Synalloy Corporation (Q1 Earnings)

April 30, 2019

Corporate Speakers:

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

Participants:

- Michael E. Hughes, SGF Capital Management, LP, Analyst

PRESENTATION

Operator: Good day, ladies and gentlemen. Thank you for standing by.

Welcome to the Synalloy Corporation's First Quarter Earnings Conference Call. (Operator Instructions)

I would now like to introduce your host for today's presentation, Mr. Craig Bram, President and CEO of Synalloy Corporation. Sir, please begin.

Craig C. Bram: Good morning, everyone. Welcome to Synalloy Corporation's First Quarter 2019 Conference Call.

As always, Dennis Loughran, our CFO, is with me today. Dennis will provide a review of the Q1 financials, and then I'll provide some comments on our business segments and the positive trends that we're seeing so far in 2019. We'll follow that up with opening the call to questions.

Dennis?

Dennis M. Loughran: Thanks, Craig. Hello, everyone.

As usual, the financial results were 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 $0.9 million or $0.10 per diluted share as compared with income of $3.8 million or $0.44 per share in the first quarter of 2018. First quarter non-GAAP adjusted net income was $0.6 million or $0.07 per diluted share as compared with adjusted net income of $3.7 million or $0.43 per diluted share in the first quarter of 2018. First quarter non-GAAP adjusted EBITDA totaled $4.8 million or 5.6% of sales compared to the prior year's first quarter total of $7.6 million or 13% of sales.

As pointed out in the earnings release, inventory price change losses impacted results total on a pretax basis $3.4 million in the first quarter of 2019 compared to a gain of $2.5 million in last year's first quarter. On an after-tax basis, that represents a $4.1 million difference between the 2 quarters.

The combined adjusted EBITDA as a percent of sales for the operating businesses in the first quarter was 7.6% compared to the prior year's first quarter of 15.2%, the primary factor in the decline being the inventory price change differential.

At the end of the first quarter, our outstanding borrowings against our ABL facility totaled $72.1 million, down $4.3 million from the December 31, 2018 total. The decrease is primarily related to decreased working capital primarily in the inventory category. The calculated ABL facility remaining availability as of March 31, 2019, was approximately $25.2 million. In addition, the balance of the $20 million term loan drawn on January 1 to support the acquisition of ASTI stood at $19.3 million at the end of the first quarter 2019.

I will now turn the call back over to Craig.

Craig C. Bram: Thanks, Dennis. The Company is off to a great start in 2019 as each of our business units performed in line with or exceeded the first quarter forecast for both revenue and earnings. As noted in the earnings release, we are reaffirming our guidance for 2019 and expect revenue totaling $340 million and adjusted EBITDA of $30 million. The adjusted EBITDA forecast assumes cumulative inventory price change losses for the year of $3.4 million and negative manufacturing variances of $0.7 million. Increasing surcharges in April and May will generate inventory price change gains to help offset the Q1 losses, assuming the surcharges continue to hold up.

In the Metals segment, we continue to make significant progress on multiple fronts. First, the ASTI acquisition was completed on January 1, and the integration of that unit has gone very well. They'll be converted to our Company-wide ERP system on June 1, providing the management team with the same timely information that's available in each of our business units. Combining the raw material purchases of ASTI with Bristol metals has generated savings in line with expectations, and we are proceeding with sharing best practice production methods across these units as well.

Turning to our storage business in West Texas. Throughput at that unit has increased in a rate of over 30% from the prior 2 quarters. Bottlenecks have been reduced and employee turnover has much improved. Some of the largest E&P companies, including Exxon and Chevron, are committing greater resources to the Permian, with both Chevron and Occidental pursuing an acquisition of Anadarko, a large holder of acreage in this part of Texas.

We expect higher oil prices, both WTI and Brent, to jump start drilling activity in the Gulf of Mexico, which will directly benefit the sales of heavy wall, seamless carbon tube at our Houston operation.

Recently, Specialty Pipe & Tube landed the largest order in the history of that Company. We will be manufacturing mechanical tubes that will be used in a parabolic solar field in the Middle East. The order will be filled over the next 18 months or so, and while the size of the order is not on the scale of some of our project work in the Stainless Steel Pipe segment, it carries very attractive margins nonetheless.

The welded stainless steel pipe market is off to an interesting start to the year. You will recall, this time last year, the President was implementing tariffs across the steel industry. Considerable buying was taking place in advance of those tariffs, helping to increase volume for both domestic and certain foreign manufacturers in the first quarter of last year. For example, South Korea is on a quota program, and they concentrated their shipments into the U.S. early in 2018 and again in January of this year. For the first quarter of this year, volume in the North American welded stainless steel pipe market was down about 13% over the first quarter of last year.

Bristol Metals volume was down only 7%, resulting in an increase in market share of approximately 370 basis points. While volume was down from last year, we do not believe it is an indication of lower end market demand but simply timing related to the tariffs last year.

We have secured several distributor inventory stock buys in April, totaling upwards of $9 million and are quoting on several more. Product mix was very positive in the first quarter, with special alloy sales at a higher percentage of total sales than they've been for some time. All in all, except for the inventory price change losses, there was much to like in the Metals segment in Q1.

The Chemicals segment continued to post organic growth in revenue and earnings in Q1, and we expect more of the same for the remainder of 2019. The capital projects to expand our biocide capacity at CRI is underway, and we've had success in adding new business to our blending operation in MC.

Before opening the call to questions, I want to comment on Privet's interest in acquiring the Company. As outlined in our response letter last Friday, the Board believes that Privet's valuation is inadequate. Simply put, if we are to sell the Company, our shareholders deserve a higher price. I've spoken with several of our largest shareholders, and they agree with the Board's position. We will certainly keep you updated should anything new develop.

We'll now open the call to questions.

QUESTIONS AND ANSWERS

Operator: (Operator Instructions)

We have a question that's coming from the line of Mike Hughes from SGF Capital.

Michael E. Hughes: I apologize, I missed your prepared comments because I was on another call, so maybe you've addressed some of these questions. The first one being the backlog from BRISMET, the almost $44 million, does that include the Galvanized acquisition? Or is that kind of a like-for-like number?

Dennis M. Loughran: It should include all of BRISMET, which includes Galvanized.

Michael E. Hughes: Okay. So if you strip out the Galvanized number, what was the backlog?

Dennis M. Loughran: I have not broken that into the components, so I'll have to dig in and I'll provide you with the answer after the call.

Michael E. Hughes: Okay. Okay. On the last call, which was in early March, I think you said the backlog stood at a little less than $30 million. Was that number excluding the Galvanized acquisition? Because if it included it, it implies that March order growth was really, really strong.

Dennis M. Loughran: Yes. So like I said, we'll pin that down and provide the appropriate answer to that. I believe it should have always included all of BRISMET.

Michael E. Hughes: Okay. Okay. Can you just comment on March and April order trends for BRISMET?

Craig C. Bram: Yes, Mike, the -- we've seen the orders pick up most recently. As I mentioned in the prepared remarks, we've got a number of stock buys that have showed up in April. We booked about $9 million of stock buys just this month, and we've got several other larger ones that we're quoting on. So we've seen a pickup in activity. If you look at the imports, they were very strong in January, most of that coming from South Korea. But we gained a market share -- actually, the domestics gained market share over the imports during that period of time and we picked up market share as well.

Michael E. Hughes: Right. And Korea, I'm trying to remember how the quarter works with Korea. I guess they were out of the market in the second half of last year and now they're back into the market until they hit their quota again. Is that right?

Craig C. Bram: That's exactly right. They shipped heavily in the first 3 or 4 months of last year and they shipped very heavily in January. But if they follow the same trend, they'll be out of the market again probably by June.

Michael E. Hughes: Okay. And then the guidance that you gave in late December of '18, and I'm speaking to the EBITDA, did that assume that there would be the inventory loss of almost $4 million at the time? Or is that an adjustment as you move through the first quarter?

Craig C. Bram: We don't forecast nickel profits or nickel losses. So on an apples-to-apples basis, if you look at 2018 adjusting out the inventory profits, we are at roughly $28 million of EBITDA, and the forecast for this year was $34 million excluding any inventory profits or losses.

Michael E. Hughes: Okay. And then the other question, on the inventory loss or gain number. I know you always talk about the surcharge. What about the underlying cost of steel? How does that function or play into that number, if at all?

Craig C. Bram: I'd say that the pricing has been more aggressive in the first quarter of this year primarily because there's been some additional product in the distribution channel. There was some consolidation among a couple of master distributors that resulted in -- one of the masters buying another master, and so they've got more inventory than they've typically had. And you also had some folks, again, buying maybe a little bit speculatively towards the end of last year. So the pricing generally in the welded stainless steel pipe market has been a little more aggressive this year than it was last year. And then couple that with the fact that surcharges are down, the total selling price on a per pound basis. On the commodity product, the 304 and the 316 is certainly lower than it was this time last year. But the difference for Bristol Metals is we're selling a lot more special alloy product in the first quarter, so the mix and the margin on those products offset the more aggressive pricing on the commodity alloys.

Michael E. Hughes: Do you have the specialty alloy mix from a pound perspective in the first quarter?

Craig C. Bram: First quarter on a sales basis, it was about 21%. On a pounds basis, it was about 12%.

Michael E. Hughes: Okay. So the 12% is up significantly from the first quarter of last year, which, in my notes, I have at 3.5%. Is that correct?

Craig C. Bram: That's right.

Michael E. Hughes: Okay. And then just moving on to Palmer. The backlog was down to $15 million. I guess the throughputs increased. If you've already addressed this, I can go back and read it. But how did the order rate look throughout the quarter?

Craig C. Bram: Order rate has been good. We've just done a much better job of putting the tanks through the facility. We eliminated some bottlenecks, specifically in the paint blast area. And our turnover -- you guys might recall, we made some adjustments to our pay rates out there in the second half of last year to try and tamp down a level of employee turnover, and we had some success there. So the throughput has been really strong throughout the first quarter. And probably in April, they will set a record in terms of a revenue base in the storage tank business.

Michael E. Hughes: And how did the profitability look at Palmer on a year-over-year basis? Was it up or down?

Craig C. Bram: It's up quite a bit.

Michael E. Hughes: Okay. And then moving on to the Chemicals division. I believe the revenue was down year-over-year as was profitability. And there is new business that I think ramped in the second half. So can you just speak to that?

Craig C. Bram: Yes. The revenue -- we had organic growth again in the first quarter, and profits are actually up when you strip out the -- we picked up a fairly sizeable payment on a legal claim that we had in the first quarter of last year. So if you strip that out, you'll see the increase in profit as well. We've got some good stuff coming online. We're -- the biocide project is underway out at CRI, and that's in direct response to 4 existing customers that need us to generate more volume and one new customer. And overall, on the MC side, we're bringing in additional blending business, which, you may recall, that was an area where we had some excess capacity.

Michael E. Hughes: Okay. And what's the margin target -- the full year margin target for the Chemicals division?

Craig C. Bram: On that EBITDA margin?

Michael E. Hughes: Either EBITDA or operating?

Craig C. Bram: The EBITDA margin target is going to be in the 10% to 11% range. I don't have the gross profit margin numbers handy. I don't know if, Dennis, you can put your fingers on that or we can get back to Mike later.

Dennis M. Loughran: Yes.

Michael E. Hughes: Okay. That's fine. And then one last question. The -- I saw that the ASTI acquisition performed above your expectations. I think there was probably an inventory mark-to-market loss in the quarter. Number one, is that correct? Two, did you adjust for that in the EBITDA number?

Craig C. Bram: Yes. You're talking about the big acquisition charge at ASTI. I think it's like a $1.3 million that's related to adjusting the inventory, Dennis?

Dennis M. Loughran: Yes. So in our adjusted EBITDA, that total number includes about $1.35 million related to the inventory, yes.

Michael E. Hughes: Okay. So it was adjusted for. Okay.

Operator: (Operator Instructions)

I'm showing no additional audio questions in the queue at this time. I'd like to turn the conference back over to management for any closing remarks.

Craig C. Bram: As always, we appreciate your interest and look forward to sharing more information within -- over the next couple of months. Thanks very much.

Operator: Ladies and gentlemen, thank you for participating in today's conference. This concludes the program. You may now disconnect. Everyone, have a wonderful day.