Transcript of
Astec Industries, Inc.
First Quarter 2021 Earnings Call
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Participants

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Analysts

Mig Dobre - Robert W. Baird
Stanley Elliott - Stifel
Steve Ferazani - Sidoti

Presentation

Operator

Hello, and welcome to the Astec Industries, Incorporated First Quarter Earnings Call. As a reminder, this conference call is being recorded. It is my pleasure to introduce your host, Steve Anderson, Senior Vice President of Administration and Investor Relations.

Thank you. Mr. Anderson, you may begin.

Steve Anderson - Senior Vice President, Administration and Investor Relations, Astec Industries, Inc.

Thank you, and welcome to the Astec first quarter earnings conference call. My name is Steve Anderson, and joining me on today's call are Barry Ruffalo, our Chief Executive Officer and Becky Weyenberg, our Chief Financial Officer. In just a moment, I'll turn the call over to Barry for 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. And these statements are intended to qualify for the Safe Harbor liability established by the Private Securities Litigation Reform Act. Any such statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions. Factors that can influence our results are highlighted in today's financial news release and others are contained in our 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 GAAP, which are US 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 US GAAP and therefore are 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. Management of the company uses both GAAP and non-GAAP financial measures to establish internal budgets and targets and to evaluate the company's financial performance against such budgets and targets.

You should also note, comments made during today's call will refer to non-GAAP results and a reconciliation of GAAP to non-GAAP results are included in our news release. All related earnings materials are posted on our website at www.astecindustries.com including our presentation, which is under the investor relations and presentation tabs.

And now, I'll turn the call over to Barry.

Barry Ruffalo - Chief Executive Officer, Astec Industries, Inc.

Thank you, Steve. Good morning, everyone and thank you for joining us on this morning to discuss our first quarter earnings results. I want to start out by thanking the entire Astec team for their hard work and dedication during a busy quarter marked by a significant ramp up in demand in a tight labor market. While our results were challenged this quarter, our team continued to serve our customers and drive operational excellence across the organization through our OneASTEC business model for continuous improvement. As we continue to navigate through the pandemic, the health, safety and well-being of our employees, suppliers and customers continues to be our top priority.

During my remarks today, I will begin by discussing key highlights and drivers from the quarter and then provide an update on our operations. I will also discuss what we're seeing in terms of demand in our supply chain, before turning the call over to Becky for details on our financial results. We will highlight progress made on a strategic transformation and then open the call for Q&A.

Starting on slide four, here are today's key messages. First, we had a challenging start to the year, as we experienced commodity inflation in a tight labor market, which hampered our ability to leverage the restructuring actions taken as part of our transformation to simplify focus and grow the company. Positively, we are seeing improvement in the flow through our facilities and we continue to see significant demand for our products achieving record backlog with orders of 72% year-over-year. Becky will address this topic in more detail later in the call.

Second, we continue to position our business to meet strong and increasing customer demand. Customer sentiment remains positive through 2021 and many of our customers are seeing order books fill up into 2022. We are focused on providing our customers with industry leading technology solutions to deliver value and support our Rock to Road initiatives.

Third, we're well positioned for future growth with our streamlined organizational structure, strong balance sheet and ample liquidity. We continue to drive operational commercial excellence across the organization.

Fourth, during the first quarter, we continue to execute against our transformation strategy to simplify focus and grow the business. As I mentioned during our last earnings call, we will prioritize the growth pillar in 2021 with a focus on both organic and inorganic strategic growth opportunities. We have a number of organic growth initiatives underway and I'm excited to share more details with you later during our call.

Lastly, as we move forward into 2021, our increased focus on growth will allow us to build upon our strong foundation. We are transforming our business with a focus on operational excellence and profitable growth to drive long-term stakeholder value creation. It's an exciting time here at Astec and we continue to have a long runway ahead of us.

Turning to slide five, this is our business segment breakdown. Our revenue mix during the quarter was 29% Materials Solutions and 71% Infrastructure Solutions. Under this structure, we serve the Rock to Road value chain.

Our OneASTEC business models on slide six. Our focus on operational excellence has enabled all of our factories to operate throughout the pandemic with little disruption and we are flexing our operations to meet the current spike in demand. Further, we are leveraging our global capacity to reduce lead times and manage costs while optimizing revenue within our footprint.

Lastly, we have not experienced any significant supply chain disruptions to date, however we're not immune from supply chain disruptions caused by the recent surge in oil [ph] demand. That being said, we are constantly maintaining ongoing discussions with our suppliers to identify and mitigate these risks. We have also expanded the depth of our supply chain with multiple supply sources in anticipation of a potential tightness going forward.

Turning to slide seven, I will highlight some industry dynamics that we are seeing and what we are hearing from our customers. We are seeing a spike in demand across our businesses driven by favorable industry dynamics and pent-up demand from the pandemic. We believe we are in the early innings of an up-cycle in North America, as we see strong residential real estate demand, typically followed by games and non-residential construction. Optimism for increased US infrastructure spending is prevalent as there is bipartisan support for an Infrastructure Bill in 2021. If approved, this would provide a tailwind to our business for years to come.

During the first quarter, we saw labor shortages and inflation. We expect these headwinds to continue through 2021. On the labor front, we are starting to see improvement from early 2021 and are taking actions to improve the flow of products through our facilities. To mitigate the impact of steel inflation, we're utilizing strategies and include forward contracts and advanced steel purchases to ensure supply minimize the impact of price volatility. As the leader in many of our markets, we're taking pricing actions as needed.

Now moving on to slide eight, where we highlight some of our ESG initiatives. We are working to elevate our initiatives and drive them across the organization. We have a long history of conducting businesses ethically and responsibly with a focus on sustainable products to drive energy efficiency and conserve resources. We have an internal focus on reducing the carbon footprint of our products and facilities.

I recently signed the CEO Action for Diversity & Inclusion pledge, which evidences our commitment to advance diversity and inclusion within the workplace. Further, we empower our employees to support communities where we operate and live. I am proud that our team is willing to give back. We continue to gain traction on our ESG initiatives throughout the organization and our team is excited and engaged for this company wide focus. We look forward to updating you on our progress.

In summary, our first quarter results were challenged by inflation and tight labor markets during a period of strong customer demand. While some of these factors will continue to the second quarter, we have taken actions to help mitigate these issues on a full-year basis. As I mentioned previously, demand for our products remains resilient, as demonstrated by our record backlog and positive customer sentiment. Also, of note, we believe these factors will balance some of the seasonality we typically evidence in the third and fourth quarters.

We are adapting to this new environment and continuing to serve our customers while also executing our strategy and driving commercial and operational excellence across the organization. The effort put in by the team over the last 20 months to build a strong foundation throughout our company will pay dividends to our customers, employees and shareholders over the long run. While we are still in the early innings of our transformation, we are pleased that we drove change at a good pace in an effort to place ourselves in the best possible position to leverage what we earned from the market.

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

<u>Becky Weyenberg - Chief Financial Officer, Astec Industries, Inc.</u>

Thank you, Barry and good morning, everyone. I'm pleased to join you on today's call. Starting on slide 10. First quarter revenues decreased 1.5% to $284 million compared to the prior year quarter. Equipment sales decreased slightly while part sales decreased 2% compared to the prior year period. Excluding used equipment sales, our first quarter sales are slightly up compared to the prior year quarter.

Our backlog increased an impressive 72% to nearly $421 million at quarter end, driven by higher materials and infrastructure solutions orders, which were up 91% and 61%, respectively. Higher orders were driven by pent up customer demand after COVID-19 uncertainty in 2020. The backlog growth is also driven by our strong commercial excellence initiatives, including leveraging our

OneASTEC organic cross selling efforts. The sales teams continue to build momentum by demonstrating the Rock to Road value that we bring to customers.

First quarter adjusted EBITDA decreased 24% to $18 million, compared to $23.7 million in the prior year period, and adjusted EBITDA margin fell 190 basis points to 6.3% compared to the prior year period. The margin decline was driven by unfavorable sales mix primarily due to softness in Material Solutions sales, as a result of our strategic footprint rationalization and in infrastructure solutions by the decision to competitively price in order to penetrate targeted markets. Establishing a more global supply chain will offset this margin pressure in the future.

Adjusted SG&A expenses increased 4% on a dollar basis, primarily due to increased costs for centralization and infrastructure efforts associated with our transformation initiatives. $3.6 million higher software licensing costs including a $1.5 million out of period expense recorded during the first quarter of 2021 incurred in the fourth quarter of 2020, $2.2 million of incremental expenses for acquired businesses, and 800,000 of higher amortization costs primarily related to accelerated amortization on certain of our intangible assets. These increases were partially offset by decreases associated with $4.5 million of lower tradeshow and promotional expenses, $4 million of reduced expenses for closed locations, and $1.9 million of lower travel expenses due to continued travel restrictions. Our Q1 results include $4.5 million of in period costs that will not repeat in 2021.

Adjusted earnings per share decreased 58% in the quarter to $0.41 compared to $0.97 in the first quarter of 2020. Of note, first quarter 2020 adjusted earnings per share included a $0.42 benefit from the Cares Act. Excluding this benefit, first quarter 2021 earnings per share declined approximately 25% year-over-year. Our adjusted net effective tax rate for the quarter was 9.7%, driven by stock compensation tax deductions. Our expectations for the full year tax rate in 2021 are in the 16% to 17% range.

Turning to slide 11, we highlight the key drivers of our year-over-year adjusted EBITDA margin contraction of 190 basis points. In Q1, we realize benefits from the Mequon facility closure in the second half of 2020. However, this was offset by sales mix and manufacturing variances. Regarding the product mix, we realized more international sales than normal where our emergence on some products are lower than what we realized domestically. As mentioned earlier, efforts to build our global supply chain will improve the international margins as we grow this part of the business.

Further during the quarter, we saw negative margin impact for manufacturing variances mainly due to the same product moves. The receiving locations continued to ramp up with a significant influx of new labor and showed month-over-month improvement during the quarter. The inefficiencies that come from training new employees improving our processes on these new product lines will taper off as the year progresses. As previously mentioned, higher corporate costs were driven by investments related to automation, as well as the integration of the three acquisitions we completed during 2020.

Moving on to slide 12, our infrastructure solutions business revenue decreased slightly to $201.5 million in the quarter, driven primarily by lower domestic sales, due to a strategic reduction in used equipment during 2020. This was partially offset by strong international sales which grew 22% compared to the prior year period. Gross profit decreased 7% to $48.5 million and gross margin decreased 170 basis points to 24.1% driven by commodity inflation and the larger than normal international sales levels. We continue to support our customers during this time as we are seeing strong and increasing demand for highway and road building construction products across the country.

On slide 13, our Material Solutions business revenues decreased 3.8% to $82.9 million compared to the same period a year ago, driven primarily by the transmission of our Mequon product lines to other Astec sites. As previously mentioned, manufacturing efficiencies are improving as the workforce gains experience with the new products. Gross Profit declined 4.8% to $20 million, while gross margin decreased by 20 basis points to 24%, driven by softer volumes as well as under absorption related to the closure of the Mequon facility.

Despite the lower year-over-year results in Material Solutions, we saw strong backlogs which increased nearly 91% compared to the prior year period, driven by increased dealer restocking and strong market activity. As mentioned in previous calls, our dealers reduced their inventory throughout the pandemic to protect their balance sheets, just as many companies did. They are now in the process of rebuilding them as they see the strong market demand.

Turning to slide 14, we continue to maintain a strong balance sheet with minimal debt and net cash position of over $164 million. Given the current environment, we remain focused on strong liquidity and cash preservation to withstand sustained periods of market uncertainty. Overall, we have available liquidity of $319 million, including nearly $165 million of cash on hand, with only $1.7 million in total debt as of March 31, 2021.

We are not leveraged at all today and we know that in the future there will be times where we will be leveraged over this range but on a long-term basis, we will strive to operate routine 1.5 to 2.5 times debt-to-EBITDA. As Barry noted, we remain focused on maintaining a strong and flexible balance sheet with ample liquidity, and believe that this will enable us to withstand a variety of economic situations if needed.

Now on slide 15, just a reminder on our capital deployment framework, which is consistent with what we have previously shared. Our capital allocation priorities remain unchanged in the current environment. When we consider the various avenues of capital deployment, we do so in the context of our long-term strategic objectives and related revenue, earnings and cash flows in order to maximize shareholder value. Importantly, we remain committed to funding the dividend. We have not repurchased any shares since 2018 and do not expect to do so in the near term to preserve our financial flexibility.

On slide 16, we summarize our strategic and disciplined approach to M&A, which helps to support our growth pillar. We're only considering strategic acquisitions that align with our growth strategy and meet our internal financial criteria. Our strategy for M&A is to fill gaps that we see within our customer supply chain, as we look to grow regionally and attractive markets. We also seek to maintain the number one or two positions in the product lines that we have. We believe M&A is a mechanism that will allow us to accelerate our investment in technology and innovation.

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

Barry Ruffalo - Chief Executive Officer, Astec Industries, Inc.

Thanks, Becky. Now moving on to slide 17, I'll provide a quick overview of the three pillars of our strategy for profitable growth; simplify, focus and grow. First, simplify; during the first quarter, our organization benefited from actions that we had taken to consolidate and rationalize our footprint and product portfolio during 2019 and 2020. As a result of these actions, we were able to leverage our global footprint and flex operations to help meet increased customer demand. Second, focus; we continue to strengthen our customer centric approach driving commercial excellence streamlining processes and instilling a performance-based culture. Finally, grow; we remain well-positioned to capital on global growth opportunities in 2021 and this pillar remains the key focus area for us this year.

We are reinvigorated innovation, leveraging technology to unlock internal synergies, while also enhancing the customer experience, exploring global growth opportunities, and carefully allocating capital to maximize shareholder value. Although first quarter had its challenges, we continue to simplify the business, focus on opportunities and position the company for growth. I am confident our team will be able to continue to execute on our strategy throughout economic cycles.

Continuing with our growth opportunities on slide 18, I would like to highlight some key organic growth opportunities we're seeing across our businesses. Our long-term year-over-year organic revenue growth target is 5%, which we expect to be driven by these opportunities highlighted on this slide. What I like about these areas of opportunity is that they're all intertwined with each other. As we execute in one of these areas, it will multiply the impact that we get from another and overall. This is really the power of the OneASTEC business model.

First, we see organic growth opportunities in our international business and for our first quarter international results demonstrate we are gaining traction on this front. Secondly, we see opportunities to drive growth in our parts and services businesses. We remain focused on new product development and continue to see expansion with our dealer network. Another example of an organic growth opportunity is a cross selling of concrete and asphalt plants where over 30% of our customers own and operate both types.

But we have mentioned this opportunity in the past; we're now starting to see our plan turn into reality as cross selling is driving growth. Lastly, we are focused on enhancing relationships with our strategic accounts. As I mentioned in my earlier remarks, we've been focused on winning competitive partnerships and accounts, particularly in international markets. We are gaining traction with these new customers and expect them to drive growth in the future.

Slide 19 outlines some of our major milestones were executing against on our transformational journey and the progress we've made to date. During the first quarter, we made progress on our simplified pillar, as we continue to optimize our footprint by relocating products from our Mequon locations to other Astec sites. We expect to further drive simplification and consolidation of our facilities through the relocation of our Tacoma products to other Astec sites in late 2021.

Under focus, we are focused on driving operational excellence across organization through our OneASTEC business model. We continue to see progress in our operational excellence initiatives across the organization. For example, value stream mapping was used by one of our sites to optimize product flow and reduce cycle times by 25%.

Under grow, as I mentioned previously, we have a number of organic growth opportunities across our businesses. We remain committed to providing our customers with industry-leading technology solutions that provide value and support our Rock to Road initiatives. We are confident our innovation and technology, particularly Telematics, will support future organic growth opportunities across the businesses.

During the quarter, we hired a Senior Vice President of Corporate Development and Strategy. This role will help drive the growth pillar over transformation strategy. The cost savings from the actions taken are being reinvested in our businesses to drive profitable growth and maximize shareholder value.

I'll conclude on slide 20 with our key investment highlights. The first quarter of 2021 was marked by a ramp up in demand accompanied by commodity inflation and tight labor market. We continue to position our businesses to adjust to these evolving market dynamics while executing our strategy. I am proud of the work our team accomplished, as we continue to strengthen organization, position ourselves for growth, but we can and will do better in the future.

We remain well positioned in the market due to the superior customer service leadership positions with a niche attractive markets and a culture of continuous improvement. We remain committed to our 2023 targets of 10% to 12% EBITDA margin and a greater than 14% return on invested capital, as highlighted in our December 2020 Investor Day. I am optimistic and excited about the future for Astec and confident in our ability to continue to build upon our strong foundation.

With that, operator, we're now ready to open the call for any questions.

Operator

First question comes from the line of Mig Dobre with Robert W. Baird. Please proceed with your question.

Q: Yes, thank you. Good morning, everyone.

Barry Ruffalo - Chief Executive Officer, Astec Industries, Inc.

Good morning.

Q: A lot to talk about today but I guess where I would like to start is maybe with the bridge that you provided on slide 11. Maybe we can talk a little bit about some of the elements that are on this bridge. I'm curious to get a little more perspective on the 127 basis points of erosion from sales mix in international, that's about $3.6 million on my math. So, I mean, clearly, this is a pretty material figure for a quarter. Can you give us a sense for all that transpired here? And maybe more importantly, based on what's in the backlog right now, what should we expect in Q2 and beyond in terms of similar type headwind?

Barry Ruffalo - Chief Executive Officer, Astec Industries, Inc.

Hey, Mig. Good morning. Thanks for the question. This is Barry. I'll take this one. So on slide 11, as you can see, the good news there is that we are seeing some favorable impact relative to the efforts that we put in across 2020 with the manufacturing efficiencies and headcount-related type of savings, relative to -- and we expect to see that continue to grow as we go through 2021. Relative to the international sales, as we looked at the opportunities, when we think about asphalt plant type sales, one of the biggest sellers we have actually has references in the marketplace.

As much as we are a leader in this space, there are pockets, certainly even in the United States and around the world where we don't necessarily have a deep penetration. In the first quarter of 2021, what we realized was a significant increase in those types of targeted sales where we were trying to grow our presence. And as we look forward for the rest of the year, Mig, and we look through our backlog, which we've done a nice job of really pricing for inflation, and managing, we do not see this type of reoccurrence as we move forward throughout the course of the year.

So I look at this as kind of a bump unfortunately, one that we're not pleased with but just to be very transparent with you and the rest of our shareholders, that's what we realized in Q1. So you might say why would we have taken those types of sales? As I said, a lot of the asphalt plant type equipment sales are really based on customer reference. And the other part of it is that as we deepen our penetration in some of these gap markets, it also allows us to go back out and realize more part sales in the future, which I think is really an important part of our strategy moving forward.

As we've mentioned, before, we continue to find ways to grow our parts revenues. As you can imagine, our margins, obviously on parts revenues are quite healthy. So those are all the reasons that we've actually taken those actions, made those decisions, and unfortunately realized that result really in a mature way in one quarter.

Now, I'll also comment that these types of sales are not new for us. This obviously is a strategy where we've used in the past to go in and try and deepen our penetration in certain markets across all of our product lines. It just so happens in Q1 of 2021, it was materially more from a revenue perspective than what we would have normally realized on an ongoing basis. And again, I'll reiterate that we do not see that type of impact as we move forward through the course of 2021.

Q: Okay. I appreciate the context there. You talked about pricing in the backlog and you also highlighted a number of inflationary headwinds, talked about steel, you talked about labor. Can you maybe provide some context on how you're thinking about the price versus cost dynamic as the year progresses? I believe I heard Becky say that Q2 was going to be a bit of a challenge, but you're expecting to be neutral on a full year, that would imply to me that the back half, you'd have to be better than neutral, you'd have to be positive to make up for Q2. So if you can maybe like parse out these elements and essentially help us get a better sense for what our expectations should be for Q2, since you're saying this 127 basis points of headwind goes away but obviously, we have to deal with potentially other headwinds near term.

Barry Ruffalo - Chief Executive Officer, Astec Industries, Inc.

Thanks, Mig. I appreciate your perspective on that. I can tell you that, as we've alluded to, in the past, the company and the group and the teams have done a really nice job of staying abreast of what's going on with inflationary type items, specifically steel. And so as we've moved really early, prior to 2021, and we've been staying active on this, I feel good that the organization has done a nice job of taking pricing actions in the past as much of this as we can on to our customers. Today that's actually gone quite well for us and we haven't seen a lot of cancellations or pushback relative to that.

I think our customers are wise enough to understand what's going on, in general, economic aspect of inflation. And obviously, they see some strong demand, they've had record years and so we haven't had too much of a problem passing that on. We've even gone as far, Mig, on pricing, specifically in the material solution side, to actually look at our backlog and determine which one of those orders are retail orders and which one of those are stocking order for dealer. And actually, we took the price up for every backlog that is a stock order for dealer. So, we're not even really per se protecting the backlog, we're trying to find ways to be proactive in passing that along as well.

So, as we move forward across the year, I think the only exposure that we typically would see is really in Q2, although our analysis shows that while there is some exposure that it's not significantly material, so we generally feel good about that. And certainly, we feel better about Q3 and Q4 from a pricing perspective, Mig. So, I hope that answers your questions and gives you some more color around your interest.

Q: So then, if I'm looking at the gross margin that you put up in Q1, based on your comments, is it fair for me to infer that gross margin improves in subsequent quarters relative to Q1? Is there some sort of seasonality here that we need to be aware of? How would you frame that?

Barry Ruffalo - Chief Executive Officer, Astec Industries, Inc.

Great question, Mig. As we look forward, the two things that really impacted our gross margin in Q1, unfortunately, was the targeted market revenue that we've already talked about. In addition, the other gross margin impact that's really worth speaking to, as you know, Mig, we made a decision in 2020 to take a restructuring action to close down our Mequon, Wisconsin facility, and move that production from that location into other Astec sites. That was absolutely still the right thing to do.

As we made that action, what we ran into, unfortunately, was -- as we move the product, the labor market in the receiving locations was much tighter than what we would have anticipated. And so therefore, we had a hard time trying to find people to come in and go to work. And obviously there's inherent type training inefficiencies and those types of things, which you can imagine, to go with that type of a move as well.

So as stated in the opening part of the call, Mig, we've seen improvement from January to February, to March and into April in regards to our performance and our improvement in absorption in our sites, receiving sites, so we feel like we're on the right track. We'll work through that as we go through Q2, with the intent of as we get into Q3 and Q4 that we'll really be able to leverage that volume more effectively. But again, we feel better about Q2 than we did for Q1 results. And so I think that's all heading in the right direction, Mig.

Q: All right. I do have more questions, but I'll be back in the queue and maybe come back on follow ups. Thank you.

Barry Ruffalo - Chief Executive Officer, Astec Industries, Inc.

Thanks, Mig.

Operator

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

Q: Hi. Good morning, everybody. Thank you, guys, for taking the question.

Barry Ruffalo - Chief Executive Officer, Astec Industries, Inc.

Good morning.

Q: You mentioned backlogs projecting out to 2020. Is there any color you guys can provide on what sort of projects or how would you characterize maybe those line to businesses that more highway focused, residential focused, just curious?

Barry Ruffalo - Chief Executive Officer, Astec Industries, Inc.

Yeah, so I think the real question is, what's driving the backlog growth? And I tell you, as we've talked about before, Stanley, our customers primarily had a record year in 2019. Even with a pandemic, they had another record year in 2021. And so they've had some good years. And as they look forward -- from my conversations with all of them, as they look forward into 2021 into 2022, their order books are basically full for this current year, and they are starting to fill into 2022. Keep in mind, Stanley, this is obviously without an Infrastructure Bill.

So we believe that we're in a very healthy market at this point in time, and that'll give us an opportunity to really leverage that volume, as you move through the rest of the year into 2022. One other element that I think shouldn't be missed, Stanley, is that when you think about a dealer and our company and other companies, as we went through the pandemic, the uncertainty that comes with that pandemic really supports actions from people to protect their balance sheets. And so what we saw in 2020, was that a lot of our dealers, if not all of our dealers, took action to try and reduce their inventories to protect their balance sheets. And so, as the sentiment and the activity in the markets, and your orders increase that's what really drove the restocking of their inventories, really drove a large part of our backlog as we went at the end of 2020 and continue to realize in 2021.

And what's interesting about that is, as those orders were placed in more of a stocking order for their inventory, we've already seen many of them convert into retail orders before they're even shipped. So those are all things that support to me a strong backlog and I guess one other comment even on the asphalt plant side of the business, we're already starting to see customers want to talk about orders that go into 2022. So, I really think on all fronts of our business, we see a lot of market activity, a lot of workflow which is obviously supporting our increase in backlogs.

Q: And how are dealer inventory levels now? Would you say that they're still kind of lean at this part of the construction season, kind of given where we were last year or you will this big rush in orders that we've seen here in Q4 and then in Q1, kind of get them back up to a more normal level?

<u>Barry Ruffalo - Chief Executive Officer, Astec Industries, Inc.</u>

A great question, I will tell you that there's still lean, and I just mentioned as those stocking orders really convert to retail before they even received the product that's going to continue to put pressure on them to reorder in order to try and get their fleets up to the level that they expect to get to in order to support the market activity, which obviously is a good driver for us.

Q: And then lastly, just kind of going back to that international business, in the release you had also mentioned some higher logistics costs, was it really all logistics, were these products bid at a lower price, at a lower margin as a way to get into the door. Just curious if you could kind of parse out the differences between those two.

<u>Barry Ruffalo - Chief Executive Officer, Astec Industries, Inc.</u>

So, Stanley, I'll just reiterate, we are our pricing leader. Certainly, we have price leading position in North America. And quite honestly, even when you go outside of the United States, we're still a price leader. We sell all of our products at a premium. As we identify the target markets, we will take some pricing action, because as a premium in most of these markets, if not all of them, that's -- in order to win that deal, we have to give more of a market price perspective, in regards to how we see those types of transactions flow through.

When we do that, Stanley, you can imagine, on these types of products, and speaking specifically to asphalt plant type products, to build that product in the United States and then ship it someplace in the world, the logistics costs become quite high, because there's a lot of space that goes with that type of a shipment. So those things are all the elements that really contribute to that larger than normal block of orders and the margin compression that really came with it.

We are, as I mentioned, being in these markets is important and, Stanley, as we continue to build out our supply chain globally, which allows us to be closer to these customers, which allows us to have reduced lead times for these customers, these investments that we've made now will pay dividends in the future, both in regards to the references that we get when it comes to selling more of those types of products in those markets, now that we're there, and also the reoccurring revenue that comes from the parts revenues and the high margins that also come with those types of sales. So as much as we are disappointed with the impact that we saw in Q1, we do like the fact that it positions us well for future earnings opportunity.

Q: Perfect, guys, thank you very much. Appreciate it. Best of luck.

Barry Ruffalo - Chief Executive Officer, Astec Industries, Inc.

Thank you.

Operator

Thank you. Our next question comes from one of Steve Ferazani with Sidoti. Please proceed with your question.

Q: Hi, good morning, everyone.

Barry Ruffalo - Chief Executive Officer, Astec Industries, Inc.

Hi, Steve.

Q: Becky, I think you did a pretty good job of walking through the impact to SG&A. You did such a great job with cost containment last year, really over the last year and a half, we did see the uptick this quarter. Just trying to get a sense of how much of that is one-time and sort of how we should think about no run rates with SG&A moving forward? Can you continue the trend of sort of lower, obviously, with revenue higher, you'll have higher sales costs, but just sort of, can you give us a basic trend on SG&A?

Barry Ruffalo - Chief Executive Officer, Astec Industries, Inc.

Steve, this is Barry. I'm going to take a shot at that first, and I'll turn it over to Becky, to clean it up. So, when we think about SG&A, here's how we look at it. If you build off of the run rate that we had in 2020 in SG&A dollars, there are adders to that as we move into 2021. As we've said all along, there are parts of our business, Steve, that we've under invested in for many years.

And we feel it's important to make those investments in order to continue to build our foundation, in order to be able to grow off of that. So, the areas that we've seen and you've obviously now seen in our Q1 results that have been adders is, as we move into 2021, we had to recharge really our AIP and commissions, your Annual Incentive Plan and commissions for 2021, as we expect to have higher sales and better performance than we did in 2020. We do see some of the travel entertainment costs starting to come back.

Now we're not factoring in all of those costs, we're factoring in a portion of those realizing that we're probably not going to certainly start the year traveling as much as we maybe would have liked to. And certainly, we don't necessarily see all of it coming back, as we go through 2021. We also have made an investment in our new product development, as we become closer to our customers, we put in product management type capability, where we can actually understand the voice of the customer and develop products that are like the Shuttle Buggy 3000.

We've launched that product, we listened to our customers, and our backlog is very strong in that product, the lead times are very long in that product, longer than we'd like. But it just is a testament to when you listen to customers, and you develop products in appropriate ways, we can actually generate a lot of revenue margin from those types of investments. So, New Product Development or NPD, is another one that we've that we've made an investment in and is probably more than what we have in 2020 as we move into 2021.

And then the last one I'll maybe comment on is we are doing some things around OneASTEC branding initiatives. And so, there's some expense there that will offset some of the reduction that we would see from a kind of expo type of a spend. So, I want to mention that as well. So those are the areas that really take us from that run rate of 2020 to a higher spend in SG&A to 2021, obviously offset by what Becky alluded to in the earnings script, really around the $4.5 million one-time impact. So, as you kind of net that all out, I think that gives you a little bit of a sense of what to expect as we go through 2021 with the understanding that the whole team is working hard to reduce those costs as much as we can on a forward-looking basis.

Anything you want to add there, Becky.

Becky Weyenberg - Chief Financial Officer, Astec Industries, Inc.

I think you got.

Q: No that's great. That's very helpful. Just another question I want to add on was in terms of your backlog, and obviously, everyone's having the labor and supply chain issues. But what's your sense of the stickiness of backlog, if some of these get stretched out and delayed? Have you had to go back to customers in terms of some of these projects -- some of these equipment orders getting delayed and what's the reaction be?

Barry Ruffalo - Chief Executive Officer, Astec Industries, Inc.

Great question, Steve. And I'd tell you that what's really great is that our backlog is very sticky. And we haven't seen much of any cancellation, even with a long lead times. I think where we would probably see the impact of the long lead time is really upon the coating process. And that's whether or not the customer is willing to wait for our products that obviously have a lot of value for them and they realize that, not just even on the initial sale, but on the service and support that we are an industry leader in. So I think that once it gets into our backlog, we found and we see now currently that it's a really good order and so that's how I'd maybe answer your questions. Is that helpful?

Q: That is helpful. Thanks. Appreciate your time this morning. Barry and Becky, thanks.

Barry Ruffalo - Chief Executive Officer, Astec Industries, Inc.

Thanks, Steve.

Operator

Thank you. Our next question is a follow up from Mig Dobre with Robert W. Baird. Please proceed with your question.

Q: Thank you for taking the follow up. I'm a little bit confused, Becky, so maybe you can set me straight here. You're talking about an aggregate of $4.1 million of costs that were incurred in Q1 that are sort of Q1 specific. That was on the SG&A line? Am I correct in my understanding there?

Becky Weyenberg - Chief Financial Officer, Astec Industries, Inc.

Yes, that's correct. That was SG&A.

Q: Okay. So, ex that, we're talking about 54 million of SG&A, you've done 56 and change in Q1 of 2020. Barry kind of highlighted some of the some of the things that will be add-ons in terms of all the investments. But you're obviously starting the year excluding this one-time item, would SG&A lower year-over-year, yet I also know that in Q2 through Q4 of 2020, there were some pretty extraordinary things happening with COVID, and maybe some sort of temporary savings and whatnot. So maybe kind of going back to the prior question that was asked here and trying to understand the potential outcomes here for SG&A for the full year, as we're looking at that figure and we're using the full year number of 2020, call it $189 million, what sort of an appropriate inflation on top of that -- can you help us understand, is it a factor of 5 million, is it 10 million? Do we go back to where we were in 2019? How do you guys think about it?

Barry Ruffalo - Chief Executive Officer, Astec Industries, Inc.

I think the major elements there, Mig, are the ones that I've already run through, without giving you the sizes of those types of investments. Now, I would tell you that when you look at our projected run rate on dollars spent in SG&A for the rest of the year, take out that one-time cost in Q1 and you're probably pretty close. Now, there's going to be some puts and takes there as we go through the year, as you can imagine. As I mentioned earlier as well, we're going to continue to drive that as low as we can realizing that we still do need to make investments in this company where we've been under-invested. So, I think that that actually gets you pretty close to a dollar value that we would expect. And certainly, we'll continue to keep you updated on that as we move through the course of the year.

Q: Okay. So, Barry, to be clear, what you're saying here is that excluding this $4 million item in Q1, the annual run rate would essentially be 216 million, so you are of annualizing above where you were in 2019, given all these incremental costs and investments. So I guess my question is this, do you have comfort that, from a gross margin standpoint, you can generate enough lift in order to be able to generate margin expansion for the full year, given what you sort of outline here? That's my final question. Thank you.

Barry Ruffalo - Chief Executive Officer, Astec Industries, Inc.

That's a great question, Mig, and I think generally your analysis on SG&A is not far off. Without committing, we haven't given guidance, but I think generally, you're very close in regards to SG&A spend. And relative to the gross margin, even in a challenged Q1, we generated just above 24 -- let's call it 24% gross margin. With all the actions that we've taken in 2020 and as I talked about the two major impacts in the Q1 of 2021, relative to the larger than normal targeted sales, margin compression, and then the margin compression that we realized with the restructuring activities and that actually improving, certainly even up to year-to-date, we would expect that we'll have margin growth, as it moved through the rest of 2021.

And I just want to take a second, Mig, if you don't mind, to call out the employees and teammates that we have in Astec that have worked their tails off really through the first quarter of 2021, in order to get product to our customers as effectively and efficiently as possible. So as much as we're disappointed with the margin compression has come with that, I couldn't be more pleased with our organization in regards to the efforts that they put forth to get us to the point that we did, it didn't certainly go without a lot of hard work and certainly some overtime to support that as well. So, I just want to take the chance to thank all the Astec employees that could be listening to the call.

Operator

Thank you. Ladies and gentlemen, I don't now like to turn it back to Steve Anderson for closing comments.

Steve Anderson - Senior Vice President, Administration and Investor Relations, Astec Industries, Inc.

Thank you, Jen. We appreciate your participation in this conference call and 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 19, 2021. The transcript will be available under the investor relations section of the Astec Industries' website within the next five business days. Again, all that information is contained in the news release sent out this morning. This concludes our call. So thank you and, as always, delighted to have follow-up calls for additional questions, as we progress throughout the quarter. Thanks very much.

Operator

Thank you. Ladies and gentlemen, this concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.