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Transcript of
Astec Industries Inc
Fourth Quarter 2018 Earnings Call
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Participants
Rick Dorris - Interim Chief Executive Officer, Chief Operating Officer
David Silvious - Chief Financial Officer
Steve Anderson - Vice President, Director of Investor Relations

Analysts
Peter Ziel - Baird
Stanley Elliott - Stifel

Presentation

Operator
Good day, ladies and gentlemen, and welcome to the Astec Industries' Fourth Quarter 2018 Conference Call. All lines have been placed in a listen-only mode, and the floor will be open for your questions and comments following the presentation.

At this time it is my pleasure to turn the floor over to your host, Vice President and Director of Investor Relations, Steve Anderson. Your line is open, sir. Please go ahead.

Steve Anderson - Vice President, Director of Investor Relations
Thank you, Jess. Good morning, and welcome to the Astec Industries conference call for the fourth quarter and full year ended December 31, 2018. As Jess mentioned, my name is Steve Anderson. Also on today's call are Rick Dorris, our recently appointed Interim CEO and Chief Operating Officer, and David Silvious, our Chief Financial Officer.

In just a minute I'll turn the call over to Rick, but before we begin I'd like to remind you that our discussions this morning may contain forward-looking statements that relate to the future performance of the company and these statements are intended to qualify for the safe harbor liability established by the Private Securities Litigation Reform Act. Any such statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions. Factors that can influence our results are highlighted in today's financial news release and others are contained in our annual report and our filings with the SEC. As usual, we ask that you familiarize yourself with those factors.

So at this point, I'd like to introduce you to Rick Dorris.

Rick Dorris - Interim Chief Executive Officer, Chief Operating Officer
Thank you, Steve. Good morning, everyone, and thanks for joining us. I'm very pleased to be here today speaking with all of you as Astec's Interim CEO. While I'm new to the CEO role, I'm not new to Astec. As many of you know, I've been with the company for 20 years. Most recently I served as Executive Vice President and Chief Operating Officer. Prior to that I was the Group President of the Energy Group for two years and the President of one of our subsidiaries Heatec for ten years. I'm also a registered professional engineer in the state of Tennessee.

This experience has given me a tremendous understanding of our markets, our customers, our employees and how we operate, enabling a seamless leadership transition. Since stepping into this position, my focus, together with the rest of the management team and with the support of the board, has been to continue executing on the company's strategic priorities. During the past year we have taken decisive steps to improve the company's financial performance and ensure capital is directed to the areas that we believe will drive the greatest value for our shareholders.

Overall our core business remains strong and we continue to see positive momentum. With our core businesses performing well, we have continued to take steps in support of our long-term goals of increasing operational efficiency, reducing costs and improving profitability. We took some additional actions in the fourth quarter, and I'd like to speak to those briefly.

As you know we have been working collaboratively with our pellet plant customers in Georgia to pursue a potential sale of the plant. While we remain in discussions regarding a potential sale, the timing of a transaction and the ultimate sale price are uncertain. After careful consideration, our board and management team made the decision to record a write-off of $65.7 million in the fourth quarter. We will try to recover as much of that as possible through the sale of the plant.

By taking this action, we have fully transitioned away from the wood pellet business entering 2019 and have eliminated any potential impact to future results. Our efforts in the wood pellet industry began in 2012 in order to diversify into new areas at a time when the road building and aggregate industries were at a low point. We have since determined that we are not a good fit for the industry due to the size, complexity and time frames associated with the fabrication, installation and commissioning of wood pellet plants.

We also made the decision to discontinue operations at our subsidiary in Germany, Astec Mobile Machinery. This is a small company and it did not provide the returns we expect from our subsidiaries. We reported a restructuring charge of $1.8 million in the fourth quarter, and we expect the wind down of this business to be completed in 2019. Going forward this will save approximately $1 million per year.

We have also consolidated our Dillman operation into Astec Incorporated. We will continue to offer Dillman products to our customers, but the Dillman factory in Wisconsin will be known as the Astec Prairie Du Chien facility, and will be more closely managed as part of Astec Incorporated. As a result of these two actions, we have reduced the number of subsidiaries from 20 to 18.

We also focused on our inventory in the fourth quarter and have written down slow-moving inventory to their net realizable value. With the transition away from our wood pellet business, the consolidation of Dillman and Astec and the wind down of Astec Mobile Machinery underway, we are optimistic in our outlook for the Infrastructure Group moving forward. Astec already has a dominant share of the asphalt plant market in North America and we will be introducing two new entry level asphalt plants in 2019 that will improve our competitiveness in other regions of the world. Additionally we will be introducing new paving equipment for both the domestic and international markets.

The companies in the Infrastructure Group have always been leaders in innovation in their industry segments and we're excited about the new products coming from this group in 2019. We're committed to making Astec the best it can be and to delivering value for all our shareholders.

With that, I'll hand the call over to David to discuss our results from the fourth quarter and 2018 as a whole.

David Silvious - Chief Financial Officer
Thank you, Rick, and thank each of you for joining us this morning. I'll run through the financial results quickly here.

The net sales for the quarter were $317 million compared to $312.4 million last year in Q4; that's an increase of 1.5%. International sales were $68.8 million compared to $67 million in Q4 last year, a 2.7% increase. The increase in international sales for the quarter-over-quarter occurred primarily in Africa, in Europe and in Russia. Those increases were offset by decreases in Canada and Brazil and in Australia. For the quarter our international sales increased in the Ag and Mining Group and decreased in the Infrastructure Group and Energy Group.

Domestic sales were $248.2 million in the fourth quarter of 2018 compared to $245.4 million in Q4 last year, a 1.1% increase. For the quarter domestic sales increased in our Ag and Mining Group and the Energy Group and decreased in the Infrastructure Group.

Part sales were $72.5 million in Q4 of 2018 compared to $69.3 million in Q4 of 2017, a 4.6% increase in part sales. For the quarter, part sales increased in the Ag and Mining Group and were essentially flat in the other two groups.

Forex had a negative impact of $2.4 million on sales quarter-over-quarter.

Attached to the press release is a glossary reconciling GAAP amounts as reported to adjusted amounts that we'll discuss in this call. So as adjusted in both periods, revenues were $317 million in Q4 this year compared to $306.8 million in Q4 last year, a 3.3% increase. Domestic sales increased 3.5% quarter-over-quarter as adjusted. This would also make Infrastructure sales for the quarter $124.9 million compared to $141 million for Q4 2017, an 11.4% decrease as adjusted.

On a year-to-date basis, sales were $1.17 billion compared to $1.18 billion last year, a 1.1% decrease in sales year-over-year. International sales year-over-year, they were $255.8 million this year compared to $252.4 million last year, a 1.3% increase. On a year-to-date basis, international sales increased primarily in South America outside of Brazil, in Africa and in Europe and those increases were offset by decreases in Southeast Asia, in Brazil and in Russia. And for the year international sales increased in the Ag and Mining Group, decreased in the other two groups.

Domestic sales were $915.8 million compared to $932.3 million last year, a decrease of 1.8%. And for the year, domestic sales increased in the Ag and Mining and Energy Groups and decreased in the Infrastructure Group.

Part sales on a year-to-date basis were $308.7 million compared to $283.4 million last year. That is an increase of 8.9% in part sales year-over-year. For the year part sales increased in each of our groups.

Forex had a negative impact year-over-year of $700,000 on sales.

As adjusted in both years, revenues were $1.246 billion in 2018 compared to $1.18 billion in 2017, an increase of $69.6 million or 5.9% increase as adjusted. Domestic sales increased 7.2% year-over-year as adjusted and this has made Infrastructure Group sales for 2018 $517.1 million compared to $545.7 million in 2017, a 5.2% decrease.

Fourth quarter gross profit was a negative $1.6 million compared to $62.8 million in Q4 2017, and the gross profit percentage then was a negative 0.5% for Q4 of 2018 compared to 20.1% in Q4 of 2017.

The absorption variance for the fourth quarter of 2018 was $9.7 million under absorbed compared to last year's fourth quarter under absorbed variance of $3.8 million. As adjusted the consolidated gross margin for the fourth quarter of 2018 is 24% compared to 21.6% in the fourth quarter of last year. As adjusted, the gross margin for the Infrastructure Group is 22.7% in the fourth quarter of 2018 compared to 21.3% in the fourth quarter of 2017.

On a year-to-date basis gross profits are $135.8 million compared to $243.1 million. The gross profit percentage then was 11.6% compared to 20.5% for the full year last year. Our absorption variance for the full year of 2018 was $17.5 million of under absorbed overhead compared to $1.3 million of under absorbed overhead in 2017.

As adjusted, the consolidated gross margin for 2018 is 23.8% for the full year compared to 23.3% for 2017. The gross margin then for the Infrastructure Group as adjusted is 22.4% compared to 22.6% for the full year of 2017.

SGA&E for the quarter was $54.7 million or 17.3% of sales compared to $44.8 million or 14.3% of sales in the prior year, an increase of $9.9 million or 300 basis points of the percent of sales. The drivers of SGA&E in the current year are things like consulting fees, as you know we're involved in our strategic sourcing project; research and development costs; payroll and related costs; some exhibit experience; and some legal and accounting fees. For the year SGA&E was $209.1 million or 17.8% of sales compared to $187.6 million or 15.8% of sales last year; that's a $21.5 million increase or 200 basis point increase.

Items driving the year-over-year change in SGA&E are payroll and related costs, consulting fees again. Recall that we acquired RexCon at the first of the fourth quarter last year, so we have a full year of RexCon this year compared to last year where we only had one quarter. Some legal and professional fees, accounting fees and some travel expenses.

Note that we had a restructuring and impairment charge on a separate line item that includes the goodwill impairment charges and the restructuring charges related to the discontinuation of our German subsidiary.

Our operating loss for the quarter was $69.4 million compared to $18 million of operating income in Q4 of 2017. And for the year operating loss is $86.4 million compared to operating income of $55.5 million in 2017. As adjusted, operating income was $21.2 million for the fourth quarter compared to $21.4 million for the fourth quarter of 2017, and on a year-to-date basis the operating income was $87.8 million in 2018 compared to $86.1 million in 2017.

The effective tax rate this year is 32.8% in the fourth quarter compared to 41.1% in the fourth quarter of 2017 and 29.4% for the year-to-date compared to 34.3% for the year last year. The 2018 effective tax rate is higher than the federal statutory rate due to the actual tax benefits that were derived from the various charges that we recorded during the year and especially in the fourth quarter, combine that with the lower federal statutory rate in 2018 versus 2017. We expect the 2019 effective rate to return to a more normal 25% to 26%.

Our net loss for the quarter was $47 million compared to $10.9 million of net income in the fourth quarter of 2017, that's a loss per diluted share of $2.08 in the fourth quarter compared to income per diluted share of $0.47 in the fourth quarter of 2017, a decrease of $2.55 per share. On a year-to-date basis our net loss was $60.4 million compared to $37.8 million for the full year last year net income; that's a decrease of $98.2 million. And the loss per share then was $2.64 for the full year compared to $1.63 of earnings per share in the prior year; that's a $4.27 decrease.

On an as adjusted basis net income was $14 million this quarter compared to $13.2 million in Q4 of 2017; that's $0.61 per share in this quarter compared to $0.57 per share in Q4 2017. That's an increase of $800,000 or 6.1% increase in net income and a $0.04 per share or 7% increase in earnings per share.

On a yearly basis, net income was $67.3 million or $2.92 per diluted share compared to $57.7 million of net income last year of $2.49 per diluted share. That's an increase of $9.6 million in net income or $0.43 per diluted share, which is 17.3% increase in income per share.

EBITDA for the fourth quarter was $62.6 million to the negative; that is compared to $25 million of EBITDA in Q4 of 2017 which represented 8% of sales in the prior quarter. For the year-to-date basis EBITDA was $57.9 million negative or 4.9% of sales as a negative number compared to EBITDA of $82.7 million in the year of 2017; that represented 7% of sales.

Now as an adjusted basis our EBITDA in Q4 is $28.1 million or 8.9% of sales compared to EBITDA of $28.5 million for the fourth quarter 2017 or 9.3% of sales in that quarter. And on a year-to-date basis EBITDA was $116.3 million or 9.3% of sales compared $113.2 million for 2017 or 9.6% of sales; that's a 2.7% increase in EBITDA year-over-year as adjusted.

The total backlog at December 31 of 2018 was $345 million compared to $411.5 million at the end of 2017; that's a decrease of 16.2%. Excluding pellet plant backlogs, and it's already excluded in the 2018 number, but excluding it out of the 2017 number that would make the 2017 number $341.4 million, making the December 2018 number an increase of 1.1%.

International backlog at the end of 2018 was $84.2 million compared to $75.6 million at the end of 2017, an 11.5% increase. Domestic backlog at the end of 2018 was $260.7 million compared to $335.9 million at the end of 2017, and excluding pellet plants in the 2017 number it makes the domestic backlog at the end of 2017 $265.8 million. That makes the 2018 number decrease of 1.9% domestic backlog as adjusted.

Forex had a negative $3.4 million impact on backlog year-over-year.

Moving on to the balance sheet, our receivables were at $134 million at the end of 2018 compared to $120 million at the end of 2017, a $14 million increase. Our days outstanding were at 38.2 compared to 34.3 at the end of last year. Our inventory is at $355.9 million compared to $391.4 million at the end of last year, and we're at 2.5 turns this year compared to 2.4 turns for the full year 2017. We owe $58.8 million on our $100 million domestic credit facility that existed at 12/31, and we have $25.8 million in cash and cash equivalents on the balance sheet.

Letters of credit outstanding are $11 million at 12/31, leaving a borrowing availability of $30.2 million. Subsequent to yearend we did amend our credit facility to expand it to $150 million and extend its maturity to the end of 2023 and all other elements of that credit facility remained the same. We have $2.8 million in debt in Brazil, used to finance that company and their building and their inventory.

Capital expenditures for the quarter were $9.6 million. Capital expenditures for the full year of 2018, $27.4 million, and for 2019 we're forecasting around $32 million for capital expenditures. Our depreciation for the fourth quarter of 2018 was $5.6 million compared to $22.1 million for the full year of 2018, and for 2019 we are forecasting depreciation of approximately $24 million.

That concludes my prepared remarks on the financial details, and I'll turn it back over to Rick Dorris.

Rick Dorris - Interim Chief Executive Officer, Chief Operating Officer
Thank you, David. I'll speak briefly about our outlook for 2019. We recently attended the World of Asphalt Show and I have visited with several large customers in the past few weeks. We're hearing from our customers that they are busy, have good backlogs and expect a good year in 2019. Given our recent order activity, current backlog and discussions with our customers, we feel good about the first half of this year. We're cautiously

optimistic on the second half of 2019 as more than half of the states in the US have mechanisms in place for stable infrastructure spending.

Even though the current Federal Highway Bill does not expire until September of 2020, President Trump and Congress appear to be willing to work together to increase infrastructure spending before the end of this year, and a much needed increase to the federal gas tax is being discussed as a way to fund highway projects. Our customers also have good private sector work.

To help us capitalize on the current solid end markets, we have a strong balance sheet and we've taken several significant steps to improve our operational performance. The strategic sourcing efforts we began last year is on track to deliver savings on raw materials, components and logistics this year. Our sales and operational planning programs will provide better scheduling, better inventory control procedures and a cash release from reduced inventory. The quality and operational excellence training programs are continuing and will help us provide better performance for our customers and shareholders.

Our new international sales plan is also proceeding and will allow us to better serve our international customers and increase international sales. We recently opened a new international sales and service office in Santiago, Chile to serve Latin America. We're excited about our opportunities in 2019 and how our ongoing initiatives will improve our operations.

For the first quarter of 2019 we believe our sales will increase between 3% and 6% versus the first quarter of 2018, with gross margins of 24% to 25%, operating margin of 7% to 8%, and EPS between $0.80 and $0.90. For the full year of 2019 we believe sales will increase between 4% and 7% versus 2018, with gross margins of 24.5% to 25%, operating margins between 7.5% and 8%, and EPS between $3 and $3.50.

Before I close, I'd like to provide an update on the CEO search process and mention the new director our board announced today. With respect to the CEO search process, the board is working with a leading executive search firm to identify and evaluate candidates for the permanent CEO role. I've communicated to the board that I am committed to leading Astec in the interim capacity as long as necessary. We will provide updates on this process as appropriate.

Additionally just this morning the board announced Mary Howell as its newest director. Mary currently serves as CEO of Howell Strategy Group, an international consulting firm. She previously served for 24 years as an officer of Textron and has served on a number of public company boards. The board is confident that Astec will benefit greatly from her deep knowledge and experience. With Mary's appointment, the board has added three new independent directors in the past year, bringing fresh insights, extensive experience and operational execution and optimization and expertise in the construction and building materials industries.

At Astec we're committed to creating the highest quality products, while also focusing on operational excellence. We believe the inventory management and procurement initiatives that we have in place, as well as our exit from underperforming businesses, will enable us to deliver stronger financial results this year and for many years to come.

In summary, we're making changes to position the company strongly for the future. I'd like to thank all of our employees for their hard work. I'm encouraged by everyone's ongoing focus and commitment and look forward to seeing what we can accomplish together as we advance our strategic priorities, focused on improving profitability and driving shareholder value.

Thank you again for joining us today. I'd like to now turn the call back over the Steve.

Steve Anderson - Vice President, Director of Investor Relations
Rick, thank you for those comments. Jess, if you would poll for questions, we'd be glad to move into the Q&A.

Operator
Certainly, thank you. The floor is now open for questions. We'll go first to Mig Dobre with Baird.

Q: Hi, good morning. This is Peter Ziel on for Mig Dobre. So maybe just starting with demand in Infrastructure in particular, I think there was a comment on the third quarter call, so in late October, that the backlog there was flat year-over-year after some good order activity in the beginning of the fourth quarter, but it looks like maybe that flowed down in the back part of the quarter. Could you just maybe talk about cadence through the quarter and maybe how that's carrying into 2019 in Infrastructure in particular?

Rick Dorris - Interim Chief Executive Officer, Chief Operating Officer
There was some delay in some of the mobile equipment orders in the fourth quarter, mainly due to the weather; the contractors were trying to catch up. They had so much rain last year that they were delayed on completing some projects and were busy trying to get those done and delayed orders. But, we started seeing that trend reverse a little bit at the end of the quarter.

Q: So I guess it sounds like maybe a bit better going into the year. I guess maybe relative to the 4% to 7% full year growth rate for the company, where do you see Infrastructure shaking out relative to that?

Rick Dorris - Interim Chief Executive Officer, Chief Operating Officer
Infrastructure should be right in that same range.

Q: And then maybe shifting to Agg and Mining, which obviously had a good couple years, but I suppose you understood the factor of comps, this can't go on forever. Can the order activity continue in 2019 and then comping two years of double-digit growth, does that kind of come back more to the 4% to 7% range or can that maybe outgrow and be above the company average again this year?

Rick Dorris - Interim Chief Executive Officer, Chief Operating Officer
We expect Aggregate and Mining to have another good year this year. The outlook for them is good; aggregate has been good. Domestically we are seeing a little increase in mining orders, too, so we expect that 2019 will be another good year for Aggregate and Mining.

Q: And then maybe lastly, just on the strategic sourcing and some of the raw mats and component things that you mentioned will be coming through in 2019, is there any quantification that you can provide or also just kind of the cadence of how we should think about the gross margin progression through the year?

Rick Dorris - Interim Chief Executive Officer, Chief Operating Officer
We have said in the past that we expect our gross margins to be up to 26% by the end of the year and a good portion of that increase is due to the savings that we'll have from strategic sourcing.

Q: Okay. I appreciate it. I'll leave it there.

Rick Dorris - Interim Chief Executive Officer, Chief Operating Officer
Thanks.

Operator
We'll move next to Stanley Elliott with Stifel. Stanley your line is open.

Q: Sorry about that. Thank you guys for taking the questions. Real quick, could you talk a little bit about the leverage? I mean obviously not a big deal, but it is from running a pretty much a net cash sort of position did see it creep up a little bit. Was that to support projects, was that a change in philosophy and how you're thinking about it? Just curious what you have to say there.

And then it looked like you had repurchased some shares, too, if you could kind of help us directionally about thoughts on that going forward.

Rick Dorris - Interim Chief Executive Officer, Chief Operating Officer
What was the first part of the question, Stanley?

Rick Dorris - Interim Chief Executive Officer, Chief Operating Officer
Leverage.

David Silvious - Chief Financial Officer
So on that leverage you may recall that we settled with Holland earlier in 2018 or mid-year 2018 and that was a cash payment. We were debt free prior to that, but then that was $68 million that we had to settle with them for and then we did do some share buybacks during the year. We are authorized at a $150 million level, and we did do some to the tune of about $24 million during 2018.

Q: Okay, thank you. And then thinking about kind of [audio disruption].

Steve Anderson - Vice President, Director of Investor Relations
I'm sorry, Stanley, we can't hear you on this end. I don't know if we have a connectivity problem, but can you restate?

Q: Yes, I'm actually calling from Europe so this is probably one of many things going on. But thinking about the [audio disruption] businesses, and I think you said 18 divisions, is that the right number now or when you were going through this operation and this exercise did you identify other businesses that maybe weren't quite the strategic fit? I'd love to hear [audio disruption].

Steve Anderson - Vice President, Director of Investor Relations
Stanley, we're getting part of your question. I'll restate up to this point and maybe you can jump back in and correct if this is not accurate. The question was along the lines of we now have 18 subsidiary companies, previously 20. We have discontinued our German operation; it did not meet our return expectations.

Dillman is being operated as part of Astec Inc. Astec Inc has owned the stock of Dillman. The Dillman product is very much available to our customers and important to the company. We do continue to look at our companies on an ongoing basis to meet our return thresholds to provide shareholder value. That will continue to be an ongoing process.

Rick Dorris - Interim Chief Executive Officer, Chief Operating Officer
We're also looking at ways that we can better utilize facilities that have extra capacity, by transferring work from a facility that needs more capacity and we think that will help us increase our overall capacity across the corporation.

Q: Is there any way to guestimate on maybe what sort of footprint you could combine anything along those lines, from a high level perspective?

Rick Dorris - Interim Chief Executive Officer, Chief Operating Officer
Well, that's basically what we're trying to do by shifting work. We are not really looking at combining footprint facility-wise, but we are looking at shifting work from one facility to another where it's feasible.

Q: Perfect, and thank you very much and sorry for the technical difficulties.

Steve Anderson - Vice President, Director of Investor Relations
No problem, Stanley.

Operator
And gentlemen, there appear to be no further questions at this time. Mr. Anderson, I'll turn the call back to you.

Steve Anderson - Vice President, Director of Investor Relations
Thank you Jess. We appreciate everyone's participation on the call today and thank you for your interest in Astec. As our news release states, today's call has been recorded. A replay of the call will be available through Match 15, 2019 and an archived webcast will be available for 90 days.

A transcript will be available under the Investor Relations section of the Astec Industries' website within the next seven days, and all of that information for your reference is contained in the news release we sent out earlier today.

So at this point, we will conclude call and we thank you all again. Have a good week.