VIAVID
communications simplified.

ASTEC Industries, Inc.

First Quarter 2022 Results Call

May 4, 2022

CORPORATE PARTICIPANTS

Steve Anderson, *Senior Vice President of Administration and Investor Relations*

Barry Ruffalo, *President and Chief Executive Officer*

Becky Weyenberg, *Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Joe Grabowski, *Baird & Co.*

Steve Ferazani, *Sidoti & Co.*

PRESENTATION

Operator

Good day and welcome to the ASTEC First Quarter 2022 Results Call.

After the speaker presentation, there will be a question-and-answer session. Please be advised that this conference is being recorded.

I would now like to hand the conference over to our speaker today, Mr. Steve Anderson. Please, go ahead.

Steve Anderson

Thank you and welcome to the ASTEC First Quarter 2022 Earnings Conference Call.

Joining me on today's call are Barry Ruffalo, Chief Executive Officer, and Becky Weyenberg, Chief Financial Officer. In just a moment, I'll turn the call over to Barry to provide comments and then Becky will summarize our financial results.

Before we begin, I'll remind you that our discussion 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. 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 filings with the SEC. As usual, we ask that you familiarize yourself with those factors.

In an effort to provide investors with additional information regarding the Company's results, the Company refers to various U.S. GAAP, generally accepted accounting principles and non-GAAP financial measures, which management believes provide useful information to investors. These non-GAAP financial measures have no standardized meaning prescribed by U.S. GAAP and are therefore unlikely to be comparable to the calculation of similar measures for other companies. Management of the Company does not intend these items to be considered in isolation or as a substitute for the related GAAP measures.

A reconciliation of GAAP to non-GAAP results are included in our news release and the appendix of our slide deck. All related earnings materials are posted on our website at www.astecindustries.com, which is under the Investor Relations and Presentation tabs.

Now, I will turn the call over to Barry.

Barry Ruffalo

Thank you, Steve. Good morning everyone and thank you for joining us.

I will begin with a brief overview of the quarter, followed by highlights of progress made on our continued strategic evolution and key messages from the quarter. Then Becky will share details on our financial results and capital deployment. I will then share more detail on what we're seeing in terms of demand and current market dynamics and conclude with a discussion of our recent acquisition and a reminder of our ESG priorities. I will then open the call for Q&A.

Beginning with Slide 4, end market demand remained strong for our products and services as evidenced by another quarter of sales growth and record backlog. Looking back over the quarter, we saw the continuation of challenges from the fourth quarter continue in the first quarter, with January being the most impacted. Since then, we have witnessed a steady progression of improving conditions in the environment in which we operate, giving us confidence that future performance will improve.

Our entire organization is working hard to overcome the supply chain, logistics, and cost challenges we face. I am proud of their progress as we gain traction on mitigating these challenges. Pricing action we have already implemented and our taking now should be realized in future quarters, giving us additional tailwinds to support our margins. Customers are anxious to get our products and we are on track to improve output to convert our backlog into profitable sales. I think we are set up for steadily improving performance throughout the balance of this year and I'm confident in our team's ability to overcome the challenges we are facing.

As you can see in our key messages, we saw another quarter of top line growth driven by solid market demand and positive customer sentiment. First quarter's sales increased 2.4% compared to last year, and we grew backlog to record levels for the sixth consecutive quarter. I continue to be extremely encouraged by conversations with customers as they are seeing robust demand and are eager to receive our industry-leading solutions.

Second, we continue to be impacted by supply chain and logistics constraints that are being felt across the industry. This has limited our ability to meet strong customer demand, and it has impacted our bottom line results. In addition, the labor restrictions we experienced in Q4 related to the COVID-19 pandemic lingered into January. Our OneASTEC operating model is instrumental in mitigating the challenges we faced by driving price realization to offset inflation, proactively addressing supply chain disruptions and on-boarding new talent.

Third, we stand with the people in Ukraine who have been impacted by the conflict in the region. We are in support of and in compliance with the U.S. sanctions against Russia and hope for a quick and peaceful end to the violence in Ukraine. Our exposure to Russia is immaterial to our financial results other than any indirect impact the industry may feel from steel inflation, customer sentiment, or increased energy costs.

Fourth, we remain well-positioned to execute and grow with a strong balance sheet and continued focus on operational excellence, which enables us to operate in challenging macro environments and invest in growth.

Fifth, we made significant progress in building out and enhancing our technology platform with the addition of a Chief Technology Officer in our recent acquisition of mines. I will say more about the mines acquisition later in the call, but now I'd like to tell you about Sid Verma, the newest addition to our executive team. As Chief Technology Officer, Sid is responsible for providing strategic direction in formulating innovation plans, strategic partnerships, and technology investments. He brings a wealth of experience in industrial systems and manufacturing, and I'm confident in our strategic digital vision and roadmap to drive technology innovation at ASTEC.

Lastly, we have positioned our business for the future, pursuing profitable growth that drives long-term stakeholder value that is guided by our simplified focus on growth strategy. This focus provides us a stable framework to address the current macro trend headwinds we're now facing.

Turning to Slide 5, we continue to operate as OneASTEC, a proven framework that gives our team the tools to navigate industry headwinds. This model is customer-centric and focused on the Rock-to-Road value chain where integrated business is best-positioned to deliver unmatched value, which is further illustrated on Slide 6 with our portfolio of industry-leading solutions.

The OneASTEC approach touches everything we do from channel retention and development to operational excellence and efficiency. Guided by common values, we're positioned to mitigate the supply chain and logistic disruptions being faced by our locations. The actions we're taking are driving greater efficiency, helping us identify multiple sources for critical components, and enabling us to better meet growing customer demand. It is not always easy, but I remain confident that our continued focus on the OneASTEC model will serve us well through 2022 and beyond.

Slide 7. As I mentioned in my opening remarks, demand remains strong for our products across both Infrastructure and Materials Solutions. Our commercial team and I continue to have conversations with customers who share positive sentiment for their businesses, which in turn supports our optimistic sales outlook for 2022. Our record backlog reflects continued strong demand for our solutions and we have numerous initiatives in place to help us expand capacity to meet higher demand.

The Federal Highway Bill is a long-term tailwind for our business and can further augment existing demand growth across our markets. We see significant near-term demand for our products, and we have a strategy in place to augment those market tailwinds with incremental organic and inorganic growth initiatives.

We successfully established and implemented initiatives to address labor shortages, including actions to strengthen our recruiting process and actions to improve our engagement, retention, and attraction. Doing so enabled us to build headcount in a challenging environment during 2021, which now positions us to better serve our customers. Looking forward, we see additional needs to bring in talent to ensure we are meeting customer demand and believe the continuation of our current practices will allow us to expand our workforce as needed.

Supply-chain logistic disruptions remain a concern. Of note, electrical components tend to be the most challenging. Our sourcing team is working tirelessly to identify secondary supply sources and engage with partners who understand our long-term outlook and can meet our demand requirements.

We continue to deploy operational excellence initiatives and leverage our OneASTEC business model to increase throughput and mitigate the impact of these challenges. We also continue to invest capital for equipment to deliver product more effectively and are exploring expansion of our footprint into low-cost territories.

We have focused efforts to leverage pricing power in the market to pass through higher inflationary costs. We anticipate elevated commodity, transportation, and logistics costs to continue across the industry through 2022. As the price leader, we implement further price increases as needed to offset higher inflationary costs.

Taking a look at Slide 8, you can see our backlog trend over the last eight quarters. This quarter, we achieved our sixth consecutive quarter of record backlog, really doubling the levels seen this time last year. We have confidence in our backlog as experience tells us that these orders tend to be sticky and are rarely canceled. Current expectations are that these orders will be converted into sales within approximately three quarters.

We have several initiatives to increase capacity to meet higher demand such as increasing headcount in our manufacturing facilities. In addition, we now have manufacturing engineers to increase project management capabilities, and we're investing in capital to expand facility output, leveraging cross-site manufacturing where possible to continue our journey of further automation. We believe these actions will accelerate the conversion of our backlog to sales and better enable us to deliver products to our customers at the desired time.

In summary, we achieved another quarter of sales growth and grew backlog to record levels once again, showing the strength in end market demand and the desire our customers have for our high value products and services. Our operating and commercial teams are responding to the dynamic macro environment, following our playbook to mitigate supply chain disruptions, rising costs, and labor challenges in order to meet strong demand and serve our customers.

I remain optimistic that 2022 will be a positive year for ASTEC, our customers, and our shareholders.

With that, I will now turn the call over to Becky to discuss our detailed financial results.

Becky Weyenberg

Thank you, Barry. Good morning everyone.

As shown on Slide 10, first quarter sales increased 2.4% compared to the prior-year quarter to $291.2 million. Parts sales were strong with a 9.7% increase and were partially offset by a slight decrease in equipment sales of 1.7%. Domestic sales were up 3.9% and international sales decreased 3.6%. Due to strong end market demand, we once again reached record backlog levels, increasing 98.4% to $834.7 million at quarter-end, driven by both Materials Solutions and Infrastructure Solutions orders, which were up 90.7% and 103.3% respectively.

Order activity remains robust as customer demand continues to rise, bolstered by strong commercial excellence initiatives that are positioning us to win more orders. In parallel, we are focused on deploying operational excellence initiatives across the organization to mitigate the macro challenges we are currently facing. Although some of the supply constraints are easing, we remain diligent to deliver more value-added services, products, and solutions to our customers.

First quarter Adjusted EBITDA decreased 10% to $18.8 million compared to the prior-year period as cost inflation was slightly ahead of favorable volume price and mix, and Omicron-related manufacturing challenges re-occurred early in the quarter. We continue to work to offset the inflationary pressures we are seeing through pricing actions. Adjusted SG&A expenses decreased 3.5% or $1.7 million, driven primarily by lower healthcare costs and favorable, deferred compensation expense.

These reductions were partially offset with increased activity for sales-related activities, as well as travel costs as our employees reinitiate face-to-face contact. Adjusted earnings-per-share of $0.41 decreased $0.09 compared to $0.50 in the first quarter of 2021 and included $5.3 million of transformation, restructuring, and other costs. Our adjusted net effective tax rate for the quarter was 21% due to reduced tax benefits from stock compensation, partially offset by the increased net benefit for foreign derived income.

On Slide 11, we highlight the key drivers of our year-over-year Adjusted EBITDA decline of $2.1 million. The negative impact from inflation was mostly offset by volume pricing and mix. The impact for manufacturing was a slight headwind early in the quarter. We expect to fully offset inflation with price increases, higher volume, and favorable mix, and anticipate that manufacturing efficiencies will again become a tailwind as we progress through 2022.

Moving on to Slide 12, our Infrastructure Solutions sales declined 2% to $197.5 million in the quarter, primarily due to unfavorable net volume pricing and mix. Domestic sales were up 1% while international sales fell 15.6%. Parts sales grew 5.7% while Equipment sales were down 7.2%. Segment gross profit decreased 13.1% to $41.9 million, and gross margin percent decreased 270 basis points to 21.2%, driven by the negative impact of higher inflation, net of volume pricing and mix, and manufacturing inefficiencies. Infrastructure Solutions' backlog at the end of the quarter increased 103.3% to $517.7 million as we continued to see strong and increasing demand for high re-enrolled (phon) building construction products across the country.

Turning to Slide 13, our Materials Solutions sales increased 13% to $93.7 million compared to the same period a year ago, driven by increased demand across product lines and regions, with domestic sales up 11.9% and international sales up 16.1%, versus the first quarter of 2021. Segment gross profit increased 19.5% to $23.9 million, and gross margin percent increased 140 basis points on higher volume, pricing, and mix, and manufacturing inefficiencies offsetting the negative inflation impacts. Materials Solutions backlog at the end of the quarter increased 90.7% to $317 million, driven by continued dealer restocking and strong market activity.

Turning to Slide 14, we continue to maintain a strong balance sheet with minimal debt. Overall, we have available liquidity of $258.9 million, including over $111 million of cash on hand, with only $5.3 million in total debt at the end of the quarter. With leverage at virtually zero, we are well-positioned to maintain a strong and flexible balance sheet with ample liquidity that we believe will enable us to withstand a variety of economic situations. Should we need to incur higher debt levels in the future, we will strive to operate between 1.5 to 2.5 times net debt-to-EBITDA.

Turning to Slide 15, our disciplined capital deployment framework remains consistent with what we have previously shared. We are following a targeted capital deployment approach within the context of our long-term strategic objectives, and related revenue, earnings, and cash flows in order to maximize shareholder value. We estimate that our capital expenditures will be in the $40 million to $50 million range versus prior range of $30 million to $40 million for 2022.

Regarding acquisitions, the pipeline remains strong and our strategic approach remains consistent with a focus on acquisitions that align with our strategic filters and financial criteria to support our growth pillar.

The MINDS acquisition completed in early April is a good example of this, as it positions us to grow our digital platform and better serve our customers, bringing additional growth opportunities to us.

Lastly, we remain committed to delivering returns to shareholders, primarily through funding our $0.12 per share quarterly dividend.

With that, I will now turn it back over to Barry for his closing comments.

Barry Ruffalo

Thank you, Becky.

Slide 16 shows the various organic opportunities we're pursuing in support of our growth pillar. We expect to drive year-over-year organic growth over the long term. In the first quarter, international sales were slightly lower than one year ago and represented just shy of 20% of our total sales. However, we expect a longer-term trajectory to be positive as we gain traction. Further, we are increasing our investment to expand our manufacturing footprint to low-cost territories, which helps improve margin and strengthen our international presence.

Next, opportunities to drive growth will continue in our Parts and Services business. I would like to recognize the ASTEC team for the achievement of a new quarterly record for parts sales. First quarter part sales were $99.2 million, up 10% year-over-year, reflecting the momentum we are gaining. Opportunities related to dealer expansion, cross-selling, strategic accounts, and new product development round out our organic growth initiatives. These are long-term pursuits and our dedicated team is working hard to realize our potential. We're gaining momentum across these areas and I'm confident our related strategic initiatives will drive future profitable growth across our business.

Turning to Slide 17, our strategic approach to M&A begins with a set of filters to ensure that the target company aligns with our growth strategy. If a target meets these criteria, then we look for financial characteristics that meet or exceed our long-term metrics and would achieve our goal of being accretive to EPS in the first full year. But that is a backup.

I'm excited to share with you our most recent acquisition, MINDS Automation Group, illustrated on Slide 18. MINDS i's the leader in plant automation control systems and cloud-based data management in the asphalt industry. This technology really complements the capabilities of the Grathwol acquisition that we completed in late 2020 and allows us to build a truly digital and connected platform with which we can better serve our customers, improve our efficiency, utilization of our parts, and service opportunity. I'm very excited to welcome the MINDS team to ASTEC, and I'm excited about the opportunities that these two acquisitions will provide for us and for our customers.

Next, on Slide 19, I would like to remind you of our ESG journey in our areas of focus in 2022. We continued to invest in resources to accelerate sustainability initiatives. We are in the process of establishing KPI baselines and tracking for greenhouse gases emissions, utility consumption, and other material factors. Lifecycle assessments and major product categories are being conducted and will further enhance our ability to design products to provide value for our customers.

Along with these investments in resources, we will continue to advance social initiatives with a focus on employee safety and welfare in addition to diversity, equity, and inclusion, both internally and in our communities. Lastly, we will focus on maintaining product governance practices through board oversight, cybersecurity, and (inaudible) discipline.

Turning to Slide 20, you can see a summary of our key investment highlights. These elements have been a consistent narrative for us and illustrates what distinguishes ASTEC in the investment landscape. We've developed leadership positions in attractive markets that are aligned with secular growth trends. Our commitment to innovation enables us to deliver high-quality products and superior customer service. This has positioned us to further benefit by creating a reoccurring revenue stream for high-margin aftermarket business.

The result is a strong balance sheet to create more shareholder value and enable us to face macro challenges. All of this is supported by our team's progress aligned with our simplified focus on growth strategy, leading to profitable growth.

In closing, we are never satisfied and are always striving to improve our performance. I'm proud of what we are accomplishing and confident our strategy is leading us to a brighter future. We are truly operating as OneASTEC and are bringing tremendous value to our customers across the Rock-to-Road value chain. These accomplishments are the foundation for achieving our long-term targets of 10% to12% EBITDA margin and greater than 14% (phon) return on invested capital.

I'm optimistic for the future of ASTEC and confident that we're on the right path to building sustainable, long-term stakeholder value.

With that Operator, we're now ready to open up the call for questions.

Operator

Thank you, sir. Our first question comes from the line of Mig Dobre with Baird. Your line is now open.

Joe Grabowski

Good morning guys. It's Joe Grabowski on for Mig this morning.

Barry Ruffalo

Morning, Joe.

Joe Grabowski

Good morning. Can you talk about pricing on new orders this quarter? How did it compare to pricing in the second half of 2021? How does price-cost look going forward?

Barry Ruffalo

Joe. This is Barry. Thanks for the question.

So obviously, as we reported through most of 2021, we've been addressing the price-cost ratio throughout the course of the year. Obviously trying to take pricing up and also do other things in the business to offset it as well in regards to manufacturing efficiencies, so on and so forth. As we look at Q1 of this year, we're happy to say that we look at the price-cost ratio as basically being neutral. In the quarter, we lump it in the bucket on the side with volume and mix. Volume and mix actually pull that bar down a little bit but on a price-cost basis in Q1, we were neutral.

As we look forward into 2022, obviously we expect more inflationary pressure, but we also have pricing in our backlog that we haven't realized at this point. So, we feel like we're well-positioned, at this point anyway, understanding of what we see for inflation, to have the majority of that, if not all of it, offset by the pricing that's yet to come.

Joe Grabowski

Got it. Okay, thanks. That's helpful.

I guess my follow-up question would be, gross margins in the quarter rose strongly versus Q4. Q4, obviously, last year was the lowest quarter of the year for gross margin in each segment. Should we consider those gross margins in Q4 an aberration, and how do you expect gross margin to progress through 2022?

Barry Ruffalo

As we talked in the Q4 earnings call, Joe, we were happy that, up until that point, really through Q3 of 2021, we were able to maintain that 23% to 24% gross margin average. Q4 obviously had some unprecedented circumstances for us with regards to supply chain, COVID-related absenteeism, so on and so forth, which as we also mentioned, flowed into the first part of 2022. So we do feel like that was an extraordinary set of circumstances and it hit us all at one time. We feel good that the team has posted a good Q1 relative to Q4.

As you look at the results, Joe, you can see that Materials Solutions gross margins were good, Infrastructure Solutions, when we look at the margin, that's where we had the most difficulty in the first part of 2022 around COVID-related absenteeism, under-absorption, and supply-chain issues. We've also seen some of those issues resolve themselves as we went through Q1. We feel better about how we're going to progress through 2022 obviously than we did in Q4 of 2021.

Joe Grabowski

Got it. If I could maybe just sneak in one more quick one. You talked in the press release about elevated steel costs obviously. How are you managing the higher cost? I guess, what mechanisms are you using to maybe reduce the steel inflation that you're seeing right now?

Barry Ruffalo

Thanks for the question, Joe.

We meet on a monthly basis, if not more, certainly at least monthly at our Steel Council, and we look at what's going on with that important material as it is part of cogs within our business. I guess from my experience over the years, there's not just one silver bullet in regards to how you really manage your steel purchases or protection of steel on material margins. We use all the different options.

Primarily—you probably have heard or have been watching yourself that steel was high as we entered into 2022, hot rolled coil dropped back off, plate stayed about where it was. Since that point in time, we've seen hot rolled coil go back up but now it's starting to plateau. We believe that the actions that we're taking are serving us well to manage and protect our material margins.

We're certainly not speculative when it comes to steel. We use things like forward buys. We use a little bit of everything, Joe, in order to make sure that we're protected. So, we do feel good about our visibility there and our ability to manage that both in how we buy and in how we actually price to manage it as well.

Joe Grabowski

Okay, perfect. Thank you very much.

Barry Ruffalo

Thanks, Joe.

Operator

Thank you. Our next question is from the line of Steve Ferazani with Sidoti and Company. Your line is now open.

Steve Ferazani

Morning, Barry. Thank you. I appreciate all the color on the call.

I do want to follow up Joe's questions on the sequential improvement because I think probably to a lot of us, it was a significant surprise, knowing that Omicron, you had noted previously peaked in January.

I'm trying to get a sense, one, of the financial impact of Omicron, Q1 versus Q4, and whether it mattered that it was early in the quarter versus late. Also, we're getting a sense from other companies that the electrical component issues in terms of supply chain are, if not getting better, actually may be even getting worse.

If you could touch on both those topics in terms of how you managed Q1 versus Q4.

Barry Ruffalo

Good morning, Steve. Thanks for the question. I would say, in Q4, we had about $11 million of under-absorption, in Q4 of 2021. We've seen improvements in under-absorption in Q1 of 2022. As I mentioned earlier, the biggest impact for us in the quarter of Q1 in 2022 was really in the Infrastructure Solutions business. That's where we saw in January the biggest impact from COVID.

That was a tough month for us but as we look back and look at our performance in February then March, we've seen improvement there. Our COVID-related absentees have dropped off significantly after January. Now, we start to see and hear about more in the news, the Omicron a little bit of an escalation spike. We haven't necessarily seen that to have any material impact on our operations recently, but we feel good that maybe that part of the variants are behind us in regards to the COVID-related absenteeism.

Now we can simply just focus on supply chain and logistics issues, which ultimately now are really our biggest constraint for us to continue to grow our volumes and reduce that backlog and deliver product to our customers as they continue to have a high demand for everything that we provide, really across the board, Steve.

Steve Ferazani

Okay. When we think about the growing backlog and the time of completion and industry-wide issues, how much is that driving what was a pretty significant growth in your Parts business, which I imagine is higher margin, and how do you think about parts sales this year, knowing that you're looking at three, four quarter backlog and how much that can drive that higher-margin portion of sales?

Barry Ruffalo

Great question, Steve.

I would tell you that I give more credit to the actual Parts organization and the hard work that they've put into really driving execution on our strategic initiative to grow our aftermarket parts sales. They've done a lot in regards to using different systems, incorporating better data, looking across the organization at inventories and availability, better communication with our customers. And so I really attribute our Parts growth in dollars really to the team and the work that they've put in in order to make sure that we're having good strategic deployment and good execution in the items that they're—actually items that they're driving.

I would say more credit goes to them. Obviously, there probably is a little bit of customers who may be wanting to trade out equipment but have to run them a little bit longer because of the lead times in which they're dealing with, and so, there's probably a piece of that or maybe some protectionism in regards to making sure they have the parts when they need them because of that. But I think ultimately, I give more credence to the work the team is doing to drive that Parts growth than maybe that market dynamic.

Steve Ferazani

Great. If I could just squeeze one more in.

In terms of SG&A expectations for the remainder of the year, can you provide a little color there?

Barry Ruffalo

Yes. The SG&A reduction that we saw in Q1 was really driven by stock compensation and also a healthcare reduction cost. We were still holding to the previously announced range of SG&A that we talked to at the beginning of the year.

Steve Ferazani

Great. Thanks, Barry. I appreciate it.

Barry Ruffalo

Thank you.

Operator

Thank you. We don't have any further questions at this time. Mr. Anderson, please continue.

Steve Anderson

Thank you, Reyes. We appreciate your participation on this conference call. Thank you for your interest in ASTEC. As today's news release indicates, today's conference call has been recorded. A replay of this conference call will be available through May 18, 2022, and an archived webcast will be available for 90 days.

The transcript will be available under the Investor Relations section of the ASTEC Industries website within the next seven days. All of this information is contained in the news release distributed earlier this morning.

This concludes our call and as always, I'm happy to connect if you have any additional questions. Thank you. Have a good day.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.