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Transcript of
Myers Industries Inc.
First Quarter 2016 Earnings Call
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Participants

Monica Vinay - VP, Investor Relations & Treasurer
Dave Banyard - President and Chief Executive Officer
Kevin Brackman – VP, Corporate Controller and Interim Chief Financial Officer

Analysts

Gabe Hajde - Wells Fargo Securities
Adam Josephson - KeyBanc Capital Markets
Matthew Paige - Gabelli & Company

Presentation

Operator
Greetings and welcome to the Myers Industries, Inc. First Quarter 2016 Earnings Call. At this time all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. (Operator instructions.) As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Monica Vinay. Thank you. You may begin.

Monica Vinay - VP, Investor Relations & Treasurer
Thank you. Good morning. Welcome to Myers Industries First Quarter 2016 Earnings Call. I am Monica Vinay, the Vice President of Investor Relations and Treasurer at Myers Industries. Joining me today are Dave Banyard, President and Chief Executive Officer, and Kevin Brackman, Vice President, Corporate Controller and Interim Chief Financial Officer.

Earlier this morning, we issued a news release outlining the financial results for the first quarter of 2016. If you have not yet received a copy of the release, you can access it on our website at www.MyersIndustries.com, under the Investor Relations tab. This call is also being webcast on our website and will be archived there along with a transcript of the call shortly after this event.

Before I turn the call over to management for remarks, I would like to remind you that we may make some forward-looking statements during the course of this call. These comments are made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. Such statements are based on management's current expectations and involve risks, uncertainties and other factors, which may cause results to differ materially from those expressed or implied in these statements. Further information concerning these risks, uncertainties and other factors is set forth in the company's periodic SEC filings and may be found in the company's 10-K filing.

I am now pleased to turn the call over to Dave Banyard.

Dave Banyard - President and Chief Executive Officer
Thanks, Monica, and good morning, everyone. Thanks for joining us. I'm going to start on slide 3 with a summary of Q1 2016. In general, I would like to start by saying I am very pleased with our results in the first

quarter, mainly because we came in exactly where we thought we would. I think it's very important that you do what you say you're going to do and I'm very excited that we did that both on the top and the bottom line.

Going through the summary here. Our net sales were down 3.3%, about 2% of that was currency and organic we were down 1.3%. Again, this is in line with our expectations. Our gross margins were up nicely; 260 basis points to just under 32% due to a combination of lower input costs and operational improvements along with our some product line rationalization.

Our adjusted earnings per share were up 75% to $0.21 and our free cash flow—I'll pause here for a minute—it's a negative number but it was $4 million better than last year and just to remind everyone, we do have a bit of a first half, second half seasonality to this business, so generally speaking, we do have a negative cash flow in the first quarter and I will go into more detail on that in a later slide.

We did have several large one-time charges during the quarter that I'll go into more detail later on, but $8.5 million of that was non-cash impairment charges in our Brazil business and $2 million related to severance charges.

Next slide. I'll go into a little more detail on the financial summary. Starting at the top with our sales, down 1.3% on an organic basis. I want to highlight here that if you factor in the price reduction that we have from our resin - the businesses indexed to resin - we were up in volume by about 1.3%. So not a bad result.

On the gross profit line, up 260 basis points, a real nice operational improvement there. About half of that improvement was from our input cost, our resin cost. The other half was from operational improvement and product rationalization. I will also say that we were up about the same amount, 260 basis points on a sequential basis from Q4, and as I pointed out, we do have a seasonality so the revenue is up. So, real nice flow through on the increased revenue from Q4, which we're very pleased with.

Our adjusted SG&A was down a little bit, that's mainly corporate costs, resulting in an adjusted operating income of about 220 basis points. I want to highlight here that our first half operating margin of 7.7% is a pretty good number - 7.5% to 8%, is historically a pretty good number for us. So, we're very pleased with the 7.7% operating margin.

A number of details on here about the other components. That brings us down to our adjusted earnings per share from continued ops of $0.21.

Next slide. Going into a little more detail here on the balance sheet starting in the upper left corner of the slide. Balance sheet is in great shape. We did increase our net debt slightly but our net debt to EBITDA ratio is still at 2.9 times. On the cash flow side, on the lower left you can see that we do have a negative number in the cash from continuing ops, it does reflect a little bit of our seasonality as we come into a higher volume half of the year. I will also say here, though, that some of that decline in cash is due to some self-induced inefficiency that we're going to work on moving forward. So, a better result there year-over-year but something we still have some opportunity to work on.

The middle section here is CapEx, that's a big number and it's bigger than I think our run rate is. The vast majority of that capital spending is the result of projects that were already in process from last year through the fourth quarter. So it's a bigger number than I think we're going to have going forward and that's all I'll say about that for now.

Moving over to the right side here, working capital at about 9% of sales. I think that's a good reflection of where we are, operationally. I think it's a decent number if you compare it to other companies, but I think there's also opportunity here for us to improve on that moving forward. So that's a good base line but I think we're going to operate in the mode of improving that as we move forward.

Next slide. Now I'm going to spend a little time going through each of the segments results for the first quarter, starting on the left side with material handling. Sales were down 3%; on an organic basis they were flat. We had some nice wins in our industrial businesses, both gaining share with some nice project wins, as well as increasing our channel coverage. And I think if you look at the industrial markets out there overall, we outperformed in the first quarter.

Similarly, we had some nice share gains in our vehicle segment, particularly in the auto business. We won a nice large model launch at a major auto manufacturer. And that business has done quite well for us so far in the past few quarters.

In our food and beverage segment, excuse me, in our food and beverage markets, as you know a large component of that is the Ag business. The volume was actually up in the first quarter, I don't believe that says anything about the year other than it was some pent up demand from last year not being as strong towards the end of the year. But it's a nice sign that we did have a good steady pace of business through the first quarter.

Volume up, as we mentioned earlier, with the indexed pricing, some of our revenue was down. In Brazil, both the auto and the beverage markets were down significantly and that severely affected our business. I want to go into a little more detail here on the impairment charges. Towards the end of the quarter, we heard from one of our large customers that their orders were going to be spotty throughout the year and that there wouldn't be any orders for a significant portion of the year. That triggered us looking at our goodwill and resulted in the impairment.

Moving forward, as you may remember, we took some restructuring actions in the fourth quarter. We thought that would be enough. As we look forward we are looking at next steps to take here through the second quarter and we'll come back to you with more on that as we figure out what the best option for us is in Brazil.

On the margin side of the material handling business, the margins were up nicely as a result of both of the favorable input costs but also from some nice work that we have done last year with some restructuring but also factory efficiency throughout the organization, as well as some good work in product rationalization, picking the right products to sell at the right margins.

Moving over to the distribution business. Sales were down 4%. The market indicators there would say that the market was maybe flat, maybe slightly up in some cases. So, we feel that we're not doing as well there. A large part of that has to do with the sales force initiative that we're working on right now. Again, as I said last quarter, this is the right initiative to do. It's the right strategy but it's going to take a little bit of time and our business is going to hurt a little bit from it on the way.

We did lose a few days of selling as we were implementing this in the first quarter and we're hoping to continue to work through this for the rest of the year and to turn this particular business around. On the good side though, here on our Patch Rubber business we did see a nice large win in the retread business there. And on the margin side, if you break the business out a little bit in more detail, the distribution side through a lot of the product rationalization and improvements we've made, did have decent margins through the quarter but our Patch Rubber business had a very poor operational efficiency in the quarter in our factory and that resulted in the reduction in operating margin.

Next slide. I will finish here by talking about our 2016 outlook. The main message here is that our outlook hasn't changed. We're holding to what we said a couple of months ago. We're expecting our full year revenue to be flat to down low single digits. One thing I wanted to highlight in here is that the second quarter is a tougher comparison to the second quarter of 2015. We had a very strong quarter last year in Brazil in the second quarter and we also had a number of our Ag customers ask to have orders delivered in the second quarter that was a little more seasonally higher than what we would normally see. So we expect the second quarter to be down low to mid-single digits but we're still holding our year to what we said before.

In the middle section here, you see our revenue and profit initiatives. Those haven't changed since last we spoke. And then at the bottom here you see our capital allocation priorities, again none of which have changed since last quarter.

On the right side I want to talk a little bit about our market by market growth outlook.

In the consumer business, we're expecting that market to be slightly flat. And that's slightly worse than what we said last quarter and really what's happening there is we see that market's starting up a little later in the season than what we're used to and so we're thinking that that's going to be slightly worse than what we thought last time.

Our vehicle segment, we're going to hold where we said last time, up low single digits. In the food and beverage market, slightly worse, down mid-single digits and that's all due to the Brazil business. Our business here in North America is doing as we expected. The industrial business, we're expecting to be slightly better and that's mainly due to some of the share gains and channel expansions that we've done here in the first quarter. That market itself is fairly choppy with a number of the indicators going in a couple of different directions.

And finally in the auto aftermarket. We think that market is perhaps flat for the year but for our performance, we're expecting to be slightly down and that's again mainly due to our performance and initiating our new sales force initiative.

That's all I have from our prepared remarks and we'll be ready to take questions now.

Operator
(Operator instructions.) Our first question comes from the line of Chris Manuel with Wells Fargo Securities. Please proceed with your question.

Q: This is actually Gabe Hajde sitting in for Chris. A couple of questions for you. Dave, I think you talked about, of the 260 bps of margin improvement, about half of that was from favorable input cost versus selling price. I think that's about $2 million. Can you breakout how much of that might be sustainable or what's driving that? Is that just a disconnect or a lag effect from falling resin versus selling pricing? Maybe what product lines and/or division, I guess, that mostly falls in?

Dave Banyard - President and Chief Executive Officer
Sure. I'm not going to go into detail on which businesses this affects; I think we've stated in the past that our index is about 18% to 25% of our total spend. So, really, what we're seeing there, and I'll give you my view of the PE market and the PP market. I think the first quarter year-over-year was favorable. I think from a sequential standpoint it got a little worse but then that sort of balanced out here as we've moved on into the second quarter.

In terms of the PP market, I think that the prices are up slightly. That's not as much of a portion of our business. We have about 20% of our businesses in polypropylene and we expect that to be slightly worse going forward as we look at the market. There's some opportunity there for some more capacity to come online. But generally speaking the PE market we expect to be able to continue to have favorable pricing through the year. PP is a little more questionable.

Q: To summarize, I mean would you expect to have to give some of that back or you're expecting kind of a neutral price-cost relationship for the rest of the year, such as the other 130 basis points of margin improvement is sustainable?

Dave Banyard - President and Chief Executive Officer
I see where your question is. Yes, I think so. I think with the operational improvements we have made are permanent ones and I think we should be able to sustain those.

Q: All right. Can you update us in terms of a CFO search and maybe your thoughts there on timing?

Dave Banyard - President and Chief Executive Officer
Sure. I don't have any specific timing for you but the process is definitely on track to where we thought it would be. I will also say that we have got a great team here, particularly with Kevin and Monica that are holding the fort down. So it's going as we expected it to and we'll keep you updated as we move forward.

Q: Okay. That's helpful. And then, Dave, with respect to the working capital initiatives that you spoke of, I think 9% to revenue and maybe some selective opportunities. Do you know what components you're looking at and how maybe we can quantify it? Are we talking about maybe 50 or 100 basis points of opportunity over the next two years?

Dave Banyard - President and Chief Executive Officer
Yes. I'm not going to quantify it but I think all of the elements are areas that we're focused on and it depends on which P&L you're talking about. Some of the businesses still have some inventory opportunities and that's either driven because of their operational inefficiencies or because of just how they've operated regarding inventory in the past. I think there's also opportunity for us to put permanent fixes in place, if you will, on terms with our customers and with our suppliers and we're working on those.

I think we've got some one-time benefits that have shown up in the past and that's made our working capital a bit choppy. I'd like to see it be a little smoother so that you can see what the real run rate is and then improve off of that. It's easier to improve off of a steadier platform. So, that's what we're shooting for in this year and then that'll make it fairly obvious where the opportunities are to improve.

Q: Okay. And one last for us. In the distribution business, sounds like there's some sale initiatives going on. Do you know about how long that may take to come to fruition for you in terms of whether it's top line growth and/or margin improvement in that business?

Dave Banyard - President and Chief Executive Officer
Sure. Well, I think we're going to be able to capture some of each as we go because this is a full comprehensive initiative here. If it was one element of the commercial process, I would say, be able to give you a shorter time line and a more definitive expectation in terms of improvement. But there are a lot of different elements to what we're trying to change within the organization there. And so, it's going to take the better part of the year here and we'll see slight improvements as we go and implement each part but as you're making changes like this, as you turn the page on one change you face roadblocks in the other parts of the changes that you're going to make.

I mean, in order to make a sales force more efficient, there is not just one thing you have to do. There are a number of things that we need to do to support our team and feel much better. I did spend a couple of days in the first quarter out in the field with some of our sales team and I learned a ton from that. We have some great people out there. There are a lot of things we need to do to help them be better and more effective at their job. Some of them are easy, some of them aren't.

Operator
Thank you. Our next question comes from the line of Adam Josephson with KeyBanc Capital Markets. Please proceed with your question.

Q: Dave, just one clarification on the resin question that Gabe asked. Your EBIT was up $3 million, adjusted EBIT. How much of that was resin?

Dave Banyard - President and Chief Executive Officer
About half of the improvement was from resin.

Q: Okay. And then in terms of your full year sales outlook, I know you talked about consumer being a bit worse because of a later start. I was hoping you could elaborate on that. Food and beverage being worse because of Brazil. I know you have couple of businesses in Brazil so I just was hoping you could kind of talk about the state of your different businesses there, obviously, which precipitated the write down. And then you talked about your industrial outlook being better on account of share gains, but it sounds like you're saying the market as a whole has not improved over the past three months. Can you elaborate on all those issues, if you don't mind?

Dave Banyard - President and Chief Executive Officer
Sorry, Adam, tell me what the first market question you had was again?

Q: Sure. Consumer, you said it is starting a little later than what you're used to.

Dave Banyard - President and Chief Executive Officer
Sure. So a couple of things at play. I'll go through them in order here and start with the consumer. Couple of things at play here. I don't think we did ourselves any favors by launching our new products late. So, we've got, what I think is one of our better products out in the field now, but as you can imagine, any new product doesn't take off immediately. So there's a little bit of a lag there.

But also, we saw some choppiness within the first quarter, particularly at the big boxes in terms of their point of sale data and so it's just been a little bit slower. It's nothing that I'm terribly worried about. Year-over-year we're fine. It's just that it's a little slower than what we were expecting for the year. And that could be driven a little bit by the weather. It could be driven a little bit just by how the big boxes are planning their inventory right now but our point of sale data would indicate that we're kind of in a good place with them in terms of managing inventory.

So I think it's just end markets. I think if you look at maybe some of the turf companies out there that are selling lawnmowers and that kind of stuff, they're not seeing huge growth right away early in the year either. So we'll see how the second quarter plays out. It is a very short-term horizon that we have within that business. But so far it's steady but not up. It's just a change from what we had said a couple of months ago.

So in Brazil, the automotive markets down there are down significantly and that affects our business. The bigger portion of our business is in beverage and that's down significantly. Part of that is there's some M&A going on that's clouded the picture from last year, but it's also the market itself is, people are just not spending capital down there right now. Could that improve as the government stabilizes? Perhaps, but we are not expecting to have a great year in Brazil.

And so we're looking at the different steps we need to take to make sure that we're prepared for that and we're looking at a bunch of different options as to what we can do there and once we're ready to roll that out we'll let you know.

Q: Just a couple of clarifications. On the Brazil, the consumer, you're talking returnable bottles, specifically beer.

Dave Banyard - President and Chief Executive Officer
Correct.

Q: And so your customers are not replacing their flow to the extent they have historically?

Dave Banyard - President and Chief Executive Officer
That's correct. And what is clear is that they have told us they're not buying. What's unclear—and it seems as though the market is following that. The market indicators we see are that the market itself is down in a similar fashion, but at some point, they're going to run out of crates, they're going to have to order something. So it's unclear when and at what volume. We've reduced our expectations significantly based on the information we have today.

Q: Right. And before I get to the industrial piece, the beer production there in Brazil has fluctuated wildly. Year-to-date it was down, I think, 18% in March. It was up 10% in April. Do you have any sense as to what the underlying trends are because the production data has been just all over the map?

Dave Banyard - President and Chief Executive Officer
Yes, I think the underlying trends are there's a bias to saving cash and so we are considered a capital spend as part of what we're doing. So they're trying to just use what they have longer. Now there may also be a glut of inventory out there for various reasons, I don't know that for a fact but that could be a contributor. I think it's just a clamp down on spending, but I don't know that there is going to be some sort of rebound of pent up demand down the road. So it's just, they're using what they have for longer.

Q: And just a couple of others, Dave, just on industrial. You have a slightly better outlook not because of the broader market but because of your share gains and channel expansions. The broader data has been up and down. How would you characterize the US industrial market at this point?

Dave Banyard - President and Chief Executive Officer
Yes. Up and down is the best way to describe it. So, you look at things like industrial production, capacity utilization, those things are flat. You look at new orders and those are positive and that's good, I like to see that. Inventories are still high but coming down perhaps but then you look at other—I look at things like automation industry is a bellwether leading indicator in that. Their results in the first quarter weren't great.

So capital spending seems to be lower but then demand maybe is picking back up. Those are the mixed signals we're looking at, so we're cautious there. I think that there's opportunities for us and I'm excited about those and so we're going to focus on where we have opportunities to win and increase our channel coverage and that will hopefully be buoyed by a market that comes back. But I don't think there's anything solid that would tell you the market's going up.

And then, of course, last week we got pretty bad first quarter GDP numbers, not that I just look at that alone, but that's not a great number either.

Q: Right. And just one clarification on the consumer piece, Dave. So you mentioned that the big box retailers have not been ordering, I guess, up to their usual standard. The weather seemed pretty great in the first quarter, unusually mild. Is there any reason why the weather would have been problematic from the perspective of your consumer business or the broader market?

Dave Banyard - President and Chief Executive Officer
Yes. It's tough to say, and I'm always hesitant to talk about weather because, (A) it's something we can't control, and (B) you can always find an argument for weather on one side or the other. But I think that the good side of the weather being warmer, is that the housing market had some continued building going on and we would think that housing starts is a good indicator for us. But for whatever reason—and we have this, we see data from our end retail outlets. We see what their point of sale data is and it's very tepid. I don't have an answer for you on that, Adam, but that's—

Q: Sure I appreciate it, Dave. And then just one last one about the results compared to your expectations. Sales obviously in line, margins were higher. Was there something that particularly surprised you to the upside in the quarter, be it either your productivity or the resin benefits that you experienced?

Dave Banyard - President and Chief Executive Officer
Well, to be fair, I think that our expectations—that the results were right in line with our internal expectations. So I didn't see any surprises. No. I think we came in right where we thought we would be.

Operator
Thank you. (Operator instructions.) Our next question comes from the line of Matthew Paige with Gabelli & Company. Please proceed with your question.

Q: I was wondering if you could provide a little color on the new sales team initiative and how that impacted sales in the distribution segment at least during the quarter?

Dave Banyard - President and Chief Executive Officer
Sure. Thanks. I think the couple of key things on that is as you're rolling something like this out, there's training required, and that's going to take you away from selling for a couple of days. So you start right there, we're in the hole, because you can't get those days back. But I'll also say that we've had some turnover and some of that's a good thing and some of that's going to continue to happen when you have a change like this and that's also affecting our selling days out there. So it's primarily selling days and when you think about changing the mindset and implementing new tools for a team, there's training involved in that and that slows you down and keeps you from doing the key thing that we want our sales people doing, which is being out there and selling.

And when I talk about training, I'm talking about targeting new types of customers, selling new kinds of products and then training in more efficient ways of managing time. They have a short-term negative impact because again, to train someone you have to take them away from what they're doing. But then long-term it makes them more efficient and the idea there is that we're going to have more time selling, which is what we want.

Q: Got it. And then you saw solid margin gains on the material handing side. What levers do you have left to pull on the distribution side of the business to keep improving profitability there?

Dave Banyard - President and Chief Executive Officer
Good product mix. A good strategy focuses on what products are not only serving your customer best but also serving your internal piece best. So, a lot of what you see, and again, I think the top level distribution margin decline in the first quarter didn't reflect what I'd say are solid gains that we're making in that arena with the distribution portion of the business. We just had a bad inefficient quarter at our patch rubber business and that really dragged margins down.

So, all in all, if you continue to improve what you're offering to the customer in terms of products but also services and how you're selling to them, you're going to see margin lift there. So that's our goal with that business, it's part of this sales force initiative—a big part of it is targeting the right customers and targeting the right products to be selling to those customers.

I have one more piece. Some of that is what we're not going to sell. One of the things I'll say is, a lot of businesses like this have been doing some of the same things for a long time and it's hard to change those habits. I understand that, but sometimes we're not selling the right products with enough emphasis and some products we probably shouldn't be selling. So, we're going through all that right now.

Operator
Thank you. Ms. Vinay, there are no further questions at this time. I would like to turn the floor back to you for any final remarks.

Monica Vinay - VP, Investor Relations & Treasurer
Thank you. We thank all of you for your interest in Myers Industries and your time and participation today. As a reminder, a transcript of this call will be available on our website within approximately 24 hours. A replay will immediately be available via webcast or call. Details can be found on our website at www.myersindustries.com. Thanks and have a great day.