that figure has been reduced by $13.6 million due to rigorous management of inventory and accounts receivable.

In these uncertain times swathed by the COVID-19 virus, we are redoubling our efforts to improve our liquidity and reduce debt through the end of this year, with further inventory reductions of approximately $7 million, estimated refunded taxes made available through recent tax changes of approximately $2 million, and responsible constraints on capital spending until the economy is normalized of approximately $2 million. The calculated ABL facility remaining available as of March 31, 2020, was approximately $19 million.

I will now turn the call back over to Craig.

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

Thank you, Dennis.

The first quarter saw weaker year-over-year demand, particularly in the metals segment. Pricing pressure negatively impacted material margins for the entire company. Excluding Palmer, material margin declined by $3.85 million over the first quarter of last year. This was with pounds shipped virtually unchanged from the prior year. We were able to proactively offset a portion of this lost material margin through our cost-cutting efforts as discussed during our year-end outlook. Again excluding Palmer, we reduced our costs by $1.54 million year-over-year. Savings from the cost-cutting initiative will increase over the next several quarters, providing additional financial support to our results.

Let me also provide an overview of our welded pipe and tube business. This includes Bristol metals and ASTI. For the first quarter, pounds shipped were up almost 6% over the same period last year. We gained 3.4 points of North American market share in the welded stainless steel pipe category. However, with weak demand particularly in the commodity alloys, pricing for this segment of our business remained under pressure. While demand was reasonably good for our ornamental product line, our coal suppliers had an unexpected extension in their delivery lead times, which negatively impacted ASTI's pounds available for shipment. Overall, prices were down 10% for the welded pipe and tube segment over the same period last year. Material margin fell by $0.14 per pound over the same period last year and was down $2.9 million on an absolute dollar basis.

We continue to show solid improvement in our cost structure with every major category down from the prior year. Labor and benefits declined by $413,000 or $0.028 per pound. Shipping costs fell by $57,000. Manufacturing costs were down by $102,000 or $0.017 per pound. And SG&A was down $360,000 or $0.015 per pound. In total, costs were down $932,000 or over $0.065 per pound for the welded pipe and tube segment.

Bookings in the first quarter for this segment were also strong. That said, we saw order activity soften a bit in April. Our backlog remains in good shape at the Bristol facility but is lighter than we would like to see at Munhall. ASTI's customer base, excluding the medical sector, which was strong in the first quarter, is slowly ramping back up, but Q2 sales will likely trail Q1.

Our seamless carbon business saw pounds shipped decline by approximately 7% over the prior year, while selling prices were down roughly 8%. Material margin was down $0.09 per pound and down $709,000 on an absolute dollar basis.

Costs were down for this product line as well. Over the prior year, shipping costs fell 8% on a per pound basis, and labor and benefits were down 19% on a per pound basis, while SG&A was down 8% on a per pound basis. Manufacturing expense was up $12,000 over the prior year due to higher insurance expenses and greater depreciation. In total, costs were down $254,000 over the first quarter of last year or a total of $0.05 per pound.

Order activity in April was below the first quarter as the heavy industrial markets and energy market showed signs of stress from the shutdown of the economy. As previously reported, we have ceased manufacturing operations at our Palmer of Texas facility. We currently have fewer than 10 individuals employed at this operation. Drilling activity has fallen precipitously with the decline in WTI prices, and there are no signs of quick recovery.

As we collect accounts receivables and sell remaining inventory, we expect to extract several million dollars of capital from this unit in the coming weeks. Similarly, we'll evaluate increasing production at Palmer when the COVID-19 pandemic is over and the oil and gas industry in the Permian Basin returns to normalized pricing and demand levels.

Turning to the Chemicals segment. Pounds shipped were down 7% over the first quarter of last year, but prices were up 10.2%. Effective March 1, we instituted a 4% price increase across a portion of our products. Material margin, however, declined by $264,000 year-over-year.

The Chemicals segment also generated solid cost savings in shipping, manufacturing expense and SG&A, combining for total savings of $216,000 year-over-year. However, labor and benefits were up $79,000 due to a very large medical claim. As a result, employee benefits were up $189,000, exceeding the $110,000 in savings in production-related labor.

We continue to ship several tanker wagons per week of hand sanitizer. While this product line has increased substantially with the COVID-19 outbreak, we believe the hygiene practices going forward will continue to create a strong market for hand sanitizers.

With the ISM Manufacturing Index for April hitting its lowest level since April of 2009, we remain focused on expense reduction and cash flow management.

As Dennis mentioned, the CARES Act will allow us to utilize net operating losses and carry them back 5 years. We expect this to generate an estimated $2 million in tax refunds over the next 2 quarters. We will also have an additional estimated tax refund of $1 million for the 2019 tax year.

The property and business interruption claim for the heavy wall press is being finalized, and we're pursuing a cash settlement in excess of $1 million after deductible, which should also hit in Q2 or early Q3.

At the end of last year, we changed insurance brokers to address higher premiums in the property and casualty coverage. And after a successful remarketing of our properties this spring, we are saving over $600,000 annually. The new coverages were bound at the end of April, so the savings will kick in at that time.

At Bristol Metals, we've had an ongoing dispute with our supplier of industrial welding gases for the Munhall facility. We believe that they have overcharged Bristol Metals approximately $1 million over the last 3 years. Unable to negotiate an acceptable settlement, we filed a lawsuit in the Eastern District of Virginia.

Finally, we are pursuing a property tax valuation review at SPT's Houston operation, which should result in savings of $200,000 annually.

As our order book dictates, we will, of course, adjust our headcount accordingly over the next 2 quarters.

We'll now open the call to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question is from the line of [James Lewis].

Unidentified Participant

I was wondering [about] this quarter's profit.

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

Excuse me? I didn't hear the question.

Unidentified Participant

I was wondering what the, I guess, second quarter profit was and the first quarter profit as far as Bristol Metals segment division.

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

We don't break that out on the calls for competitive reasons.

Unidentified Participant

Oh, okay. Well, that was my question. I was going to listen to everything, but you said you just had a strong market and everything and revenue backlog. So I was just -- well, listen, [when you came on], I didn't hear none of those numbers or anything, so we'll have to wait on that.

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

Great.

Unidentified Participant

Okay. No problem with that.

Operator

(Operator Instructions) And at this time, there are no further questions.

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

All right. As usual, we appreciate your support. Thank you very much.

Operator

Thank you. This does conclude today's meeting. You may now disconnect.

Editor

Forward-Looking Statements

This transcript may include "forward-looking statements" within the meaning of the federal securities laws. All statements that are not historical facts are "forward-looking statements." The words "estimate," "project," "intend," "expect," "believe," "should," "anticipate," "hope," "optimistic," "plan," "outlook," "should," "could," "may" and similar expressions identify forward-looking statements. The forward-looking statements are subject to certain risks and uncertainties, including without limitation those identified below, which could cause actual results to differ materially from historical results or those anticipated. Readers are cautioned not to place undue reliance on these forward-looking statements. The following factors could cause actual results to differ materially from historical results or those anticipated: adverse economic conditions; the impact of competitive products and pricing; product demand and acceptance risks; raw material and other increased costs; raw materials availability; employee relations; ability to maintain workforce by hiring trained employees; labor efficiencies; customer delays or difficulties in the production of products; new fracking regulations; a prolonged decrease in oil and nickel prices; unforeseen delays in completing the integrations of acquisitions; risks associated with mergers, acquisitions, dispositions and other expansion activities; financial stability of our customers; environmental issues; unavailability of debt financing on acceptable terms and exposure to increased market interest rate risk; inability to comply with covenants and ratios required by our debt financing arrangements; ability to weather an economic downturn; loss of consumer or investor confidence and other risks detailed from time-to-time in the Company's Securities and Exchange Commission ("SEC") filings. The Company assumes no obligation to update the information included in this transcript.

Important Other Information

The Company, its directors and certain of its executive officers are participants in the solicitation of proxies from the Company's shareholders in connection with the Company's 2020 Annual Meeting of Shareholders. The Company has filed a definitive proxy statement and BLUE proxy card with the SEC in connection with any such solicitation of proxies from the Company's shareholders. SHAREHOLDERS OF THE COMPANY ARE STRONGLY ENCOURAGED TO READ SUCH PROXY STATEMENT, ACCOMPANYING BLUE PROXY CARD AND ALL OTHER DOCUMENTS FILED WITH THE SEC CAREFULLY AND IN THEIR ENTIRETY AS THEY CONTAIN IMPORTANT INFORMATION. Information regarding the identity of potential participants, and their direct or indirect interests, by securities holdings or otherwise, are set forth in the definitive proxy statement and other materials filed with the SEC in connection with the 2020 Annual Meeting of Shareholders. Shareholders can obtain the definitive proxy statement, any amendments or supplements to the proxy statement and other documents filed by the Company with the SEC at no charge at the SEC's website at www.sec.gov. Copies are also available at no charge at the Company's website at www.synalloy.com.