

Titan International, Inc. (TWI)
Transcript of Q1 2020 Earnings Call and Webcast
Thursday, May 7, 2020 9:00AM ET

Company Participants

Paul Reitz - President and Chief Executive Officer

David Martin - Senior Vice President and Chief Financial Officer

Todd Shoot - Senior Vice President, Investor Relations and Treasurer

Conference Call Participants

Joe Mondillo - Sidoti & Company

Kirk Ludtke - Imperial Capital

Presentation

Operator: Ladies and gentlemen, thank you for standing by, and welcome to this morning's presentation. I would now like to introduce Todd Shoot, Senior Vice President of Investor Relation and Treasurer at Titan International. Sir, please go ahead.

Todd Shoot: Thank you. Good morning, and welcome, everyone, to our first quarter 2020 earnings call. On the call with me today, I have Titan's President and CEO, Paul Reitz; and David Martin, Senior Vice President and CFO.

I will begin with a reminder that the results we are about to review were presented in the earnings release issued this morning, along with our Form 10-Q, which was also filed with the Securities and Exchange Commission this morning.

As a reminder, during this call, we will be discussing certain forward-looking information, including the company's plans and projections for the future that involve risks, uncertainties and assumptions that could cause our actual results to differ materially from the forward-looking information. Additional information concerning factors that, either individually or in the aggregate, could cause actual results to differ materially from these forward-looking statements can be found in the harbor statement included in today's earnings release attached to the company's Form 8-K filed earlier today as well as our latest Form 10-K and Forms 10-Q, all of which have been filed with the Securities and Exchange Commission.

In addition, today's remarks may refer to non-GAAP financial measures, which are intended to supplement, but not be a substitute for the most directly comparable GAAP measures. The earnings release, which accompanies today's call contains financial and other quantitative information to be

discussed today as well as a reconciliation of the non-GAAP measures to the most comparable GAAP measures.

Today's earnings release is available on the company's website within the Investor Relations section under News & Events. Please note, today's call is being recorded. A copy of today's call transcript will be made available on our website.

I would now like to turn the call over to Paul.

Paul Reitz: Thank you, Todd. Good morning, everyone. I hope all of you and your families are as safe and healthy as you can be and working through these times the best you can. I've mentioned on prior calls the tremendous resolve of Titan and the people at our company in dealing with the many cycles we've seen in our industry and end markets over the past 35 years. The 2019 was one of those challenging years in Titan's long history, but we worked hard and believe we are positioned well entering 2020 to see a good earnings rebound, driven by our internal actions on what we saw as relatively flat expected sales levels. Needless to say, we now find ourselves in the midst of a pandemic of historic proportions and much has changed in the 2 months since our last earnings call.

On today's call, we're going to discuss the impact of COVID-19 on our business operations during the first quarter and then the continuing impact into Q2, along with the actions that Titan is taking to deal with the crisis.

Titan was impacted early on with our undercarriage plant in Tianjin, China. Our facility experienced an additional shutdown period after the China New Year that resulted in a few million dollars of lost sales and a little over \$500,000 in lost gross profit. We monitored that situation closely. We adapted as required. However, as we all know now, the virus rampantly spread from China and hit central Italy in a major way, where Titan has a total of 3 undercarriage plants and 1 wheel plant.

Then it moved into Spain, where we also operate a foundry and a casting facility. So as a result of that, the negative impact from the virus in our first quarter expanded, especially within our earthmoving and construction segment, where we saw volumes fall 23% and segment operating income decreased by \$12.5 million due to that much lower volume that -- resulting from the crisis and the unabsorbed overhead, along with the additional virus mitigation costs.

As the virus spread into North America in early to mid-March, the federal government decreed our manufacturing plants part of the critical infrastructure necessary for agricultural production.

I do want to state that Titan is proud of the role that we play in our nation's critical infrastructure. But that really pales in comparison to the pride we have with our employees throughout our global operations that have stepped up during this period to keep our plants operating. Since our U.S. plants did not experience a shutdown, we quickly adapted to these circumstances by creating a COVID-19 team, consisting of management, operations and union reps to meet multiple times a day and execute on plans to keep our employees safe without missing our production needs.

In the first quarter for North America, we saw our aftermarket business hold up quite well on the tire side, while OEMs for both our tire and wheel businesses were down significantly due to production closures at their plants, stemming primarily from the pandemic.

The virus was slower to reach our Brazil location, so the biggest impact there in Q1 was really the weakness in the reais. Absent the currency devaluation, our sales in Brazil were flat in the first quarter with improved gross margins. The government stay-at-home decrees related to the virus didn't take effect until early April, which did result in our plant closing for 2 weeks. I do want to state our team in São Paulo were diligent during that shutdown period, really developing new operating processes, procedures, got the agreement and the buy-in from the union. And as a result, we were able to resume operations with nearly 100% attendance.

In response to the virus pandemic, Titan has managed our business operations during the first quarter quite successfully, and we've really adapted to a changing marketplace quite well. However, overall visibility into demand remains quite limited as OEMs continue to adjust their production schedules. We do have certain customers stating they believe the second half of the year will make up for a good chunk of lost sales. So in light of this view, combined with being deemed critical infrastructure in a number of locations that I previously noted, we will keep our plants operational while also adjusting to these fluctuating demand levels. However, we fully understand it's crucial we maintain our skilled employees to ensure that Titan is able to capitalize on these upside opportunities with the pent-up demand that will certainly present themselves later in the year.

So to accomplish that balance, we are reducing working hours, eliminating temp staff, shutting down operations as needed really to ensure that we're matching the cost of our operations with the current

demand and also to protect our efficiencies and our working capital levels. It's obviously a constant juggling act but, again, Titan has been through many of these cycles before, and we are able to react quite quickly to the fluctuations with our staffing levels; with the only caveat, as we've mentioned in this call and in the prior call, you run into weaker absorption levels when that happens.

While broader OEM demand remains low on a global basis at this time, farmers are jumping into the field, they're quite active. Our food supply chains, as we've seen quite heavily on the media, must continue to operate. So we do have good reason to believe that second half demand in the ag sector will strengthen to meet both existing and pent-up demand and also to start looking to build back some inventory levels for 2021.

The ultimate impact of the pandemic on our 2020 results is uncertain and will be based on a number of factors regarding the duration of the virus and the impact on our customers' operations and demand. We've recently seen the U.S. ag dealer's sentiment index recorded the biggest drop on record, but on the flip side, 2020 dealer sales expectations are only down 6%. We expect the pandemic impact to be more significant in the second quarter, with the second half of the year looking to gain back some of the lost sales seen during the height of the pandemic. As a result, we're looking at 2020 EBITDA levels to be relatively in the range of what our 2019 performance was.

Now with that being said, the challenges and the uncertainty brought on by the COVID-19 global health pandemic and the difficult market conditions for most businesses and industries clearly reinforce the importance of mitigating risk and having a strong supply chain. That's where Titan is clearly a business partner that our customers can win with in the long term. We have an extensive global network that operates on a regional basis near many of our customers' plants. We build good products with strong brands that continue to lead the way in innovation. Thus, we are an excellent solution for our customers as they look to mitigate risk. It's much clearer now to many that risk is an element that has been undervalued as globalization took off, especially in our end markets where we've seen demand be under constraint and supply continue to grow.

I recall a professor I had in grad school some 20-plus years ago, I'll never forget him preaching in class on a regular basis that the biggest business mistake we will all make in our careers will be to underestimate beta and risk no matter what we ended up doing as a living or where we worked. Looking back, he was right. I firmly believe Titan is now well positioned to be an excellent solution for our customers as they will certainly seek to reduce risk in their supply chains in the future.

We've seen a major trend in all of our lives over the past 2 months to buying things online. That's not a case in our industry. We still rely on an extensive distribution network. But the point is the same: people are changing their buying behaviors, and that will happen in our industry as well. The importance of a solid, less risky supply chain will be increasingly important in our industry. And we've all noticed that companies in May have started taking longer shutdowns due to supply chain issues, not just a slowdown in customer demand or other pandemic issues that have impacted demand.

Also, as you think beyond OEMs to our tire business, where, again, as I stated earlier, we operate through dealers and a distribution network, they are also going to be looking to operate with less inventory to mitigate their risk and their capital costs. And that's putting a premium on tire manufacturers that can get the right tire to the right place at the right time. Think about how much harder that is to do with a supply chain that's some 5,000 miles away.

As we've been discussing on prior calls, we've made extensive investments in the 80/20 process to manage our inventory and our production processes. That will and has made us better at having the right inventory available to serve our customers and, once again, mitigate their risk. Let's not forget through all this noise, I said it on the last call and I'm going to say it again on this one, at the end of the day, Titan builds good products that are important to our customers.

Now there's no question that in the near term, trends in our business will be shaped by the COVID-19 pandemic. The impact of this crisis goes far beyond the financial and operational impacts I just noted. It hits everyone with both personal and societal challenges that are simply unprecedented. As we all know, you learn a lot about people when the rubber hits the road and challenges are all around you. I personally can say I've been impressed with our team, and how they've really risen to these incredible challenges and how we've been able to adapt. In a short time-frame, we've essentially changed how we work and operate to adapt our company to the changing times and, most importantly, protect the safety of our people. I would like to extend my sincere appreciation to each and every Titan employee for their determination, their resilience in the midst of this global pandemic that has impacted all of us in our work and our personal lives. Keeping operational during these times comes with great responsibility for both Titan and every employee working hard. We have and will continually strive to ensure the safety of our people while maintaining business continuity. Again, I am proud of our workforce and our leadership team.

I want to finish with a couple of quick comments on liquidity, as David will dive into that deeper later in his comments. In 2019, our actions to protect our balance sheet resulted in working capital improvements

of \$53 million and noncore asset sales of \$31 million. On prior calls, we've noted our ability to generate more than \$30 million from noncore transactions and also discussed our underperforming businesses that have the potential to generate additional cash beyond these noncore asset sales. We have been keenly focused on protecting our balance sheet, and the pandemic highlights the critical importance of continuing to do that.

I'll leave it there and let David do a thorough update on liquidity later. We know that time will come when mobility and commerce gets back on a path to normalcy. We believe ag will be a key part of that return in the broader economy. Our team is experienced in dealing with volatility and challenges in our end markets, and I'm confident that we'll continue to take the needed actions to work through this crisis. I want to close again with stating my appreciation to the One Titan team and our thousands of employees around the world working every day to manufacture our products.

I'd now like to turn the call over to David.

David Martin: Thanks, Paul, and good morning. Today, as normal, I will review some of the more important things, items from our performance in the first quarter, while I'll spend some time outlining our current actions to manage liquidity and profitability during this period of unprecedented volatility and uncertainty.

As we all know, the first quarter was just a prelude to the challenges that have been brought on by COVID-19. As Paul said, the second quarter was much more challenging on our -- the second quarter will be much more challenging on our financial results. But we are responding decisively with the actions to ensure that we minimize the impact where possible and also have adequate liquidity to manage through it. When we reported in early March, we certainly didn't anticipate the acceleration of the virus and the impact on our global operations that have transpired during the last 60 days.

That said, let me get into some detail. Net sales for the first quarter were \$40 million or 13% more than what we saw in the fourth quarter of 2019, with seasonal upticks in the business, particularly in aftermarket. As we described in the release, activity was much -- was more in the category of normal for operations in the first two months with the exception of our small operations in China. But as the quarter progressed, the impacts of COVID-19 started to have a more material impact on the business.

On a constant currency basis, revenues would have been down 14% for the first quarter or \$56 million from the prior year. The negative currency impact was nearly \$13 million or 3%, with much of the impact coming in Latin America and Australia.

While ag sales lagged the prior year by 10%, the biggest impact on sales again this quarter was in earthmoving and construction, where sales declined by \$40 million from the last year. The drivers were across the board, with the biggest impacts coming in our undercarriage business with a decline of \$22 million year-over-year in the EMC segment. The remaining declines were primarily in the U.K. and Australia. The consumer segment experienced a decline of \$10 million in the quarter, reflecting continued sluggishness in the utility truck tire sector in Latin America, along with North American sales related partially to deemphasized product lines.

The biggest direct impact on sales from COVID-19 were felt in Europe and, to a lesser extent, in China. From our best estimates, the net sales were impacted by \$14 million for the quarter in these areas as operations were either curtailed or suspended from government mandates or demand impacts.

Our North American wheel sales were down \$24 million -- 24% on changes in mix and pricing and, to a lesser extent, volume. Our North American tire sales were also down 9%, with the biggest driver being OEM sales as customers lowered production levels. Our aftermarket sales in Q1 were robust and in line with our expectations. Our Latin American sales were down 15% from Q1 2019, with all this coming on lower currency translation effects. Volume in Latin America was in line with expectations and our prior year levels.

Australian sales were also down \$9 million year-over-year, with the majority of this coming on lower volume in EMC as mining replacement activity was slower. But as we have discussed, we have also deemphasized tire distribution and tire servicing since the first quarter of last year, including the sale of some unprofitable branches.

Russia was in line with last year with volume up. Overall market conditions are still challenging in Russia with no significant economic activity, but dealers did increase volume year-over-year slightly.

Our overall sales volume on a consolidated basis was down 12.6% from last year.

Price and mix in the quarter was mixed between geographies and businesses, with an overall slight negative impact on sales of 1.1%. There was a slight change in mix of products sold, but pricing has declined in some areas where raw material adjustments have been made with OE customers.

The reported gross profit for the first quarter was \$27 million versus \$45 million in the first quarter of 2019. In the first quarter of 2020, we also recorded a \$2.6 million asset impairment charge related to equipment and TTRC, our tire recycling operation in Canada. This charge was necessary to reflect the current value of the equipment after we concluded our property damage insurance claim during the first quarter. Our reported gross profit margin in the first quarter of 2020 was 8% versus 11% last year. Without this impairment charge, the gross profit margin was 8.7%, a decline of \$15 million year-over-year.

Obviously, with the drop in sales of \$69 million, our gross margins naturally declined as well. But the impact from a lack of labor and overhead absorption across the business caused the decline in gross margins. In order to preserve margins year-over-year, we would have needed to lower labor and overhead by approximately \$28 million. And we were only able to reduce it by \$23 million during the quarter due to the high level of fixed costs in our plants, leaving roughly \$5 million of stranded costs and, thereby, hitting our margin. We did a nice job of managing labor and variable spending within the plants in the quarter as we continued to take necessary actions to manage the decreased volume levels. Again, we're dealing with a dynamic and ever-changing environment, making it very challenging to manage efficiency, but our teams are keenly focused on it every day.

Now I'll spend a few minutes on segment performance. Our agricultural segment net sales were down 9.8% on a year-over-year basis. Currency negatively impacted sales by 3.4% this quarter. Volume in this segment was only down 1.8%, while we had unfavorable pricing mix of 4.7%. Ag sales in North America and tire were down 5% due to the OE customers keeping production levels down. As I alluded to earlier, our OE sales in North America were down in the first quarter, primarily on lower pricing and mix on our OE sales. Russia sales were up 3.7%, while European Ag sales were down 12%. Our Latin America Ag sales were down 8% from the last year, entirely on lower currencies.

Agricultural segment gross profit for the first quarter was \$14 million, down from \$22 million in the prior year. There were no unusual impacts across the business, and the decline in margin related to lower labor and overhead absorption from lower sales, which I mentioned earlier.

Earthmoving and construction segment experienced a decrease in sales of 22.5%. On a constant currency basis, net sales would have decreased 20.2% for the quarter versus a year ago. The direct impact of COVID-19 on sales was \$11.9 million in the first quarter, primarily in Europe and China, as I've said before. Volume was down in the segment by 22.9%, while price/mix was favorable by 2.7%. ITM's undercarriage business was the largest impact of the quarter as construction OEMs accelerated their sharp decline in demand. We saw the biggest impacts in Europe and China again this quarter. Keep in mind, the construction industry only started to see contraction toward the middle part in the second half of last year. So, Q1 2019 sales still reflected a decently healthy construction market. Our European wheel business also saw a more significant decline at 29.7% due to the construction market in the U.K. Australian EMC sales dropped by \$6.7 million as we closed some branches and continued to pivot away from mining tire distribution. And finally, our volumes in North America were down 5% in the quarter compared to Q1 2019, but there was a sharper decline related to OE wheel sales.

Gross profit within the earthmoving and construction segment for the first quarter was \$10.8 million versus -- which represents a \$7 million decline from a year ago. This includes a \$2.6 million asset impairment charge. Without this, gross profit would have been \$13.4 million. The gross margin in the EM segment without the impairment charge was 9.7% versus 10.3% in the prior year. The biggest driver of the decline related to lower volume and an impact on fixed cost absorption. Considering the dramatic decline in sales, the business performed solidly with improvements in efficiency and improved pricing which -- occurring in a number of facilities as a countermeasure to depressed sales.

Finally, the consumer segment's first quarter net sales were down 24.5% compared to first quarter 2019. The negative impact from currency translation was 5.3% in the quarter. Volume decreased by 18%, and the impact of mix and pricing was negative at 1%. This had little to do with price again this quarter. It is mostly mix. The most significant impact on volume related to lower demand in the Latin America utility truck segment, along with North America, we are -- where we are deemphasizing certain product lines such as specialty products and ATV tires.

This segment's gross profit in the first quarter was \$2.5 million, which was down \$1.5 million from a year ago. Gross margin was 7.8%, which was a decline from 11.9% in the first quarter. This was reflective of lower sales volume and the impact on fixed cost absorption across Latin America, again in light utility truck sales -- truck tire sales in volume and a similar impact in North America.

Our SG&A and R&D expenses for the first quarter were \$34.4 million, which is slightly higher than the fourth quarter due to payroll taxes and slightly higher sales commissions on higher sales volume. However, this was lower than a year ago by \$4 million or almost 11%. We substantially completed our ERP stabilization efforts in the first half of 2019 related to the first phases of implementation in late in 2018. We also reduced our sales and marketing costs, and I'll discuss this a little later, but it is an imperative that we continue to evaluate our SG&A costs to support the organization in light of the current crisis, and I anticipate we'll make even more demonstrable progress on reductions as we progress through the year.

The single largest impact on the P&L this quarter was the foreign exchange loss of \$17.4 million. In the first quarter of 2019, there was a foreign exchange gain of \$5.7 million, which creates a difference year-over-year of \$23 million. As we discussed in the past, Titan has a large number of intercompany loans in place relating to our international operations that are subject to currency revaluation every reporting period. There was a significant change in currency rates in the first quarter versus the end of 2019, most notably between the U.S. dollar and euro compared to the Australian dollar, the Brazilian reais driving this impact in the P&L. We're in the middle of a restructuring project related to the rationalization of our loans and foreign legal entities that began to be implemented in the first quarter, and this drove some of the impacts as we either settled or capitalized loans. We will never eliminate this volatility completely, but I do hope to minimize it with the appropriate structure to manage our business.

We recorded tax expense in the first quarter of \$55,000 on a pretax loss of \$27.6 million. Normally, we have been recording tax expense in the region of \$2.5 million to \$3 million per quarter to reflect the normalized cash taxes we pay in foreign jurisdictions. Of course, our anticipated level of profitability in these jurisdictions is lower than what we've seen due to the impacts of COVID-19. Coupled with that, we were able to reverse approximately \$600,000 related to previously recorded contingent reserves relating to the expiration of statute of limitations.

Now let's move over to Q1 cash flow. I'll start with the fact that cash ended the quarter at \$60 million, down \$6 million from the end of the year. The impact of currency devaluation in the quarter was \$7 million, and that mostly occurred in March when the world's markets began to spin out of control. We generated approximately \$4 million of operating cash in the first quarter versus a negative \$15.6 million in the first quarter of 2019. This is despite the significant negative impact from lower earnings as we continue to drive more efficiencies in working capital management. Including the impact of noncore asset

sales and related transactions of \$12 million in the quarter, we generated free cash flow in the first quarter of 2020 of roughly \$9 million.

Our receivables increased by \$27 million in the first quarter from the year-end on the \$40 million increase in net sales from the fourth quarter. Our DSOs held steady at 56 days, and this is important as we expect to see solid collections over the second quarter during the period of most volatility on our operations.

Our ending inventory at the end of March declined by \$22 million from the end of December. As a reminder, we outlined a target of \$25 million in working capital reductions this year, not taking into effect any top line changes. Now we have strong focus with our operating teams to manage inventory very closely. As we know, there is a balance to manage lack of long-term visibility with customer demand. As recovery occurs, we need to ensure that we can meet customer expectations. Nonetheless, I do expect that working capital will remain a source of cash flow in the near term.

Capital expenditures for the first quarter were \$6 million versus \$9.5 million in the last year. Given the need to preserve cash flow in light of these challenging conditions, it has been necessary to suspend capital spending other than what is necessary to maintain our production in the near term. It is challenging to determine exactly where this will end up for the year, but at this point, I would expect it to be in the range of \$20 million to \$25 million, down from our original target of \$35 million for the full year.

Our overall debt level declined again this quarter. As of March 31, \$30 million was outstanding on our domestic ABL line, down from \$36 million at the end of December with the completion of another tranche of sales of shares on our Wheels India, along with the receipt of the property claim for our TTRC Canada operations totaling \$12 million we paid down on the line during the quarter. Due to the working capital needs toward the end of March, we did not pay down to the full extent of the receipts.

Short-term debt also declined by \$15 million during the first quarter as we paid down according to normal maturities of loan arrangements in certain foreign jurisdictions, primarily Russia and Europe. A portion of the decline related to extending a loan in Latin America in response to liquidity initiatives in late March. Our overall net debt declined by \$7 million from December.

On March 4, we outlined our initial targets for 2020. This included a \$75 million target for EBITDA on anticipated flat sales and involved impacts from key initiatives for cost reductions and profit improvements across our business. While this was just 60 days ago, the world has become infinitely more

complicated, volatile and uncertain in the meantime. So we've been updating our forecast continually every week. To say the least, the second half is not entirely clear with our customers, and they're not giving us any long-term demand expectations. Our most current forecast show a decline of around 12% in sales from 2019 levels. Our bottom line performance will be pressured as a result. With lower sales, we do currently anticipate adjusted EBITDA to be similar to our performance in 2019. It's important to note that our cost reduction and profit improvement initiatives have been and are necessary to carry us through this period of uncertainty. I'm not going to go through all the initiatives that we outlined last call again this morning, but each of these initiatives remain intact, and we've also been taking additional steps to preserve profitability and cash flow.

One important aspect that I want to outline relates to our SG&A and R&D costs. We've discussed target reductions of SG&A and R&D to \$140 million for 2020 previously. We are focusing on improving on that target now, given the challenges we face. I now anticipate and project SG&A and R&D costs should be between \$135 million and \$140 million for the full year based on our new initiatives.

I will finish my discussion this morning with what we are doing on the liquidity front to manage through the current situation. We have done the natural things by eliminating discretionary spending, nonessential travel and we have furloughed portions of our workforce in locations as we have reduced or suspended operations during March and April. In some cases, we have been able to access government programs for reimbursement of payroll costs. In the U.S., we are taking advantage to defer payroll tax payments along with certain pension obligations, among others, as provided by the provisions of the CARES Act.

For our international operations, we have been and are working with our banking partners and government-backed programs for payroll protection and loan facilities. Some of these are still in process, but we are confident we're going to be able to access loan programs in Europe that will give us additional credit capability of \$15 million to \$20 million. Based on our expected cash flow needs to manage our Latin America operations, we secured an additional \$4 million of credit and have extended approximately \$6 million of debt that would have been mature between May and November of this year for an additional year at relatively the same terms prior to the execution of the agreement.

As of March 31, 2020, current maturities and long-term debt was \$46 million. A significant portion of this relates to revolving lines of credit in our international operations, subject to annual renewals with various banks. We continue to expect that these credit lines will be rolled over and renewed at their

various renewal dates. Out of the total and current liabilities, only approximately \$6 million is currently anticipated to be paid for the remainder of 2020 in accordance with their specified maturity dates.

Headroom on our domestic ABL credit facility at the end of the quarter was \$62 million. Of course, our debt capacity is dependent on our borrowing base, subject to fluctuations in AR and inventory, which will vary in the coming months.

Over the course of the last 1.5 years, we've been able to manage liquidity with working capital, cash balances and our credit facilities. We continue to work on initiatives to sustain profitability improvements through shedding or driving positive changes in our unprofitable businesses as well as generating cash from the disposal of certain noncore assets. I mentioned on the last call that we remain on track for additional noncore asset sales and related transactions, and that continues to be the case. Our current expectation is for an additional \$20 million to \$50 million in noncore asset sales. That should be completed in the next 60 to 90 days. We're also looking at additional opportunities to increase credit capacity with our banking partners and other financial institutions.

The current crisis has not been easy on the business, no doubt about that. But our leadership and our operating teams all over the world have stepped up in ways we can only dream of to manage strongly and proactively through this. We continue to take all steps to manage the road ahead.

Now I'll turn over the call back to the operator for any questions you have.

Question-and-Answer Session

Operator: [Operator Instructions]

Joe Mondillo: This is Joe Mondillo from Sidoti & Company. So, David, could you just walk me through some of the liquidity just buckets? First off, what do you have right now, given the extended credit that you did -- have received on your revolver accessible? And were -- how much -- I assume at the end of the quarter you did not have the cash related to the CARES Act, how much was that as well?

David Martin: Well, we have not accessed any direct funds from the CARES Act, but we will be able to defer payments on payroll taxes for the remainder of the year versus -- and then pension obligations. I don't have a number on the tax side of things. But it's, obviously, on all of our U.S. payroll, so it's going to

be a fairly significant impact -- positive impact on cash flow. Pension obligations are in the several million-dollar range, I believe, for payments that will be able to be deferred to 2022. So it's that.

So -- but to go back to your original question, you -- talking about liquidity things. Go back to Europe, we have revolving credit lines that we've always had available, and they're working through particular government-backed lending facilities. The banks obviously have to get through a process with that. And - - but obviously, the government-backed piece of this in Italy primarily is going to come through, and it's mostly in our one or two operations over there. So I do expect \$15 million to \$20 million of additional available liquidity will probably in the form of committed facilities for us to be able to access for the next several years. There'll be couple-year kind of maturity on those.

In Latin America, we accessed \$4 million of additional debt, and we extended the terms of \$6 million on existing debt as well. So that's going to provide -- it's at least \$6 million that we're not going to have to pay this year, and then we have additional capability in -- and could actually executed that in March.

In the U.S., as I said just briefly that we have \$62 million of headroom as of the end of March. We had roughly \$30 million borrowed on the credit facility. As far as where we are now, I don't have any -- I don't have the borrowing base for April at this point, but we have borrowed additional funds in April, but we still have significant headroom. It hasn't changed dramatically at this point.

So I guess the biggest question is what's going to be over the next several months? I do believe that it will be decreased somewhat, but we still have more than adequate headroom to manage the business.

Joe Mondillo: Okay. So the \$62 million was what you have available on your ABL as of end of March?

David Martin: That's correct.

Joe Mondillo: And inventory liquid management, you expect more than \$25 million. I would have thought -- any way to quantify that? Or you're expecting more than the original.

David Martin: I think obviously, with the decreased sales expectations for the year, that inventory levels will come down more than that. I think working capital is a balance. We have to manage inventories at the right levels for the right times to be able to manage the recovery. But obviously, working capital is more than just inventory. And you got receivables and payables that we have to manage as well, and those go up and down. The primary source of liquidity is really on inventory, if you really think about it. And

so I think it will be more than that. That's why I think I'm confident that we're still going to be able to manage it pretty well.

Joe Mondillo: Okay. And you said you're anticipating \$15 million to \$20 million of asset sales still? Is that correct?

David Martin: No, actually, I said that I'm expecting between \$20 million and \$50 million of additional sales.

Joe Mondillo: And what -- could you provide a little more color on thoughts there just given the environment. Is this going to be over the next 12 to 18 months? Or do you think this -- are you confident - - how confident are you that...

David Martin: I am fairly confident in the numbers, and I expect that to be the 60- to 90-day range. And these are things that -- these are transactions that are in process, and I fully expect that we're going to be able to realize those.

Joe Mondillo: Okay. And then last question, just regarding sort of liquidity and cash flow. Given your expectations with the inventory and what you stated, where you're expecting Capex to be, do you have any outlook? Or do you think you'll be cash flow positive for the year on a free cash flow basis?

David Martin: I believe that we have the opportunity and it will be a balance between how much debt we pay down versus how much cash we can bank. But with all -- everything weighed together, I would expect that we're at least at parity.

Joe Mondillo: Okay. On your SG&A, R&D comments, you stated that you're looking for about \$135 million to \$140 million, is that correct?

David Martin: Yes, that's what I expect the levels to be based on our current expectations. We're driving hard on some of these cost reductions. Certainly, we're saving money on the natural things, as we've cut out discretionary spending and those types of things. But we're also looking at other structured reductions.

Joe Mondillo: Okay. And I guess last thing for me, and I have a few more questions, but I'll let someone else have a chance. In terms of your COVID impact, could you just talk a lot, Paul, on the prepared commentary on what you're doing and how it's affecting you. But I may have missed some of the details. Could you just help us explain more so, really, what's happened to your plant operations? I know there's a

lot of effects with your customers and maybe the supply chain. But in terms of your actual plant operations, was anything down in the month of April? Could you just walk us through the sort of March, April, May to date time period in terms of where your operations are and where they were?

Paul Reitz: Yes. The way I look at it is we've seen really 3 waves of the COVID-19 impact. The first one was the government-mandated closings. And so where we saw that most significantly would be in March, for this quarter, would be in Italy, where we operate mainly undercarriage. We've got 3 undercarriage and 1 wheel. And then in Spain, where we have an undercarriage foundry.

The impact at first was really just government-driven, the restrictions on operations and/or closing the plants down for a period of time to sanitize them. That took place in March. And then as you saw, the virus moved around from March into April. We saw another government decree in Brazil where we had to close down for 2 weeks. All the locations now are back operational. So what you're seeing is kind of the second wave that started impacting us in April, which would be our customers and their fluctuating demand. As they started shutting down some of their facilities, we had to adapt to that. We've done that by extending some shutdowns, taking some furloughs, reducing headcount, reducing temp labor, reducing overtime, basically controlling your output levels in relation to the demand that was coming in the door.

And now you're kind of seeing the tail end of April into May is kind of what I would call the wave 3 of the virus impact, which is the supply chain issues at some of our customers. So really to answer your question, it does kind of vary on what time period you're looking at, what wave of the crisis and that -- the waves all took place at different times of our operations, whether you're talking North America, South America or Europe. So at this point, we continue to look at it, Joe. And as David highlighted as well, we're adjusting our work schedules. We're adjusting our labor output, and we'll continue to do so whatever it takes in the second quarter and into the third to make sure that we're keeping them aligned. But the biggest impact this period, really, as you saw in our results, was to earthmoving/construction, where that first wave hit us most significantly in Europe at our Italian undercarriage facilities.

Joe Mondillo: And just a follow-up regarding that. Could you give us an idea of how much that Italy and Spain facility makes up of -- is that ITM business in Italy? Is that a large percentage of the ITM business? And how long was that down for most of April?

David Martin: Yes. So, we for the Italian business, we basically were down for a couple of weeks, if you want to -- at 100%, if you will. But then other weeks, we were at varying levels of production. For the

undercarriage operations, it's interesting. I don't have a specific number as to dollars and cents and things like that, but the -- it is the feeder for the global supply chain for undercarriage from Italy and Spain. And so it's an important aspect of that business. But again, think about, call it 50% of productive levels, if you will, in the month of April. In Spain, for example, we have various aspects of that business, but the primary undercarriage aspect of that business was down for just a couple of weeks as well. And -- but other parts of that operation that supply different other markets was running 100% due to high levels of demand.

Operator: Your next question comes from the line of Kirk Ludtke of Imperial Capital.

Kirk Ludtke: Sorry, I was disconnected for a while, but I think I've gotten most of it. And by the way, I'm glad to hear everything is -- appears to be well under control there. You guys are doing well, keeping your employees safe. I mean, that's -- it's job one. With respect to the liquidity measures you've outlined, these are -- this adds up to quite a bit of additional liquidity. I just want to make sure that I'm not double counting anything, but you're talking about \$15 million to \$20 million of additional banking availability through banking transactions.

David Martin: Yes.

Kirk Ludtke: Another \$20 million to \$50 million of noncore asset sales.

David Martin: Yes.

Kirk Ludtke: Additional net working capital reduction.

David Martin: Yes. Through the course of the year, yes.

Kirk Ludtke: Were you able to quantify? Or were you in a position to quantify how much working capital you think you can take out?

David Martin: Our initial target was \$25 million, and that was based on stable sales year-over-year. So I -- certainly, I believe that's a really achievable number given where we are, but we -- it certainly could be more than that. And again, I'm being careful about this target because as recovery occurs in the second half and then if we start to see a nice recovery, which we have absolutely no idea as to how quickly that happens, we have to manage inventories to be able to meet the demand levels and our customers' needs.

So I'm going to be careful about how much more we can predict for it. But I still believe that at least \$25 million would be achievable.

Kirk Ludtke: Okay. Thank you. And then I believe you mentioned operational levers, and I was hoping maybe you could expand on that.

David Martin: Operational levels for liquidity, you mean?

Kirk Ludtke: I mean levers of ways that you can improve liquidity through other operational means. I didn't know what that meant, but maybe that's...

David Martin: Well, I think I alluded to it a little bit earlier, but obviously deferring payroll tax payments, lowering capital expectations. We had original target of \$35 million. And obviously, with lower profitability and need to preserve cash flow, we're going to be cutting that back to \$20 million to \$25 million for the year.

And then again, the extension of pension obligations, that's several million dollars as well. So all the things that we can attach ourselves to. And then we're also in certain operations globally -- and I'd say this is more the case in Europe, where we're able to get government reimbursement for payroll protection. And these aren't loan facilities, these are just direct reimbursement to keep our payroll or and keep our workforce together. And that's particularly in the U.K. and a little bit in Italy as well.

Kirk Ludtke: Okay. Great. Thank you. And then I think you mentioned that you've borrowed another \$30 million under the revolving credit since quarter end.

David Martin: No. No, that's not the case. We had \$30 million outstanding at the end of the quarter. We borrowed a little bit more since then, but not significantly. And so that was actually -- we had \$36 million outstanding at the end of the year, it dropped to \$30 million at the end of the first quarter, and it's in and around the range of that now.

Kirk Ludtke: Ok. Well, I appreciate it. Thank you gentlemen.

David Martin: Thank you.

Operator: And your next question comes from the line of Joe Mondillo of Sidoti & Company.

Joe Mondillo: Guys, just a few follow-up questions, if you will. So just to clarify, I would assume it's fair to say that the second quarter is going to be softer than the first quarter. Is that your expectation?

David Martin: Yes, that's the case.

Joe Mondillo: And so I guess, I was wondering if you could expand on sort of what you're thinking for the back half of the year in terms of a rebound? And I guess, more so in the context of your comments that you made in the press release regarding sort of flat year-over-year EBITDA. Just curious on how you're thinking about the rebound in the back half to sort of make up for the weak first half?

Paul Reitz: Yes. I mean, it's tough to sit here today and say we have visibility into the back half of the year. And so our comments were around our internal actions that we believe will have a significant impact that we can keep EBITDA flat looking at 2020 compared to 2019.

What we see at a broader level for the back half of the year is primarily related to Ag, where we have more aftermarket exposure. We know for a fact that farmers are going to be very active. We're already seeing that here in North America, where they're ahead of the trends this year compared to last. We know that in Brazil, where we have a significant aftermarket business, the same thing will take place as well. So we feel more comfortable with ag from the perspective of the mix of our products being more aftermarket-driven, combined with the fact that agriculture is such a big part of the broader economy. Governments have to protect their supply chain related to agriculture and food. And so the risk of further downside to ag, assuming they have a good planting cycle in Russia, North America and South America and Europe is fairly mitigated because of that.

And so we don't necessarily have the exposure into the OEMs, what they're seeing right now. But I think we all can say the back half of the year, there's going to be some pent-up demand that will get released into the agricultural space. And I think we feel pretty confident that there will be a portion of the sales lost in the first half that will be recovered in the second half. Now to the extent of it, the timing of it, we clearly don't have that type of visibility at this point. But that's the ag side of it.

The construction part of our business, where you saw a more significant decline already in the first quarter, visibility is tough there. I can't sit here today -- David made some comments about the mining business in Australia being a little weaker. I think there's less visibility on exactly what that will look like, but we've already seen a stronger impact to our business in the first part of the year pertaining to

earthmoving and construction. And so again, I think as we look to the back half of the year, it points us in the direction where we believe with our internal measures, we can keep EBITDA relatively stable. But we're not able to sit here and give a sales forecast per se on what we see really beyond what we've already commented on the second quarter.

David Martin: Joe, let me just add on to that is that, I outlined it in my comments that current forecast would have us in the range of being down 12%. And obviously, first quarter and second quarter there will be higher levels of comparison in terms of a decline year-over-year. But the second half of the year, we already know. If you go back to our performance in the second half of last year, it was fairly weak. We started to see the impacts in the construction markets particularly, and we went to very low levels of volume in the fourth quarter. So that forecast would suggest that we're coming much more in line with what we did last year. And that obviously averages out to what the year-over-year performance full year would be. So that's really the premise for how we develop the forecast and the expectations around sales and EBITDA. But again, I will caution, in fact, that the visibility is limited, and this is the best we can estimate at this time.

Joe Mondillo: Yes. I was actually curious on what your thoughts were on that third and fourth quarter, especially the fourth quarter with the earthmoving. I understand that's an easier comp even though the visibility is still sort of not good at all.

David Martin: It is. Again, there was a severe destocking effort in the fourth quarter last year. So we feel like that -- I don't think inventory levels are at high levels right now. So the expectation is that maybe we can kind of see flatness in a comparative way.

Joe Mondillo: Okay. And last question for me, we're getting extended on time here, but I was just hoping to understand a little bit more on the gross margin and your cost of goods sold regarding cost actions and how you're trying to support your gross margins.

David Martin: Yes. Again, it's -- as Paul outlined, we've taken all the measures of taking out any excess of labor out of our plants all across the globe. And in some cases, we're getting government reimbursement for furloughs overseas. So that's a nice impact. So, we don't have to have the impact of those costs. We have already, all the things that we took -- that we actually have been working on for some time, the 80/20 measures that we took across our North American plants and tire that have created

better efficiency, you can -- we actually saw some of that coming in Q1, where we actually had a year-over-year better performance in margins, and I expect that to continue through the year.

We had -- last year, if you think -- if you remember, we had some pretty high cost at inventory that went through our North American wheel operations. That's, again, a very significant year-over-year impact that we believe is out of the way, and it's no longer there. So we're -- that should be a significant improvement in that profitability. And we can -- and notwithstanding the fact that we have all these things going on across the globe, we have taken costs out in just about every single operation and created better efficiencies. Our Australian business is in a better place than it was a year ago. We've had to destock a lot of the tire inventories over the course of 2019. That should help us improve profitability as well. And then the final measure really being our SG&A reductions.

Joe Mondillo: Okay. Alright, perfect. Well, thanks for taking my questions and I hope you are all well and safe and good luck with everything.

David Martin: Same to you, Joe.

Paul Reitz: Joe, Thanks.

Operator: This concludes our question-and-answer session. I would now like to turn the conference back over to Mr. Reitz for any closing remarks.

Paul Reitz: Well, I appreciate everybody joining the call today. Stay safe, stay healthy, and we'll talk to you again at the end of second quarter. Thank you.