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Q3 2019 Synalloy Corp Earnings Call

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CORPORATE PARTICIPANTS

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

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Synalloy Third Quarter Earnings Conference Call. (Operator Instructions)

I would now like to hand the conference over to your speaker today, Mr. Craig Bram, President and CEO. Please go ahead, sir.

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

Good morning, everyone. Welcome to Synalloy Corporation's Third Quarter 2019 Conference Call. Dennis Loughran, our CFO, will provide a review of the Q3 financials, and then I'll provide some comments on our business segments. We'll then follow that up with 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.

Third quarter GAAP-based income was a net loss of $1 million or $0.11 per diluted share as compared with income of $5 million or $0.56 per share in the third quarter of 2018. Third quarter non-GAAP adjusted net loss was $0.7 million or $0.08 per diluted share as compared to adjusted net income of $5.8 million or $0.65 per diluted share in the third quarter of 2018.

Third quarter non-GAAP adjusted EBITDA totaled $2.8 million or 3.7% of sales compared to prior year's third quarter total of $10.3 million or 13.2% of sales.

As pointed out in the earnings release, inventory price change losses impacted results, totaling on a pretax basis $0.6 million in the third quarter of 2019 compared to a gain of $1.6 million in last year's third quarter. On an after-tax basis, that represents an unfavorable $1.7 million difference between the 2 quarters. Having absorbed $5.7 million of price change losses on a pretax basis year-to-date 2019 compared to a prior year 9-month gain total of $5.1 million, the difference of $10.8 million represents the largest single factor in diminished performance compared to 2018 on a year-to-date basis.

As a note regarding the current status of nickel and metal valuations. With nickel at today's level, we are expecting neutral to slightly favorable inventory pricing impact in the fourth quarter of this year and modestly favorable gains in the first quarter of 2020. The projected indices for December 1 had given back about half of the benefit of nickel pricing that had accrued as of October 1 indices, which is impacting prices on orders that will ship mid- to late first quarter 2020.

We also highlighted in the earnings release 3 other significant nonrecurring factors that combined to negatively impact pretax earnings by $1.6 million for the third quarter of 2019 and $1.9 million for the first 9 months of 2019. Please reference the earnings release for further details.

The combined adjusted EBITDA as a percent of sales for the operating businesses in the third quarter was 5.9% compared to the prior year's third quarter of 15.3%, the primary factors in the decline being the inventory price change differential mentioned above, the average pricing declines experienced in welded pipe, stainless tube and galvanized tube operations compared to prior year levels.

The company had $83.1 million of total borrowings outstanding with its lender as of September 30, 2019. Since January 1, 2019, when the company borrowed $22.7 million to fund the American Stainless acquisition, of that, $20 million term loan and $2.7 million against the company's line of credit, the company has reduced borrowings by $16 million, $2.7 million against the term loan and $13.3 million against the line of credit. The major contributing factor has been a yearlong inventory management program, which has resulted in $14.2 million of reduction through September. We continue to focus on this effort and expect an additional $12 million reduction during the fourth quarter.

During the latest 9-month period, the company also paid down $2.9 million of earn-out liabilities related to the 2019 American Stainless, the 2018 MUSA-Galvanized and the 2017 MUSA-Stainless acquisitions. The calculated ABL facility remaining available as of September 30, 2019, was approximately $17 million. In addition, the balance of the $20 million term loan drawn on January 1 to support the American Stainless acquisition stood at $17.3 million.

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

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

Thanks, Dennis. Let me start my comments with a review of the Metals segment. Third quarter results did show sequential volume improvement over the second quarter of this year for 2 of our most important product lines: the welded stainless steel pipe and the seamless carbon tube. We increased market share in both product lines and remain the best-positioned manufacturer supplier in each respective market.

North American consumption of welded stainless steel pipe on a year-to-date basis was down 22% over last year, with imports off more than 32%. BRISMET's year-to-date volume by comparison was down less than 10%. Third quarter sales dollars for welded stainless steel pipe, excluding ASTI and the seamless carbon -- and seamless carbon tube were down 13.7% and up 1% over the prior year, respectively. This is in line with end market demand reflected by 3 of the larger public company distributors, MRC Global, Reliance Steel and Ryerson, which posted average Q3 year-over-year sales dollar declines of 12%.

The weak demand in the energy, chemical and heavy industrial markets that are reflected in these product lines is consistent with many of the economic indicators that we follow, including the ISM Manufacturing Index and the Cass Freight Index, both of which have been flashing negative signals for at least 3 months.

The ornamental stainless steel tube product line has performed very well since the American Stainless acquisition in January. Its primary markets of marine, transportation and architectural construction have been much stronger than the industrial markets due to their consumer orientation. Order activity remains strong, and pricing has held up as well. Raw material cost savings from consolidating purchases with BRISMET have been a primary driver in this unit exceeding our pro forma forecast for 2019.

Q3 was a difficult quarter for the storage tank business, and we expect more of the same in Q4. Capital budgets for E&P companies remain under pressure, and drilling activity has dropped precipitously in the Permian Basin, with rigs under contract down 15% since the beginning of the year. The inventory of drilled but uncompleted wells remains at a very high level, yet that has been the case now for several quarters.

Looking out to 2020, capital budgets for E&P companies in the Permian Basin are expected to contract at least another 10% from 2019 levels. In response to the market, we further reduced the head count at our West Texas facility.

Before leaving the Metals segment, let me touch on several key initiatives. Repairs on the hydraulic cylinder for the heavy wall press are being wrapped up. With some expected delays in shipping and installation, we now expect to have the press operational by the end of the year. We've begun taking orders again and have a backlog for Q1 of next year in excess of $2 million with healthy contribution margins.

Over the next 6 months, we'll be putting in place a rework operation at our Munhall facility. We have a similar operation at our Bristol facility. Instead of scrapping damaged pipe, we will rework the pipe and sell it at current market prices. The cost of the equipment is approximately $1 million, and we expect a payback period of less than 1 year.

Turning to the Chemicals segment. Third quarter volume declined 5.6% over last year. The primary cause of the decline was the asphalt project mentioned in the earnings release that was completed in the third quarter of last year. Unfortunately, that project was a onetime opportunity. Year-to-date, the Chemicals segment volume was up 4.7% over last year. The average selling price in Q3 was down 13% over the prior year, and the average selling price year-to-date was down 15%. The asphalt project as well as more tolling work and less contract manufacturing in the current year contributed to the lower selling prices.

Looking at the pipeline of new business. We have several products that will be added to the reactor capacity at the CRI facility as we head into 2020. Additionally, MC facility has several new product lines as well. These product additions will contribute approximately $1.5 million of incremental EBITDA to the Chemicals segment next year, helping to bring their total EBITDA results in line with previous peak years.

End market demand in the chemical sector has shown signs of decline. Chemical railcar volumes are down about 1.5% year-to-date, and the most recent monthly decrease is closer to 5%. While the Chemicals business remains less cyclical than our Metals segment, product mix will be a primary determinant in sales and operating profits going forward.

The company continues to focus on reducing debt and earn-out liabilities associated with recent acquisitions. As Dennis reviewed, we've made excellent progress on both fronts. Acquisitions remain a priority, but we will continue to exercise discipline with valuations and the use of leverage.

We'll now open the call to questions.

Operator

(Operator Instructions) We don't have any questions at this time. Please continue, sir.

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

As always, we appreciate your interest in the company, and we look forward to talking with you again. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect. Have a great day.
