

**Transcript of
Astec Industries, Inc.
Third Quarter 2019 Earnings Call
October 29, 2019**

Participants

Steve Anderson - VP & Director of IR
Barry Ruffalo - President & CEO
David Silvius - CFO

Analysts

Joe Grabowski - Robert W. Baird
Brian Brophy - Stifel
Brian Lau - Sidoti

Presentation

Operator

Greetings, and welcome to Astec Industries Third Quarter 2019 Earnings Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. As a reminder this conference is being recorded.

It is now my pleasure to introduce your host, Mr. Steve Anderson, VP, Director of Investor Relations. Thank you sir. You may begin.

Steve Anderson - VP & Director of IR

Thank you, Michelle. Good morning and welcome to the Astec Industries' conference call for the third quarter that ended September 30, 2019. As Michelle mentioned, my name is Steve Anderson. Also on today's call are Barry Ruffalo, our Chief Executive Officer, and David Silvius, our Chief Financial Officer.

As you may have noticed in our earnings release this morning, our presentation includes a slide deck that can be accessed by using the webcast link in the release and the deck is also on our website under the Investor Relations section and in the conference call tab. We've also filed an 8-K with that presentation this morning.

In just a moment I'll turn the call over to Barry and David to share their comments on the quarter, but before we begin, I'll remind you that our discussions this morning may contain forward-looking statements that relate to the future performance of the company. These statements are intended to qualify for the safe harbor liability established by the Private Securities Litigation Reform Act, and any such statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions. Factors that could 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.

At this point, I'll turn the call over to Barry.

Barry Ruffalo - President & CEO

Thank you, Steve. Good morning, everyone. I'm pleased to be speaking with you on my first conference call as President and CEO of Astec Industries. I've met several of you and look forward to getting to know all that I haven't in the near future.

Since joining the company in August of this year, I've spent a significant amount of time meeting the Astec team, talking to customers and distributors. While visiting every Astec site, I had the pleasure of meeting the top 100 leaders of our great organization and many of our teammates. My interactions confirmed what I already knew when joining the company. The Astec team is passionate about our business and our customers. They live our core values day-in and day-out and have a strong desire to win and create value for our shareholders. Our team members exemplify the values and culture that I'm proud to be part of. The dedication and passion for our customers was validated as I spent time in the market talking to the men and women who own and operate our equipment. I heard over and over that our equipment is best-in-class and that our service and support repeatedly earns the trust of our most demanding customers.

Let's now turn our attention to the slide deck. For those of you that are less familiar with Astec, the at-a-glance slide is a great representation of who and where we are.

Moving to the summary of the third quarter financial results, you can see that our revenue on a year-over-year basis was flat. A softer North America market was offset by growth in international sales. I know from discussions with our customers that they're busy, but have more recently held-off on capital equipment buying decisions. I also note that our dealers have a healthy amount of inventory on hand and that their leased fleets, although busy, have been slow to convert to retail sales. Those factors and the fact that we are working hard to drive down our inventory lead to less product flowing through our factories. We have been slower to right-size our capacities and that caught up with us in the third quarter.

With that said, we've taken actions to do so by reducing our workforce by 9% year-to-date which includes the decision to close two of our sites, one in Germany and one in southwest United States. I'm confident we will continue to optimize our capacity moving forward with better utilization of our sales and operating planning tools.

I want to let you know that we continue to have sharp focus on executing the Astec strategic procurement initiative. We will realize between \$2 million to \$3 million of savings in 2019 with the intent of realizing \$25 million in savings on a full-year basis in 2020. I'm pleased that our international sales help offset lower sales in North America. Our global growth strategy in investments are paying off, but we still have a long ways to go. We have exciting opportunities ahead of us and I have all the confidence in our strong global team and our leadership to be able to execute our strategic plan.

Now turning our attention to the balance sheet, you can see that we've done a good job of managing and growing it. That's just part of our DNA and will continue to be a strength as we move forward and sharpen our focus on key metrics like return invested capital and free cash flow. Our strong balance sheet gives us the flexibility to pull many levers, which we intend to use to drive increased shareholder value moving forward.

I'll now turn it over to David.

David Silvius - CFO

Thanks, Barry. Good morning, everyone. Thank you for joining us. Our revenues for the quarter were relatively flat with Q3 of 2018 and as Barry noted, the US market is down relative to the prior year but our international efforts were able to make up for the domestic softness. Forex impacted our sales by six-tenths of a percent for the quarter. Increased parts and service sales, especially domestically, offset softness in capital equipment sales. There's also evidence that our customers are working and using their equipment. Our dealers have high

inventories, including rental fleets that have historically converted to retail sales by this time of the year, but many of those rental to retail conversions have yet to occur in 2019.

Our backlog decreased by 21% and the entire decline was domestic and reflects the softness in the domestic capital equipment market. Backlog decreased primarily in oil and gas equipment, aggregate production equipment and road building equipment. While backlog fell in aggregate equipment, implied orders are up due to historically high backlogs in that equipment in Q1 and Q2 of 2018, leading to an easy comp in Q3 of 2018 when backlogs fell off. Implied orders are down in oil and gas equipment as well as road building equipment.

Adjusted EBITDA was impacted by the decline in gross margin of \$6.4 million. An increase in unabsorbed overhead of \$3.8 million over Q3 of 2018 was the primary detractor from gross margin with a remainder of the decline being a combination of primarily pricing pressure and also some product mix. SGA&E was down during the quarter due to reductions in consulting fees, payroll and related benefits and professional fees. Our long-term goal is to reduce SGA&E expenses to a run rate in the low-teens. Obviously, this will take some time but we have begun to take the necessary steps.

Adjusted earnings per share of \$0.17 for the quarter excludes \$875,000 of restructuring costs related to right-sizing the infrastructure group to reflect a post pellet plant business level as well as costs to finalize the disposal of our German operations, which we plan to complete by the end of this year.

Our infrastructure group grew revenues slightly during the quarter primarily in domestic equipment and parts. International equipment of parts decreased during the quarter in that group.

Sales increased in asphalt production equipment while decreasing in road building equipment. Asphalt production equipment is sold direct while a majority of road building equipment is sold through dealers, and as discussed previously most dealers have full inventories and are also experiencing longer-term rentals that have yet to convert to retail sales.

Infrastructure gross margin was impacted by \$1.7 million of additional under-absorbed overhead compared to Q3 of 2018. We were focused on reducing inventory within soft markets during the quarter that resulted in fewer production hours through our factories and that also put additional pressure on pricing. Adjusted EBITDA decreased due to the gross margin compression and excludes \$875,000 of restructuring costs previously mentioned. Reductions in SGA&E were a benefit to EBITDA in the infrastructure group in the quarter.

Our aggregate and mining group experienced a slight decline in sales. The largest contributor was the decline in domestic capital equipment sales. This decline was offset by an increase in international capital equipment, in international part sales during the quarter. Most of our Ag and mining group sales go through dealer distribution and again as previously mentioned, dealer inventories are high and rental to retail conversions are down relative to last year resulting in softer demand. The reduction in domestic sales volume in this group reduced production hours through our factories which led to an increase in unabsorbed overhead of \$2.1 million in the group driving the reduction in gross margin.

EBITDA was down primarily due to the decline in gross margin. A decrease in SGA&E of a \$1 million in the group benefited EBITDA during the quarter and was related to reductions in headcount along with consulting and professional fees.

Our energy group sales were consistent with Q3 of 2018. Sales of oil and gas equipment were down, but were offset by increased sales of concrete production equipment and heating equipment. The group increased its gross margin modestly as unabsorbed overhead remained flat relative to Q3 of 2018. An increase in sales of parts relative to the total energy group sales contributed to the gross margin increase as they carry a slightly

higher margin. EBITDA in the energy group increased during the quarter due to the slight margin increase as well as a reduction in SGA&E of \$1.2 million from reduced headcount and reduced consulting fees.

We continue to maintain a strong balance sheet with minimal debt. This provides us a platform to launch our longer-term strategic initiatives. We have a net cash position and ample liquidity to execute our plans. We've also made progress on working capital initiatives over the last year and that has improved our inventory turns as well as unlocking additional cash.

As we go forward, we will continue to have a disciplined approach to deploying our capital. And when we consider the various avenues of capital deployment we do so in the context of our long-term strategic objectives and our related revenues earnings and cash flows in order to maximize shareholder value.

I'll now turn it back over to Barry for additional comments.

Barry Ruffalo - President & CEO

Thanks, David. As mentioned earlier, after spending time with the Astec team and in the market with customers and our distribution channel, I have the following observations to share. I'm excited to be part of and have the privilege to lead a team that has a large set of deep foundational strengths. All of them have been validated over my first two and a half months with the company. I'm also excited to build on them moving forward by taking a fresh look at how we are organized.

Since August, we have flattened our organization by choosing not to backfill the chief operating officer role with a recent retirement. We added the role of senior vice president of innovation, which will allow us to leverage our engineering resources and R&D spend along with sharpening our focus and execution on new product development. We also added the role of senior vice president of operational excellence. This role will lead our efforts to leverage our global manufacturing and supply chain strategy and performance. We are in the early days of our lean transformation and this position will accelerate these initiatives as we continue to drive more value for our customers and our shareholders. Finally, we added the position of chief information officer. This position will build and drive our centralized ERP strategy as well as improve our data analytics and IT platforms.

I am confident that the three pillars of simplify, focus and grow are the perfect elements to define our transformation as a company. We are a complex business and that complexity makes it difficult to build strategies and leverage resources. We need to find the parts of the business that create value and focus on them and invest in them as platform for growth. Conversely, simplifying the business will also highlight non-strategic and non-core businesses that we will discontinue if it doesn't enhance long-term shareholder value.

Moving forward, we will temporarily stop the practice of giving quarterly and annual guidance. We have instead identified long-term targets that are tied to shareholder value creation. These metrics will stand through the cycles of our industry and are also tied to our incentive plans. We will measure ourselves against these targets and report our progress to you, our shareholders, on a regular basis. These targets will continue to be evaluated and updated over time based on our ability and consistency of obtaining them.

I will conclude the presentation by leaving you with Astec's key investment highlights. We have a strong foundation and I'm excited about the opportunities that lies ahead of us. I look forward to sharing further details of our new strategy and our transformation progress in future communications.

We now welcome the opportunity to take your questions.

Operator

Thank you. We will now be conducting a question-and-answer session. Our first question comes from the line of Mig Dobre with Robert W. Baird. Please proceed with your question.

Q: Good morning, guys. It's Joe Grabowski on for Mig this morning. Barry, welcome aboard. Mig and I look forward to meeting you in person at our conference next week. As you visited all of the Astec facilities over the past several weeks, what are your initial thoughts? How do the facilities compare to ones you've dealt with during your career? And then maybe more specifically your thoughts on Astec's decentralized structure?

Barry Ruffalo - President & CEO

Yes. I tell you that the visits that I had, and I was happy that I could actually get to every single one of the sites in a very relatively short period of time after starting with the company, I think first and foremost, the people is what really struck me in regards to the passion and the pride they really had for what they did, and the companies they represent. And to me, that really represents a great foundational block for us to build off of.

I would tell you that as I walked through the different facilities, there is an array of progress relative to lean transformation. I saw some that were, I would put, best-in-class and some I think where we have lots of room for improvement. And so, not that we get down on that, we look at that as a huge opportunity for us to be able to build off of and try to raise all of our sites into the top level. So there's some more work to do there and I think bringing on our new senior vice president of operational excellence that will allow us to focus not only on our lean transformation, but also performance, utilization of assets, footprints those types of things.

I think that from a decentralized model perspective, I think I'll go back to my comments around there's really no stones that we're not going to turn over to try and find value, and so therefore it's less about centralized, decentralized as it is about where can we actually make investments to grow profitably, and where are the areas where we probably are destroying value potentially, and so we should stop doing that.

I think the key for us moving forward as well is that we want to be able to stay close to our customers. I think that's been a real strength of Astec's over the number of years, and we want to make sure that we maintain that, and do that better than our competition, but we also want to find a way to be able to leverage that we're a billion dollar global company that has a lot of leverage points as well across different parts of our company. And back offices, I think with the addition of the engineering lead position or innovation lead position that's going to allow us to leverage our engineering resources more appropriately.

So I think that we're looking at the whole company and from many different lenses and trying to find ways where we can get value for our shareholders.

Q: Excellent. Great. Thanks for the color on that. And maybe just drilling into Q3 results, David, you talked a lot about the reason for gross margin being down year-over-year, but it seems to me when sales are flattish, it's surprising to see gross margin down 400 basis points and infrastructure 300 basis points, and aggregate and mining. Maybe talk about the dynamics there, and where those under-absorption variances come from when again sales are relatively flattish year-over-year.

David Silvius - CFO

Yes. It's a great question. So in the infrastructure group specifically, we can address that with mobile paving equipment. We were selling out of inventory. As you know we've had a lot of inventory there, built a lot over the past couple of years and had a very strong effort to reduce that inventory during the year and during the quarter especially and that put pressure on both pricing, and on hours through the shop. In the rest of the company, you had other inventory reduction efforts, but you also had low demand and the Ag and mining group due to the lack of the rental conversions in Q1 and Q2, which typically drives orders in Q3 to be fulfilled and those reduced hours in the shop as well.

And so, we have been slow, as Barry mentioned, to respond to that reduction in demand in our shops. Our S&OP program that is in place and has gone through several iterations year-to-date is helping us understand where the demand is, we're not building the wrong thing, and we're not buying too much, but also that we're producing the right number of hours through our shops. And so, as we continue on this journey to lean out these factories, we've got to get the right number of hours in the right place and make sure that the capacity is used and again we've got to right-size the capacity, fill it with a number of man-hours and build the right equipment. I think that's where the journey of this S&OP process, but unabsorbed overhead was a huge contributor during the quarter.

Q: Got it. Okay. Thanks for that. A couple more questions for me. So I understand that you're discontinuing guidance, but I guess I have to ask any color at all you can give on Q4 perhaps how the quarter has started here, or just any kind of top level thoughts on Q4?

Barry Ruffalo - President & CEO

Yes. I would say that, you're right, we are going to temporarily discontinue giving guidance. So I think with that being said, we'll probably pull back from giving you too much color around Q4.

Q: Okay. Yes. Fair enough.

Barry Ruffalo - President & CEO

We hope that we get to the point here in the short-term, Joe, that we can have the confidence to be able to give you guys a little bit more information about what we look like moving forward but until then, it behooves us to continue to work out our processes before we come back to that point.

Q: Yes. Fair enough. And I guess last question for me. As you mentioned your customers are busy, we see the monthly construction data and street and highway spending is still up double-digits in the US, but we are approaching an election year. We're now less than a year away from the FAST Act expiring and obviously things are pretty dysfunctional in Washington D.C. these days. How do you kind of see the Highway Bill playing out here over the next year? And with it expiring right before the election, are your customers worried about that? Are you guys worried about that? How do you think it all plays out?

Barry Ruffalo - President & CEO

Yes. I think that obviously that's an important part of the drivers within the space that we operate. There's a lot of puts and takes and a lot of moving pieces to the answers and even to the question you just asked. I would tell you that we're more focused on trying to be as profitable and as strong of a business that we can be in the cycle that we're in today and in the market that we operate in today. So if those types of drivers within our market uplift the market that we're in a favorable position and advantage position relative to the competition and can add value to our customers as quickly as possible and take advantage of that on the earning side.

Q: Yes. Make sense. Thanks for taking my questions. Look forward to seeing you guys in Chicago next week.

Barry Ruffalo - President & CEO

Yes, same here. Thank you.

Operator

Thank you. Our next question comes from the line of Stanley Elliott with Stifel. Please proceed with your question.

Q: Hi good morning. This is Brian Brophy on for Stanley. Just had a question around the SGA&E expenses. It looks like it was lower year-on-year and a little bit below what we were expecting. I was hoping you could give us a little bit of color on what's driving that.

David Silvius - CFO

The primary drivers, Brian, this quarter was consulting fees. We had the ASP program, what we call the Astec Strategic Purchasing program, that we began last year and it was in full swing in Q3 of 2018. So there were a lot of consulting fees that we were paying in that quarter. That program is complete as of the June/July timeframe this year, and so those fees are no longer in SGA&E.

In addition we've reduced some headcount. Now that headcount reduction is both in the shop and in the back office so those reductions do impact the ongoing SGA&E. And again we had some higher professional fees last year as well. So those reductions are all baked into the SGA&E that we have now.

The run rate, we want to target the lower teens. We think we should be there and we've got to get there, so to maximize shareholder value and to make this company run the way it should. So those were the items that were in there. It was about a \$1 million give or take on each of those items.

Q: Got it. That's helpful. And the low-teens as a percentage of sales, obviously that's a decently large move from where you guys are today. How do you get there? Is it sales growth? Is it cutting these expenses further? Help us kind of bridge that gap?

David Silvius - CFO

There are two things I think, obviously, you have to address is the sales growth number one, and that certainly will help impact it. But from a spending standpoint we need to create more efficiencies in the business. As Joe mentioned earlier, we're decentralized and that creates some inefficiencies. It has some advantages. We're close to the customer but it also creates inefficiencies in the business, and we need to take advantage of our mass as we go forward and be able to standardize processes and back office, anything where we can take cost out we will. So it's not necessarily cutting heads and that kind of thing. It is about creating efficiencies and processes.

Q: Got it. That's really helpful. I guess switching gears a little bit, past couple of quarters if I remember correctly you guys talked about a little bit more pricing pressure from peers. I didn't hear any of that commentary in the release or in your prepared remarks. Just wondering if something has changed there, if you guys are still seeing some competitive pressures, what's the environment like.

Barry Ruffalo - President & CEO

Yes. Brian, this is Barry Ruffalo, and I would tell you that that has not changed. I think with the market conditions that we're in today there's the same amount of pricing pressure and competitiveness in the marketplace. I do think, as David alluded to, when we looked at that the margin, the decrease, with the big part of that coming from under-absorption there was also an influence from pricing and mix as well which made up the other part of it.

Q: That's helpful. One last one for me and then I'll pass it on. I'm curious what you're seeing from a market share standpoint. How are you guys feeling given that these competitive pressures are occurring? And I'm wondering if there's any differences between product type such as like asphalt plants versus the mobile road building equipment, etc.

Barry Ruffalo - President & CEO

Yes. I would say in a general sense we don't feel like there's been any shift really in market share across the board. Certainly, from quarter-to-quarter and from product line to product line we'll see movement here and there, but nothing specific that we're going to comment or can comment on today.

Q: Okay. Thank you. I'll pass it on.

Operator

Thank you. Our next question comes from the line of Joe Mondillo with Sidoti. Please proceed with your question.

Q: Hi, good morning, everybody. This is Brian Lau on for Joe this morning. Maybe to just talk about the guidance, I understand we're kind of suspending that temporarily, but maybe retroactively based on the qualitative guidance of last quarter obviously results a little weaker than expected. What's generally your visibility look like? And then what kind of changed through this quarter?

Barry Ruffalo - President & CEO

Yes. I think the visibility again is a little different product line-by-product line. In some cases we have a backlog that takes us well into Q1. Others are a little bit more hand to mouth, so it's a mix. I would tell you that just generally when you look back at our history of being able to meet the guidance that we actually gave it's not very stellar. And so therefore I think it's maybe more of my initiative just to pause to make sure that we have a real good grasp on the markets that we're operating in the trends of the customers and can then project that into our sales and operating planning process, and then make sure that we can look forward far enough to have a sound forecast.

And so we've made a lot of progress over the last couple of months. Really I would give the team credit for making a lot of progress over the course of the year as we started to introduce the use of some of these tools, but we've got a little bit of ways to go in order to get confidence to be able to come back give you the guidance again.

Q: Alright. That's it for me. Appreciate the color. Thanks.

Barry Ruffalo - President & CEO

Thanks, Brian.

Operator

Thank you. There are no further questions at this time. I'd like to turn the call back over to Mr. Anderson for any closing remarks.

Steve Anderson - VP & Director of IR

Thank you, Michelle. Again, we appreciate your participation on this third quarter conference call and thank you for your interest in Astec. As our news release indicates, today's conference call has been recorded. A replay of the conference call will be available through November 11th 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. All of that information is contained in the news release that was sent out earlier today.

So this concludes our call. Thank you all. Have a good week.