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Q3 2020 Synalloy Corp Earnings Call

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## CORPORATE PARTICIPANTS

### Christopher Hutter

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

**Sally M. Cunningham** *Synalloy Corporation - Senior VP, CFO & Corporate Secretary*

## PRESENTATION

### Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Synalloy Third Quarter 2020 Earnings Conference Call. (Operator Instructions) I would now like to hand the conference over to Mr. Craig Bram, President and CEO. Thank you. Please go ahead, sir.

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

Good morning, everyone. Welcome to Synalloy Corporation's Third Quarter 2020 Conference Call. Joining me today is our CFO, Sally Cunningham. Also on the phone today is Chris Hutter. Chris will be assuming the role of Interim President and CEO upon my retirement from the company tomorrow.

I will have Sally report on the Q3 financials, and then I will provide some commentary on each of the business segments. Prior to Q&A, Chris will have some comments as well.

Sally, I'll now turn the call over to you.

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### **Sally M. Cunningham** *Synalloy Corporation - Senior VP, CFO & Corporate Secretary*

Good morning. As is usual practice, I will present the financial results using 3 different methods: GAAP-based EPS, adjusted net income, and non-GAAP measures filed in the earnings release and adjusted EBITDA, a non-GAAP measure also defined in the earnings release.

Starting with GAAP-based EPS, for the third quarter, the company reported a net loss of \$10.5 million, or \$1.16 diluted loss per share as compared with a net loss of \$1 million, or \$0.11 diluted loss per share for the third quarter of 2019. The primary factors contributing to the current quarter losses were, a noncash goodwill impairment in our Metals Segment of \$10.7 million, operating losses at Palmer totaling \$0.9 million and inventory price change losses, which on a pretax basis, totaled \$1.6 million.

For the 9-month period, the company reported a net loss of \$18.7 million, or \$2.06 diluted loss per share as compared with a net loss of \$2.1 million, or \$0.24 diluted loss per share for the first 9 months of 2019. The primary factors contributing to the current year-to-date losses were: a noncash goodwill impairment in our Metals Segment of \$10.7 million, a noncash impairment charge at Palmer of \$6.1 million, operating losses at Palmer totaling \$3.6 million, proxy contest costs of \$3.1 million and inventory price change losses, which on a pretax basis, totaled \$5.5 million.

Third quarter non-GAAP adjusted net loss was \$1 million, or \$0.11 diluted loss per share compared with an adjusted net loss of \$0.7 million, or \$0.08 diluted loss per share for the third quarter 2019. For the 9-month period, the adjusted net loss was \$2.9 million, or \$0.31 diluted loss per share compared with the adjusted net loss of \$0.4 million or \$0.04 diluted loss per share for the first 9 months of 2019. Third quarter non-GAAP adjusted EBITDA was \$1.6 million, down from \$2.8 million in the third quarter of 2019.

For the first 9 months of 2020, adjusted EBITDA was \$6.2 million, down from \$10.9 million for the first 9 months of 2019. Both the adjusted net income and the adjusted EBITDA metrics for the first 9 months of 2020 include add-backs of the noncash goodwill impairment of \$10.7 million in our Metals Segment, the \$6.1 million -- \$6.1 million in noncash asset impairment for the Palmer operation and \$3.1 million in costs associated with the company's proxy contest. As pointed out in the earnings release, operating losses at Palmer totaled \$0.9 million and \$3.6 million for the third quarter and first 9 months of 2020, respectively.

Additionally, results were negatively impacted by the inventory price change losses, which on a pretax basis, totaled \$1.6 million and \$5.5 million for the third quarter and first 9 months of 2020, respectively. Net debt at the end of the third quarter totaled approximately

\$71.3 million, down from \$77 million at the end of the second quarter.

I will now turn the call back over to Craig.

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

Thanks, Sally. The company continued to make solid progress on multiple fronts in the third quarter. Looking at the balance sheet, net debt was reduced by \$6 million, and we expect to bring that down by an additional \$9 million by year-end. We will file for federal tax refunds totaling \$4.5 million, with \$1 million targeted for receipt possibly before year-end and the balance targeted to be received prior to the end of the second quarter of 2021. The company continues to sell off assets related to businesses that we exited years ago or are in the process of exiting now like the Palmer operation.

Expected proceeds from these sales in Q4 will total \$500,000. Palmer sales proceeds in the first half of next year are expected to generate upwards of \$2 million in additional cash. We recently received a favorable court ruling regarding a dispute over industrial gas pricing at our Munhall facility. As a result, Bristol Metals hopes to recoup up to \$200,000 in overcharges for 2020 and should realize comparable annual savings for a period of 3 years starting in 2021. As noted in the earnings release, Q3 adjusted pretax income showed substantial improvement over the same quarter last year, up \$1.9 million.

The performance of the core business, considering a decline in sales of roughly \$9 million year-over-year, speaks to the continuing efforts to bring down our cost structure. The Chemicals Segment witnessed similar declines in volume in the quarter as its largest chemical customers experienced in their businesses. In spite of this, operating income for the segment was up 25% and 47% over the third quarter and 9-month periods of last year, respectively.

The pipeline of new products remains favorable and will have a significantly positive impact on the Fountain Inn, South Carolina facility in 2021. Our pipe and tube businesses continue to generate mixed results in the quarter and year-to-date. Polished ornamental tubing remained reasonably strong in Q3 with its consumer-oriented markets, including marine and transportation leading the way. As anticipated, when we acquired this business in January 2019, it has helped to offset the more volatile infrastructure cycle that Bristol Metals competes in.

The heavy wall seamless carbon pipe and tube businesses have been relatively steady at our Mineral Ridge facility, which serves primarily the industrial markets. The Houston operation has been under pressure with its heavy reliance on the energy industry. By far, the most challenging market conditions have been in the welded pipe and tube businesses of Bristol Metals. North American consumption of welded stainless steel pipe is annualizing at roughly 93,000 tons for 2020. This is about 5% less than 2019 and is in line with the previous trough years in the infrastructure spending cycle of 2015, 2016 and also 2009, 2010.

While Bristol Metals has taken market share in the past 2 years, aggressive pricing has pressured margins across all product lines. Not surprisingly, weak demand also led to falling nickel surcharges in the first half of the year, generating inventory price change losses totaling \$5.5 million in the first 9 months of 2020. Nickel surcharges turned positive in late summer, and we expect to generate inventory price change gains in [Q4] (corrected by company after the call).

Inventory profits in October exceeded \$230,000. Historically, the infrastructure cycle that drives Bristol Metals' end markets has been 24 to 30 months of weak demand, followed by a comparable period of strong demand. Industry participants are of the opinion that demand for welded stainless steel pipe in North America should begin to pick up in the second half of next year. The expectation is that stimulus plans will include a focus on infrastructure and that capital spending will increase across key end markets.

As stated in the earnings release, because of the uncertainty related to the COVID-19 pandemic, we have suspended all fiscal 2020 guidance and are not providing guidance for 2021 at this time.

Finally, I'd like to thank all the employees at Synalloy for making the last 10 years the highlight of my business career. You set financial records at the peak of the business cycle and have shown your resilience in the most challenging years. I'm especially proud of your efforts in 2020. The company is well-positioned for the next leg up in the manufacturing economy, and I know you will continue to

perform at the top of your game. Best wishes to all of you.

I'll ask -- I'll now ask Chris to offer some of his comments to the listeners as well.

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**Christopher Hutter**

Thank you, Sally. Thank you, Craig. Appreciate it. I want to start by commending all of my new colleagues at Synalloy for their tremendous efforts throughout this recent pandemic and over the past several years. Our more than 500 hardworking employees are producing high-quality products and providing exceptional service to customers on a daily basis. Even during these trying times, are helping us to fuel American industry and drive results for all of our stakeholders.

I'm looking forward to rolling up my sleeves and working side-by-side with everyone at the company to build on this foundation and ultimately position us as a perennial industry leader. I also want to take this opportunity to thank the Board for placing its confidence in me as interim CEO. I've only been working with my fellow directors for a few months, but in that short time, we've established a truly collaborative partnership. I believe this will be a tremendous asset for the company and myself as I take on this new role.

As I continue learning more about the company each day, it only reinforces my belief in the long-term growth potential across all of our businesses. I saw this potential as an investor, and I'm excited to help realize it as interim CEO. I believe we have the ability to become truly remarkable in the Chemicals and Metals Segments. Our shareholders, employees and stakeholders have my commitment that I will work tirelessly to leverage my experience, market knowledge and relationships to further strengthen and grow our presence in these high potential areas.

I'm also committed to ensuring that our culture from top to bottom fosters accountability, respect, transparency and teamwork. We will always show respect for our stakeholders and the communities' environments that Synalloy operates in. Over the course of the next few months, I look forward to keeping our workforce safe and sharing our plans for the future and demonstrated progress in greater detail. Thank you.

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

Thanks, Chris. We'll now open the call to questions.

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**QUESTIONS AND ANSWERS**

**Operator**

(Operator Instructions) Your first question is from David Sigford of -- he's a private investor.

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**Unidentified Participant**

Just a quick question. So nice progress on debt reduction. Thank you for giving us some clarity on the progress that you expect to see over the next couple of quarters with that. That's good. Just a question on debt. So right now market cap is about \$50 million debt over \$70 million. Will that affect the ability to refinance line of credit that expires in December 2021?

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

I'm happy to take that. Sally, you can add some comments as well. David, we've had preliminary conversations with Truist, and they remain very excited about the renewal, and we expect to have the ABL and the term debt renewed prior to the end of the year.

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**Unidentified Participant**

Okay. Very good. Another question. It was mentioned, I think, last call that you'd be performing inventory valuation in October and that with higher nickel prices, you might be able to increase your capacity on line of credit. Is that anything that was able to happen?

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**Sally M. Cunningham *Synalloy Corporation - Senior VP, CFO & Corporate Secretary***

The inventory revaluation was not able to happen in October, just the COVID-related reasons, but we are in the process of getting a new valuation, and we do expect to have a higher inventory prices with the increases -- increasing nickel prices.

**Unidentified Participant**

Okay. And then now we're ex-Palmer, we're less connected to the price of oil. I think, Craig, if I got this right, about 80% of company revenue comes from end markets not connected with oil and gas. Does that sound about right?

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

Yes, David. I think that's in the ballpark. When you look at the remaining businesses, the non-Palmer businesses, the specialty pipe and tube operation down in Houston has exposure to both the midstream energy business and also offshore. So the offshore at this point is very, very slow. And then when you look at Bristol Metals, there is the downstream energy market. But what we're talking about there is exposure to infrastructure spending on LNG, petrochemical and chemical operations. So it's in that downstream energy market, but obviously not nearly as volatile as the upstream energy markets that Palmer and specialty have some exposure to.

**Unidentified Participant**

Okay. And then do you see with the new administration -- politically, do you see a catalyst or a boost for companies that support manufacturing construction potentially?

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

There is a water and wastewater initiative and the Senate has been in there since the summertime, but obviously hasn't gone anywhere. Stimulus spending, we would expect if that were to occur, that would include some spending on infrastructure. But that's probably anybody's guess right now as to how that plays out. I don't know that any of us have a sense of where the Senate is going in terms of control and how that might impact some of the initiatives. But when you look at infrastructure spending, as I mentioned in the earnings release, there are -- it's typically 2.5 years of strong demand followed by 2.5 years of weak demand. And we -- certainly, in 2019 and 2020, infrastructure spending has been very, very low.

So if it sticks to that kind of schedule and certainly stimulus would help turn that around, we would expect to see some improvement in the second half of next year. And that's what our customers are telling us right now.

**Unidentified Participant**

Makes sense. Now, I noticed tangible net worth \$67.7 million. I think that's about \$7.44 a share. That's about consistent with June 30?

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

Yes.

**Unidentified Participant**

I noticed a -- in the chemical it's always nice to see a little operating income increase from third quarter last year. So that was good. But I noticed there was an article in [Textile World] on October 8, material science group at Synalloy introduces BioLube ECO-7, I think, designed for fiber extrusion. Is -- how is that being accepted in the marketplace?

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

Yes, the chemical business has always been in products that have catered to the lubricants which go into the textile industry. And we've had, over the years, multiple products that kind of fit that description. I've not heard anything specifically from our guys that that is a product line that goes beyond a particular customer. Typically, we told those products for a pretty specific customer. But that's something we could look into, David. If you want to follow up, we can get a little more detail on that product line for you

**Unidentified Participant**

Okay. Wish you the best, Craig, in future endeavors. You'll be out golfing here soon, I would expect.

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

Thank you, David. I appreciate it.

**Unidentified Participant**

Hey, just one other question. So right now, we have 8 Board members with you on the Board, but effective, I think, tomorrow, will be down to 7 Board members. Is that -- is there an expectation that with the new CEO eventually that will be back up to 8? Or is that anything that you could talk about?

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

I don't know that the Board has even contemplated that at this point, how they're going to deal with it.

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**Operator**

(Operator Instructions) At this time, we have no other questions in queue. If you all have any closing remarks?

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

Thank you, as always for your time. We appreciate it.

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**Operator**

Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect.

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