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PRESENTATION

Operator

Good morning, and welcome to Forterra's Fourth Quarter and Full Year 2019 Earnings Conference Call. Today's call is hosted by Karl Watson, Jr., the company's Chief Executive Officer; and Charlie Brown, the company's Chief Financial Officer. With that, I will turn the call over to Mr. Brown.

Charles R. Brown - *Forterra, Inc. - Executive VP & CFO*

Thank you, and good morning to everyone. Welcome to Forterra's Fourth Quarter and Full Year 2019 Earnings Conference Call. I'd like to point out that Forterra intends to take advantage of the safe harbor provision of the Private Security Litigation Reform Act of 1995, as noted in the earnings release we filed last night. In addition, we have posted an investor presentation on our website under the Investor tab, which contains volume and pricing information for each of our segments.

Please remember that our comments today may include forward-looking statements, which are subject to risks and uncertainties, and actual results may differ materially from those indicated or implied by such statements. Some of these risks are described in detail in the company's SEC filings, including our annual report on Form 10-K that was filed earlier this morning. The company does not undertake any duty to update such forward-looking statements. Additionally, we will refer to certain non-GAAP financial measures during the call, including EBITDA, adjusted EBITDA and adjusted EBITDA margin. You can find a reconciliation of these non-GAAP financial measures to the most recent, the most directly comparable GAAP measure and other related information, including a discussion of why we consider these measures useful to investors, in our earnings release.

Now Karl will give an update on our business.

Karl H. Watson - *Forterra, Inc. - CEO & Director*

Good morning, everyone. We appreciate you being on the call with us today to discuss our fourth quarter and full year results for 2019.

First, I'd like to thank the employees of Forterra. Our teams have finished the year well and are excited about the opportunities ahead for them in 2020. Our teams are focused on 5 improvement pillars: safety, plant level production discipline, enhanced commercial capabilities, working capital efficiency and G&A effectiveness. Executing on these will keep our team members safe, ensure we are improving daily to reduce our cost of production, give our customers an enhanced and superior experience, allow us to receive the proper value for our products, while using less working capital and administrative resources to do so. We feel like we have made some small steps towards doing so as evidenced by the 7% increase in revenue, 13% increase in gross profit and 26% improvement in adjusted EBITDA for the quarter.



Looking at the fourth quarter operating performance for each of our businesses in terms of volume, price and cost. In Drainage, shipment volumes increased by 9% in the quarter compared to last year, mostly due to improved weather compared to the fourth quarter of 2018. Despite the strong shipments in the fourth quarter, our backlogs for pipe and precast products at year-end were not reduced and remained flat compared to last year.

In Water, shipments were up 6% in the fourth quarter compared to last year. This is consistent with our expectation that our distributors' inventory destocking that we experienced earlier in the year is now behind us. The strong shipments did not dent our backlogs. At year-end, they were up compared to last year.

In regard to pricing, drainage average selling prices increased by 3% per ton, and water average selling prices increased by 4% per ton in the quarter compared to last year. In the second half of 2019, we announced 2 price increases in our Water segment, 10% for July 1 and 6% for October 1. In order to honor customer commitments made prior to the price increases, we believe the effect of these increases will become clear in the first half of 2020.

Additionally, we have announced a relatively smaller increase for April 2020. Due to the limited number of other ductile iron producers, we will not comment or answer any questions regarding the size of the increase. It is far too early to make any forecast concerning the impact of the third increase or the full impact of the prior two. Unlike Water, our Drainage market segments are more local in nature. We have announced price increases of varying amounts in nearly all of our markets. However, like Water, it is far too early to make any forecast concerning the impact of these increases.

On the cost side, in the Drainage business, input costs were up slightly in the quarter compared to last year, and Charlie will provide much more detail in his comments. In Water, we benefited from a 25% decrease in scrap metal compared to the same quarter last year. For clarity, scrap is the largest cost component in ductile iron pipe. Our conversion costs, the costs we incur to convert our inputs into finished products, were up slightly in both businesses. However, we anticipate improvements in the future as we advance improving our plant level production disciplines.

For the full year of 2019, our revenue increased 3% to \$1.5 billion; gross profit increased 21% to \$296 million; and adjusted EBITDA increased 21% to \$204 million, which exceeded the upper end of our \$200 million adjusted EBITDA guidance as weather proved to be more favorable than prior year.

With that, I will turn the call over to Charlie to discuss more specifically on our financial results, and I'll come back later to talk about 2020 outlook.

Charles R. Brown - Forterra, Inc. - Executive VP & CFO

Thanks, Karl. Before I discuss the financial results, I'll echo Karl's comments that our relative performance in Q4 and full year 2019 reflects the hard work of our teams as well as the benefit of steady product demand, more favorable weather and lower scrap costs as compared to 2018.

For the quarter, Drainage revenue was up 10% year-over-year, driven by a 9% increase in volume and a 3% increase in average selling price for our pipe and precast products. On the cost side, during the quarter, we recorded a \$5.4 million noncost -- noncash adjustment related to inventory valuation. I want to be clear, this charge is included in our adjusted EBITDA. It reflects our improved production planning process that highlighted excess inventory and aligns with 1 of our 5 improvement pillars, working capital efficiency.

In addition, focusing on another improvement pillar, plant level production discipline, we increased our maintenance spend and reduced inventory in the quarter. The \$5.4 million charge, increased maintenance and higher cost due to lower absorption are not expected to continue, but instead position our Drainage segment for future improvements.

For the year, Drainage revenue was up 10%, and adjusted EBITDA was up 13% compared to 2018. The 6% increase in average selling price and 4% increase in volume was somewhat mitigated by higher costs, some of which I covered above. But despite this headwind, the full year adjusted EBITDA margin increased by 50 basis points from 19.7% in 2018 to 20.2% in 2019.

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Switching over to Water segment. As we indicated in our comments last quarter, we believe the impact of destocking is behind us. In fact, our Q4 ductile iron pipe shipments were up 6%, and our average selling prices improved 4% over the prior year. The sale of certain ancillary products, however, did decline, limiting the quarter's revenue increase to only 4%.

Water's performance in the quarter reflects 3 of our 5 improvement pillars: enhanced commercial capabilities, which we've discussed in some detail; plant level production discipline, which yielded production quality improvements; and working capital efficiency, which helped deliver cash for debt repayment. These efforts, combined with higher volumes and lower scrap costs, resulted in a 66% Q4 gross profit increase compared to prior year.

On a full year basis, despite the 5% decrease in revenue, which was driven by volume decline in the first 3 quarters, Water gross profit increased by 35%, and gross profit margin expanded by more than 400 basis points, primarily due to lower raw material costs, production quality improvements and higher average selling prices. As a result, Water adjusted EBITDA increased 30% year-over-year.

Combined with our increased backlog compared to last year-end, we entered 2020 with enhanced confidence. Our corporate adjusted EBITDA loss was in line with our internal plan for the quarter as well as full year. The 10% increase year-over-year primarily reflected our investment in our systems and processes and is in alignment with our improvement pillar of G&A effectiveness. Our consolidated adjusted EBITDA was \$42 million for the fourth quarter and \$204 million for the year, both representing more than 20% increase over prior year numbers.

Regarding liquidity, I want to start by noting that our 2019 guidance for cash generated from working capital was between \$30 million and \$50 million, and the discretionary debt repayment guidance was between \$30 million and \$85 million.

Well, 2019 was the strongest year of cash generation in our history. Operating cash flow of \$147 million more than tripled our prior 3-year average, driven by double-digit earnings growth and almost \$52 million of working capital improvement. As promised, we used this cash to voluntarily repurchase \$87 million of our long-term debt. Combined with a \$13 million mandatory debt repayment, we've reduced our long-term loan by \$100 million in 2019.

While Forterra's leverage remains well above most anyone's comfort zone, in 2019 our team demonstrated our commitment and capability to drive improvement. Leverage is an area of concern for employees, customers, investors and vendors alike. And our team appreciates the support and long-term relations we've developed within these constituencies. We intend to deliver further improvement in leverage, but have not yet publicly defined a target. We have worked to reestablish our credibility through delivery on guidance while increasing transparency. In the third quarter of 2019, we added basic reporting on volume and price for our 2 segments, and we intend to increasingly share specific objectives as our growing credibility warrants.

Now Karl will cover our 2020 guidance.

Karl H. Watson - Forterra, Inc. - CEO & Director

Thanks, Charlie. For 2020 and beyond, we're excited to build on our momentum by continuing to focus on safety, improving plant level production discipline, enhancing our commercial capabilities and using our working capital to -- more efficiently and our G&A more effectively. We believe the end-market fundamentals will remain steady. We know we will remain focused on our 5 improvement pillars and thus expect 2020 net income to range between \$2 million and \$22 million; our adjusted EBITDA to range between \$210 million and \$240 million.

Our guidance assumes both volume and price increases in Drainage and Water segments. However, we temper these expectations with reservations around raw material costs and weather. Most raw material cost increases should be in the low single digits and somewhat offset by production discipline efforts, but scrap steel volatility could be much more significant. Weather was a significant impact on our performance, and we do not forecast 2020 to be as stable as 2019. While we cannot remove our exposure to weather, our guidance is based upon the weather patterns of 2017 and '18. As such, weather commentary should be limited to good news or significant events.



We expect 2020 capital expenditures to be in the range of \$45 million to \$55 million, and we will continue using the free cash flow generated by our earnings and working capital improvements to further pay down our debt in the range of \$50 million to \$100 million.

Having been with the company for 8 months now, I am more excited about what is possible than the day I started. We are in well-structured markets with steady demand. Our lean efforts are beginning to produce real plant-level production efficiencies. We are enhancing our commercial capabilities, which will lead to strategic and tactical price discipline. The combination of these 2 are producing and will continue to produce unit margin expansion. And these unit margin increases, coupled with our focus on using our working capital more efficiently, will allow us to generate the cash necessary to continue paying down our debt. While we have made some small steps in 2019 towards earning a full and fair return for the products we produce and the capital we employ, there's still a long way to go, much more to do and still more upside ahead of us.

I want to finish our prepared remarks as I started in by thanking all of our employees for their dedication and contribution to our rebound from the challenges we faced over the last 2 years. Charlie and I get the opportunity to talk about our improvements, but it's only because of our teammates that we get to do so. I can share with you that they are equally optimistic about the future of Forterra as Charlie and I are. As we move forward, we remain committed to providing a safe and rewarding work environment for our employees, outstanding quality and service for our customers and value for our shareholders.

So this concludes our prepared remarks. Operator, will you please open the line for questions?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question, line of Jerry Revich with Goldman Sachs. .

Jerry David Revich - Goldman Sachs Group Inc., Research Division - VP

Can you talk about the production adjustments that you folks made in Drainage? I see you've rolled down inventories, but also based on the inventory reduction, looks like your production was down versus sales that were up. Can you just frame what kind of impact the latter had on margins in the quarter and how you feel about inventories entering '20? Do you expect to produce in line with end demand essentially?

Karl H. Watson - Forterra, Inc. - CEO & Director

So three things we did in the quarter. We have a very big focus on using our working capital more efficiently. And we had too much inventory going into 2019, and we worked to reduce that.

So two things happened: One, we -- our production was less than sales. And so there was a lack of absorption. So costs naturally go up on a per unit basis. Two, we changed the way that we -- our E&O policy for the inventory. It used to be that we had a 2-year window on what would we consider obsolete, and we reduced that to a 1-year window. We thought that was effective -- I mean, prudent for 2 reasons: One, just because it's just a prudent working capital management also to change the discipline and the thought processes around our operators not to build inventory.

We do think -- and the third thing that we did is that we made an investment in 2020, in the last quarter of 2019. We had some maintenance items that we wanted to get ahead of. Because we were producing less, we had the opportunity to do that in the fourth quarter, and we took advantage of that as a prudent time to actually spend that money to prepare for 2020. So we do believe that going into 2020, our production costs will be more in line. However, we don't completely plan to produce to what we sell because we do think there is more to go in working capital on all 3 levers, payables, receivables and inventory, but there is still more to go in inventory.



Charles R. Brown - Forterra, Inc. - Executive VP & CFO

So just a couple of additional points there, Karl. The change on the excess and obsolete assumption, that's just a change in estimate and really keys in very well with what Karl brought when he joined us in July, which is a very heightened focus on working capital. So it is very much in alignment with that. And there was no change in policy. It was just a change in estimate. And that caused that \$5.4 million charge in the quarter.

And I'd also make the point that on the absorption, Karl makes the good plans for 2020. We will continue to focus on improving inventory and relieving that, which will add more efficiency going forward on our working capital. But that will probably be on a more incremental basis going forward to have less of an absorption impact than what we saw in the fourth quarter.

Jerry David Revich - Goldman Sachs Group Inc., Research Division - VP

And if we were to adjust for an estimate of the absorption impact as well as the inventory write-down, it looks like Drainage margins would have actually been up about 200 basis points year-over-year. Is -- can you just fact-check me on that math? Is that the right ballpark to think about the underlying performance?

Karl H. Watson - Forterra, Inc. - CEO & Director

On the fly, Jerry, I would say that, that is probably in the ballpark.

Jerry David Revich - Goldman Sachs Group Inc., Research Division - VP

Okay. And lastly, Charlie, can you talk about free cash flow conversion? So it looks like you're going to be allocating about 40% of EBITDA in 2020 towards repayment -- repaying debt, voluntary and principal amortization. Is that the sort of run rate we should think about in the medium term? Anything we should think about, either from a cash tax payment or TRA payments for '21 and beyond relative to the free cash conversion that you folks are generating in '20?

Charles R. Brown - Forterra, Inc. - Executive VP & CFO

Yes. So I think as you -- we have in our presentation, on Slide 12 of the presentation, a little chart that gives the 2020 view. There's really not much that will change as we go forward. I think Karl and I have both said the CapEx expectation will be very similar going forward, in the \$45 million to \$55 million range. The TRA payments will actually be reducing over time. They're a little high this year because we do have a catch-up for a 2016 obligation that will flow through. But otherwise, the underlying TRA payment would have been under \$10 million, and that, again, will decrease typically year-over-year.

And as far as the cash interest, we would certainly expect, as we continue to pay down debt, we will see that decline as well. And certainly, working capital, we've given a guidance of \$20 million to \$30 million this year. As we look forward, I would expect that, that will continue to ramp down as we get more and more effective on our working capital. But the offset would be on the EBITDA side, which we expect to be obviously improving in 2020 and beyond.

Operator

Your next question, the line of Rohit Seth with SunTrust.

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Rohit Seth - *SunTrust Robinson Humphrey, Inc., Research Division - Associate*

So just on the guidance, it seems like there's plenty of moving parts here, with water pricing, your input costs and fixed cost absorptions. And I appreciate you want to talk about the price increases in Water, but maybe you can help us think it through with just giving us some help with the guidance and what your underlying assumptions are for the Water and the Drainage business on revenue growth and margin expansion?

Karl H. Watson - *Forterra, Inc. - CEO & Director*

So we're happy to comment on pricing that has happened in the past, just not the stuff that hasn't actually gone into effect. So I can say is that what we've done in July and what we did in October in Water is flowing through into jobs that we are winning today.

Within our Water business, though, there is a very long tail. We will always honor our customer commitments, and it takes a while for that to flow through. But we expect those increases in July and October to progressively flow through, through 2020 and then even potentially to 2021. That sort of tells you how long the tail is. We have momentum in pricing. And it is -- our prices are -- that we are getting to our customers, and customers are winning work at elevated prices.

What's in our guidance for next year? We have increased volumes and prices in both businesses. We don't specifically say what those are that make up the \$210 million to \$240 million, but we are expecting both volume and price increases in both businesses.

You see what we've done in the past in Drainage. There's probably not a lot of reason to think that's going to be a whole lot different than that. And in Water, I think we will be a bit stronger than we had been in the past based upon what's happened in July and October and the natural flow in effect of those throughout the year.

Charles R. Brown - *Forterra, Inc. - Executive VP & CFO*

And I think the key point here, Rohit, is, as Karl said in his prepared comments, that weather is always just a tough call for us. I can tell you it's sunny in Dallas today, but January there was rain. And we don't know how that will impact us because it is just the first quarter. So that's always going to be a wildcard for this company. And that's why we want to make sure we had a conservative perspective. And I think 2018, in particular, was a really tough weather year for us. 2017 and 2018 is really what we are -- we have planned for.

The other one is you know our major exposure to scrap steel, and that's our #1 component going into the ductile iron pipe. That is -- right now it's in a good range, but we have seen wide variations on that. So we have taken a conservative view there as well. That is the best way that Forterra, which is subject to a couple of things that we cannot mitigate directly. That's our best way to prepare and present our information. So hopefully, that helps you understand that our ambition is always to give you the best information we can today with that conservative event.

Rohit Seth - *SunTrust Robinson Humphrey, Inc., Research Division - Associate*

Understood. And then if so, is the midpoint assuming like normal conditions? Or is the midpoint assuming -- is that kind of like an all-weather guide, like regardless of what the weather is going to do and steel prices are going to do, we think we can get to this midpoint? Is that fair?

Charles R. Brown - *Forterra, Inc. - Executive VP & CFO*

Sure. I mean the midpoint is -- the midpoint is with those base assumptions of a conservative view on scrap and a conservative view on weather. So that is -- we did the full range, was based on those assumptions.



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Rohit Seth - *SunTrust Robinson Humphrey, Inc., Research Division - Associate*

Okay. Understood. And then on your margin in Water, a lot of things went favorable -- favorably for you. Is that a sustainable number? Or is there anything onetime in there?

Karl H. Watson - *Forterra, Inc. - CEO & Director*

We had a 25% decrease in scrap prices.

Charles R. Brown - *Forterra, Inc. - Executive VP & CFO*

Yes.

Karl H. Watson - *Forterra, Inc. - CEO & Director*

If there wasn't a 25% decrease in scrap prices, it wouldn't have looked as stable as it was. However, as that is coming down, let's say, that reversed itself, we think our pricing actions will mitigate some of that. So we do believe that going forward, those sort of margins are the range that we want to be operating this business in. And actually, even more important than that, that's what this business deserves to be operating in. Whilst we've made some large improvements, we have such a long way to go to get a fair return on what we have invested in that business. So whilst they look improved, we don't think that is -- that that's certainly long term, not what we expect from that business.

Charles R. Brown - *Forterra, Inc. - Executive VP & CFO*

And just to kind of add on to that, while I discussed it at greater length in the drainage side, the same absorption issue applies to water. They, too, made significant improvement in inventory in the fourth quarter, really the second half. We're very focused on better production planning and more efficiency. But as a result of that, you do have heavier absorption costs, which does offset a portion of that lower scrap. So I think that's an important piece to keep in mind. No, Rohit, I mean, besides the obvious directional improvement; yes, we saw the benefit of scrap; yes, we had the offset of the absorption. I think going forward, we definitely look at this as a good example of the direction that we expect to be moving. And as Karl said, we still have a long way to go.

Operator

Your next question, line of Daniel Wang of Berenberg Capital.

Daniel Wang - *Joh. Berenberg, Gossler & Co. KG, Research Division - Associate*

Just the first question is on -- I know a lot's been made about the strong pricing in the water segment, but it seemed like drainage also had a pretty good year on the pricing front. Just curious as to what have been the principal driver of this? Was this just strong underlying demand? Or is there something else I'm missing?

Karl H. Watson - *Forterra, Inc. - CEO & Director*

No. It was good demand, but also to -- our commercial teams in Drainage are actually really very good. They understand market dynamics. They understand the value of our products, and they're very capable industrial pricers. And so I think it's -- as much as it is to good, steady demand, it's also due to talent. We're enhancing those capabilities. We're putting a very large effort into building out a complete commercial platform for Forterra, focusing first on the salespeople and sales discipline and sales training. But I would think that it wasn't completely demand. It was some of their efforts. And also to the stable demand going into 2020, we don't see any reason why that wouldn't be very similar in the coming year.

Charles R. Brown - *Forterra, Inc. - Executive VP & CFO*

Dan, I think it's an important -- I appreciate the call out for Drainage. It was a good year. I think we've done a lot of the things to prepare us for 2020. And Karl brought a lot of good plant-level discipline that we really needed in that business. It's an excellent platform. These are well-structured markets. We compete in very -- across some very good markets. For us, I see it as there's still room for improvement, and that's a great place to be.

Daniel Wang - *Joh. Berenberg, Gossler & Co. KG, Research Division - Associate*

Perfect. And just second on the corporate costs on the G&A portion of the business. Is it possible to quantify the magnitude of the investment into IT systems, the onetime severance charge? Some any -- I suppose, some one-off items that we can sort of net out going into 2020?

Charles R. Brown - *Forterra, Inc. - Executive VP & CFO*

Sure. The onetime severance cost was disclosed in the -- I think it was in the quarter, and I think it actually shows up in the back of the -- in one of the footnotes. So it's in the 10-K in detail. So that would be the right place to look for that. And I think it's -- well, I'll leave you to go dig that one up.

As far as the corporate cost, we don't disclose that. You know that we run 3 different ERPs here, and we have a lot of other systems that we have to support. And those are the type of costs that we're trying to -- we've spent some time. We're still digging into it, just trying to figure that out. But as we had disclosed today, our G&A effectiveness is one of our improvement pillars that will get a lot of attention going forward. And so that is, I think, a great opportunity for the future. It won't be fixed overnight. And that's why we're trying to invest prudently right now to make sure that we make the right steps forward to solve that problem.

Daniel Wang - *Joh. Berenberg, Gossler & Co. KG, Research Division - Associate*

Got you. And just lastly, on a follow-up to that. Is there any carryover effect from these investments that you might expect going into next year? Should we expect a slight step-up in corporate costs, I suppose?

Charles R. Brown - *Forterra, Inc. - Executive VP & CFO*

No, I think we're -- we are at our limit there, we need to be prudent about this and continue to reduce where we can. But I think these are smart investments. We're trying to keep them. As I think, Dan, you know, I'm a cheap son of a (expletive), and I do not want to see us spend money that we can't get good return on. So that will be something that we'll talk about more as we go forward. But no, we wouldn't -- I wouldn't ask you to step up the expense.

Karl H. Watson - *Forterra, Inc. - CEO & Director*

It is not lost on us that our G&A expenses are high and that it is an improvement lever for us, and we will not be spending more on an absolute basis and hopefully a lot less on a percent of sales basis in the coming years. But it's the reason why it sticks out at the tail end of that, like stitches in the front and then on the back end because we recognize that it is -- that we are not effective with our G&A cost, and that it is a big issue for us to get better at.

Operator

Your next question, line of Mike Dahl with RBC Capital Markets.



Michael Glaser Dahl - *RBC Capital Markets, Research Division - MD of U.S. Homebuilders & Building Products*

I had a couple of follow-ups on ancillary. So I think you mentioned that ancillary and water was a bit soft in the quarter. I guess, when I looked at the numbers that you put in the slide deck, which are helpful, if ductile iron is 80% of that segment, then that would suggest that nonductile iron was down something like 20% year-on-year. Is that right? And can you just elaborate more on what happened in the quarter and what your expectations are going into this year for ancillary in water specific?

Charles R. Brown - *Forterra, Inc. - Executive VP & CFO*

Yes. And so there was some reduction that your math is not perfect because within our ductile pipe production that we talk about, there are ancillary products within there, things like gaskets and other joints that would be appropriate, that were down. Again, that's -- yes, not -- when we do volume and price, we're specifically fixing on the pipe itself. So it's all the other pieces that were somewhat less impactful.

So I would say, a, it is other pieces within ductile iron pipe as well as our pressure pipe business and our fittings business. So not something that I think is an indicator. These -- obviously, the big focus for us is on the ductile iron pipe itself. And while we're not giving away anything else, the margins on those other businesses are somewhat less, or those other products are less meaningful.

Michael Glaser Dahl - *RBC Capital Markets, Research Division - MD of U.S. Homebuilders & Building Products*

Got it. And I guess similar question on Drainage, understanding how that this math isn't going to be perfect, but the volume price bridge would suggest that nonpipe and precast would be somewhat flatter. I guess it's same question: Can you just talk about some of the other services and non-volume-based, and how you're thinking about that?

Charles R. Brown - *Forterra, Inc. - Executive VP & CFO*

Yes. No. That's a very good question. I did want to break that out for both of those that these are our main product lines as (inaudible) we can calculate the price and product -- price and volume impacts. Within Drainage, really there's nothing specific. It would be much more probably regional. We had some weather businesses in some of our areas that do some ancillary work for us on structures. And other than that, there's nothing unusual. Again, more of a regional mix than a meaningful change.

Operator

(Operator Instructions) Your next question, line of Matthew Bouley with Barclays.

Matthew Adrien Bouley - *Barclays Bank PLC, Research Division - VP*

So the pricing efforts in water, obviously strong even despite the -- or despite the lower raw materials, and you're kind of arguing for the true value of that product. So you disclosed the 4% price increases following -- or price increase in the segment following, I guess, 2 price increases you've put out during the year. I know you said more is going to flow through in 2020. But can you -- I guess can you provide a little color on kind of the market feedback or like acceptance to these price increases? And how do we think about the realization of the headline price increases in terms of what actually will flow through the Water segment?

Karl H. Watson - *Forterra, Inc. - CEO & Director*

I think the way we look at that is that if we do speak about the stuff that's happened in the past, [the 2 and the 6,] we are moving towards nearly full acceptance of those, but it's going to take time. So it's -- and that time could be 18 months from now if they're going to slowly drift through,

but it is moving in the right direction. It's very difficult, especially for myself, who's usually brand-new to this industry, to get -- wrap my head around the tail of how long it takes. And so I -- it's very hard for me to even sort of range when this is going to happen, but we do know that the work that we are winning and that our customers are winning are at prices that are quite a bit elevated than they were before July. And at some point in time, that is going to flow through. The timing of that is really I can't comment on. If I could, I would. But it's not enough that I don't want to. I really just don't quite -- we don't quite understand when it's going to flow through because we're not in control of when the order patterns are actually in. However, new orders that we are winning are at elevated prices. So it will flow through at some point in time.

Charles R. Brown - *Forterra, Inc. - Executive VP & CFO*

And Matthew, I would just -- as we've indicated, we expect to be able to validate a lot of that performance as we go through the first half. So while Karl talks about an 18-month tail on these, which, in some cases, these products will, it will take that long for those projects to move forward. Yes, the majority of it we should see sooner.

Matthew Adrien Bouley - *Barclays Bank PLC, Research Division - VP*

Okay. That's perfect. And then I wanted to ask about the backlog in Drainage. You said it was flat, and obviously, the kind of demand strength or volume strength as a result of the weather probably played into that a bit. But I guess what are you kind of hearing and seeing on the underlying demand and end-market side in Drainage?

Karl H. Watson - *Forterra, Inc. - CEO & Director*

Lots of activity. So yes, our backlogs are flat. But normally, we're building backlog in that last quarter of the year as shipments slow down. This year, it didn't, but it didn't take it negative. There's a lot of bidding activity. We don't see any signs of any pending slowdown in work that we have the opportunity to chase. I mean, the work is out there. We just have to execute on it and win our fair share. But there's no lack of opportunities to go after this point in time.

Charles R. Brown - *Forterra, Inc. - Executive VP & CFO*

And just -- that would be, I think, an important component, not only our backlog up in Water and flat in Drainage. But as we've talked about, we're getting price, is continuing to come through, which supports the ongoing steady demand that we see.

Operator

And a follow-up question from Jerry Revich with Goldman Sachs.

Jerry David Revich - *Goldman Sachs Group Inc., Research Division - VP*

Karl, I'm wondering if you could expand around the 5 pillars that you laid out here in the prepared remarks and press release. Can you talk about the cadence of getting a return on the focus around those pillars? So what's low-hanging fruit, if you will, heading into '20? What's going to be a tailwind longer on -- Water down the line? Can you just flesh that out, please?

Karl H. Watson - *Forterra, Inc. - CEO & Director*

Thank you. Actually, I do want to talk about that. We have the whole organization focused on these 5 things. First, being safety. We are an industrial company. If you have been in 1 of our ductile iron plants, it's a tough environment, and it's a dangerous environment. So we're putting a lot of effort on that.

I would say, at this point in time, we're not world-class when it comes to safety, but we have a clear path as to how to get there. And there's actually really an impact to this. I mean if -- when we're a safe organization, we're a productive organization. It ties in very closely with the second one, our plant-level production disciplines.

Charlie and I sometimes compare notes when we go and visit, and he walks out of some of our plants a bit depressed and I walked out very excited. I get very excited about the improvement opportunities. If you look at these 2 businesses over a long period of time, they really haven't been loved that much. I mean, they were not the primary businesses of Heidelberg, and they were not the primary businesses or long-term business of a private equity firm that we bought them from. They are our businesses now. They're going to be our businesses for a very, very long time. And the amount of effort and discipline and smart capital that we're putting into these is quite different.

So like Charlie said earlier, we're not shy about making OpEx investments either in maintenance that needs to be done. We're going to treat these things as we're going to own them for a very long period of time. We're going to be very disciplined in how we manage for daily improvement. If you go into any of our plants, you will see clear signs of visual management of every single day, the people who are doing their work, understand what the metrics are, what they need to do to meet them. We see visually what the opportunities for improvement are, what they see needs to be done, what needs to be fixed, what needs to be improved upon. And when I visit plants, people are grabbing me and taking me out to very granular issues about how water is draining out of plants, how machines are operating, why is concrete dripping here. I mean, we have a real excitement down at the operating level about what is about improving our businesses. So improving those plant-level disciplines is critically important to us.

And I think to your point about low-hanging fruit and tailwinds, it's both on that. We're going to do things in this next year that will actually show results, but we have years of results to come. So I think it's both low-hanging fruit and a long-term tailwind.

To enhancing our commercial capabilities, we're -- we can't do everything at once. But what we're focusing on right now is really the depth of capabilities of our salespeople. They are the ones that are the face of the company to our customers. They're the ones that protect the value of our products and the capital we have employed. And arguably, you could say in a variable cost business, they're the most important people when it comes to the value of our business. So we're treating them as such. They are not just salespeople. They are professionals, and we're treating them professionals. We are treating them as professionals in what we are investing in them, but also to what we're demanding of them to actually lift the game, their game, our game, in order to help us get back on track.

As far as working capital, we took quite a big of chunk out of it last year, but there's still more to go. We believe that -- well, not that we believe, we know that we have too much inventory in our system or not the right inventory at the right places at the right time. We're investing a lot of time and effort into our sales inventory and operational planning to have much more of a data set to actually make production decisions versus wrapping ourselves in the flag of we need inventory to take care of customer demands, and so we're going to fill the yard up to the brim with inventory.

Having said that, though -- having said that, though, we will always, always invest \$1 more to make sure we never short our customers for the sake of working capital. Working capital is something we need to use efficiently. But it's not an end goal in and of itself.

And the last one is G&A productivity. I think I mentioned earlier, it's not lost on us that we have 3 disparate systems. We are not efficient there. It doesn't scale. This is going to be a tailwind, Jerry. This is nothing that's going to happen quickly, but it's going to be something that's not going to be on our radar screen. It is on our radar screen, and it's -- there's a lot of effort that we're making and planning to actually reduce that. But that's going to be a longer lead time item than the other ones. But I think from a safety standpoint, an operating standpoint, a commercial standpoint and a working capital standpoint, those things, you're going to see meaningful improvements in the next 12 months.

Jerry David Revich - Goldman Sachs Group Inc., Research Division - VP

Really appreciate the color there, Karl. And obviously, what the market is reacting to is a risk of a broader economic slowdown. And on that note, I'm wondering if you could talk about if demand deteriorates the downside over the course of '20. What kind of decremental margins would you target for your organization? How should we think about that bear-case scenario in terms of the drop-through for your business?

Karl H. Watson - *Forterra, Inc. - CEO & Director*

That's a good question.

Charles R. Brown - *Forterra, Inc. - Executive VP & CFO*

Well, I think the key part is that we do have backlog, which will sustain us for a period of time, and we'll certainly see if those -- if we're not booking additional work, we'll have a couple of months of float on that. But I do think it's -- clearly, as we look forward, the underinvestment in our industry is chronic. So whether you're talking about water infrastructure, drainage infrastructure and how it relates to highways, there's just there's a lot to be done there, Jerry. So if there were a very corona-driven slowdown, I do see our business well positioned to take advantage of any government stimulus that might come through. So that's the worst-case scenario.

I think on a more normalized -- I mean just a normal slowing down of the economy, I'm not overly concerned. I think, again, we have room for improvement within our businesses as the self-help Forterra. I mean following these 5 pillars, we have plenty of room to continue to enhance even in a declining demand environment.

Karl H. Watson - *Forterra, Inc. - CEO & Director*

And we're largely a variable cost business.

Charles R. Brown - *Forterra, Inc. - Executive VP & CFO*

Yes.

Karl H. Watson - *Forterra, Inc. - CEO & Director*

So we can largely scale that. Now if there's a 2008 sort of thing, I mean you follow the construction materials industry for a very long time. You certainly can model that better than I can. But we -- our plant-level operations can scale pretty rapidly down, harder up but easier down. So we are thinking through that. We do have -- we have thought through downturn plans and would have to adjust accordingly.

Operator

And I'm showing no additional questions in the queue at this time. I would like to turn the conference back over to management for any closing remarks.

Karl H. Watson - *Forterra, Inc. - CEO & Director*

Thank you, everyone, for joining the call today. We appreciate your interest, and we are looking forward to the next one. So have a good day.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes the program. You may now disconnect. Everyone, have a wonderful day.

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