



Transcript of Astec Industries, Inc. Third Quarter 2013 Earnings Call October 22, 2013

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Participants

Stephen Anderson – Vice President, Director of IR and Secretary
David Silvius – Chief Financial Officer, Vice President and Treasurer
Dr. J. Don Brock – Chairman and Chief Operating Officer
Benjamin Brock – Group Vice President, Asphalt

Analysts

Brian Brophy - Robert W. Baird and Company, Inc.
Morris Ajzenman - Griffin Securities
Jason Ursaner - CJS Securities
Ted Grace - Susquehanna International Group
Nick Coppola - Thompson Research Group
Larry De Maria - William Blair
Dan Walker - Heartland Advisors
Brian Rafn - Morgan Dempsey Capital Management.

Presentation

Operator

Greetings, and welcome to the Astec Industries Third Quarter 2013 Earnings Conference call. At this time all participants are in listen-only mode. A brief question and answer session will follow the formal presentation. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Mr. Steve Anderson.

Stephen Anderson – Vice President, Director of IR and Secretary

Good morning, and welcome to the Astec Industries conference call for the third quarter ended September 30, 2013. As Rob mentioned, my name is Steve Anderson, and I'm the Vice President of Administration, Secretary, and Director of Investor Relations for the company. Also on today's call are Dr. J. Don Brock, our Chairman and Chief Executive Officer; Ben Brock, Vice President of our Asphalt Group and President of Astec Inc.; and David Silvius, Chief Financial Officer. In just a moment, I'll turn the call over to David to summarize our financial results; and then to Don and Ben to review to business activities during third quarter.

Before we begin, I will remind you that our discussion this morning may contain forward-looking statements that relate to the future performance of the company, and that 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 annual report and our filings with the SEC.

As usual, we ask that you familiarize yourselves with those factors. At this point, I'll turn the call over to David to summarize our financial results for the third quarter of 2013. David?

David Silvius – Chief Financial Officer, Vice President and Treasurer

Thank you Steve and good morning everyone. Our net sales for the quarter were \$213.2 million versus \$218.4 million in the Q3 of 2012; that's a decrease of 2.4% or \$5.2 million. International sales for the third quarter of 2013 were \$80.8 million compared to \$84.4 million for the third quarter of 2012; that's a decrease of 4.3% or \$3.6 million. International sales represented 37.9% of Q3 2013 sales compared to 38.6% of Q3 2012 sales. The decrease in international sales for Q3 compared to Q3 of 2012 occurred primarily in Europe, Canada, South America including Brazil and Africa, and the Middle East. These decreases were offset primarily by increases in the post-Soviet states.

Domestic sales for the third quarter of 2013 was \$132.4 million compared to \$134 million in Q3 of 2012; that's a decrease of 1.2% or \$1.6 million. Domestic sales were 62.1% of Q3 2013 sales compared to 61.4% of Q3 2012 sales.

Parts sales for Q3 of 2013 were \$59.4 million compared to \$54.8 million for Q3 of 2012; that's an 8.4% increase or \$4.6 million. Parts sales were 27.9% of the quarterly sales in Q3 of 2013 versus 25.1% of the quarterly sales for Q3 of 2012. In parts sales, Aggregate and Mining Group had the largest dollar increase followed by the Mobile Asphalt Paving Group for the quarter. The Asphalt Group and the Underground Group had small decreases.

Segment revenues for the third quarter of 2013 are attached to your press release.

Net sales on a year-to-date basis were \$709.1 million compared to \$708.6 million for 2012. That's an increase of just 0.1% or \$0.5 million. International sales were \$252.5 million on a year-to-date basis in 2013 compared to \$265.1 million in 2012. That is a decrease of 4.8% or \$12.6 million. Decreases in dollars for the international sales occurred primarily in Canada, Australia, South America including Brazil, and Europe. And these were offset by increases in Africa, the post-Soviet states, Russia, the West Indies and Mexico. International sales were 35.6% of net sales year-to-date 2013 compared to 37.4% year-to-date 2012.

2013 Segments: If you look at international sales on a year-to-date basis, international sales decreased for all segments across-the-board except for the Underground Group. Domestic sales on a year-to-date basis were \$456.6 million compared to year-to-date 2012 domestic sales of \$443.5 million, that's a \$13.1 million increase or a 3% increase. Year-to-date 2013 domestic sales are 64.4% of 2013's total sales compared to 62.6% of total sales for year-to-date 2012.

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Part sales on a year-to-date basis were \$190.2 million as compared to \$187.7 million on a year-to-date basis last year. It's an increase of 1.3% or \$2.5 million. Part sales in 2013 on a year-to-date basis represented 26.8% of total sales compared to 26.5% year-to-date 2012.

Our sales by segment for the year-to-date in the quarter were all attached to your press release.

Gross profit for the quarter in 2013 was \$45.8 million compared to \$47.3 million last year. That is a decrease of \$1.5 million or 3.2%. The gross profit percentage for the quarter was 21.5% compared to 21.7% for the same quarter in 2012. We did have a negative change in the absorption variance; the negative impact from under absorbed overhead was about \$2 million during the quarter compared to Q3 of 2012.

On a year-to-date basis, consolidated gross profit was \$159.8 million compared to \$159.6 million last year, which was relatively flat. Gross profit percentage on a year-to-date basis was 22.5% compared to the same number in 2012, 22.5%, so that was flat as well.

On a year-to-date basis, our unabsorbed overhead increased \$15 million from year-to-date 2012 through September 30 to the same period in 2013, so we have a negative variance there as well on a year-to-date basis.

Gross profit by segment is also attached to your press release on that segment page.

SG&A and engineering for the quarter was \$36.6 million or 17.2% of sales compared to \$38.4 million or 17.6% of sales in Q3 of 2012. That's a decrease of \$1.8 million or a decrease of 40 basis points as a percentage of sales. The primary decrease and driver of that decrease during the quarter was a decrease in research and development expense.

On a year-to-date basis, SGA&E was \$114.8 million or 16.2% of sales compared to \$117 million in the prior year or 16.5% of sales in that year, a \$2.2 million decrease. And again, the primary driver on a year-to-date basis of the decrease there is a decrease in research and development expense.

Operating income increased to \$9.2 million in Q3 of 2013 from \$8.9 million in Q3 of 2012. That's a \$300,000 increase or 3.4%. On a year-to-date basis, operating income was \$45 million compared to \$42.6 million in 2012, \$2.4 million increase or 5.6% increase.

Again, income by that segment is on that segment page that is attached to your press release.

On the tax rate for the quarter, the effective tax rate on continuing operations is 34.7% compared to an effective tax rate in the quarter last year of 30.8% on continuing operations. It's a strange comparative because 2012's Q3 includes some positive true-ups, which reduced the tax rate, positive true-ups in the provision to return. We

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file our returns during the third quarter, and so we tried to that return and that impacted the tax rate driving it down during the third quarter of 2012. Q3 of 2013 included some true-ups in the other direction, which made the rate increase slightly. And those true-ups were related to the reduced R&D expense that we've incurred this year relative to the estimates that we've been using to drive the provision.

The tax rate for the year is 33.5% in 2013 compared to 36% in 2012, and the reason for that change, primarily, is due to the fact that in 2012 we did not have the R&D tax credit available to us. If you recall, that was passed in January of 2013, and so we were able to use both the 2012 and 2013 estimated R&D tax credit going forward in 2013, but it was not there in 2012.

Net income from continuing operations for the third quarter of 2013 is \$6.5 million. That's compared to \$6.6 million, a 1.5% decrease versus Q3 of 2012. EPS for the quarter, net income from continuing operations per diluted share \$0.28 versus \$0.29 per share for Q3 of 2012, that's a decrease of 3.4%. On a year-to-date basis, net income from continuing operations was \$30.8 million compared to \$28.5 million last year, that's an increase of \$2.3 million or 8.1% driving EPS to \$1.33 this year compared to \$1.24 last year for a 7.3% increase.

Net income attributable to controlling interest this is the very bottom line after—you recall American Augers is represented as a discontinued operation in the prior year numbers, and so in Q3 of 2013 we're at \$6.5 million compared to \$6.9 million in Q3 of 2012, that's a 5.8% decrease. EPS on that net income attributable to controlling interest is \$0.28 for the third quarter of 2013 compared to \$0.30 for the third quarter of 2012, a 6.7% decrease.

Net income for the year-to-date 2013 period is \$30.8 million compared to the year-to-date 2012 period of \$29.9 million, a \$900,000 increase or 3%. And the related EPS is \$1.33 in 2013 compared to \$1.30 in 2012, that's a 2.3% increase.

The backlog at September 30 is \$228.5 million compared to \$230.7 million the same date last year. That backlog has been adjusted for discontinued operations so the backlog of American Augers has been removed from the prior year number. The \$2.2 million decrease or a 1% decrease. International backlog at September 30 2013 was \$95.7 million compared to \$120.1 million at September 30 2012. That's a \$24.4 million decrease or 20.3%. Domestic backlog for those same dates was \$132.8 million this year compared to \$110.6 million last year at 9/30. That is an increase of \$22.2 million or a 20.1% increase. Gross backlog by segment is also attached as an addendum to your press release.

Our balance sheet continues to be very strong. Our receivables are sitting at \$97.3 million compared to \$109.3 million at September 30, 2012. Our days outstanding are 41.8 compared to 43.3 last year at this time. Our inventory is at \$339.8 million for September 30, 2013 compared to \$344.8 million for September 30 2012, that's a decrease of about \$5 million. Our inventory turns are 2.3 compared to 2.5 last year. We have no debt. We owe nothing on our \$100 million credit facility. At 9/30, we have \$46 million in cash and cash equivalents, plus we have about \$16.3 million in

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investments on the balance sheet. Our letters of credit outstanding are at \$6.9 million. Our borrowing availability, therefore, is at \$93.1 million.

Capital expenditures for the quarter are \$6.9 million and on a year-to-date basis are at \$22.1 million. We've had a budget of \$43.6 million in capital expenditures, but our run rate just tells us we're not going to achieve that number. We will probably wind up around \$30 million in capital expenditures for the year 2013.

Depreciation for the quarter was \$5.3 million, and on a year-to-date basis is \$15.7 million. Again, that budget has not changed. That forecasted number for the depreciation is still right at \$22 million.

That concludes my prepared remarks on the financial details, and I'll turn it back over to Steve.

Stephen Anderson - Vice President, Director of IR and Secretary

Thank you, David. Don will now provide some comments regarding the third quarter for this year's operations and will offer some thoughts going forward. Don?

Dr. J. Don Brock - Chairman and Chief Operating Officer

As can be seen our numbers, in my opinion, were somewhat disappointing. During the quarter we continued to experience flat revenues. Our profits for the quarter from continued operations were up about 5.3% but essentially flat. Likewise, the backlog was basically flat at around \$229 million.

During the third quarter we continued to see an extension of a wet weather into July and early August in many areas in the country, and many of our contractor customers were unable to get work started. They've had stronger Augusts and Septembers, and we experienced dry periods in most of the south in recent months. However, the sales were extremely weak during this period. People's attitude didn't make them want to buy anything when they weren't running the equipment that they had. And so it's been a slow construction season for our customers.

During the quarter we shipped the first large pellet plant to Hazlehurst, Georgia, and at this point, it is about 75% to 80% erected. We expect it to be producing product before the end of the year. Due to the fact that this was the first of its type in the world, we did not book the sale of this plant during the quarter, and hopefully, we'll include it in the revenues for the fourth quarter.

Due to the weak volume of business in the third quarter, our under absorption, as David said, was high, but we were able to reduce SG&A with less R&D expenditures to neutralize the under absorption problem.

We continued to see a downturn in international business, particularly in Canada, which has been strong for us for the past three years, but other parts of the world have picked up some of that weakness but not enough to increase our overall international sales. For the nine months, we had sales that were flat at around \$710 million. Earnings of for the nine months were up 8% from \$28.5 million to \$30.8 million.

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Looking forward to the fourth quarter and to next year, we see the fourth quarter not a lot different from the third quarter. We did last year have unusual income from the sale of Trenchor and American Augers that won't be included in this year. We would expect earnings from operations to be similar to last year, negative or taking out the income that we had from American Augers and Trenchor.

During the first quarter next year we will have a large ConExpo show in Las Vegas, and we anticipate slow incoming orders until after that show is over due to the fact that we're introducing and our competitors are introducing a lot of new versions of equipment that will be shown at that show.

We did see a very positive pickup in sales in early October in the Aggregate Group. Half of our companies did okay or well in the third quarter. Half of them that depended on international sales (Telsmith, BTI, Osborn) were weak and had very weak third quarters. And so the numbers tend to reflect the negative of those three companies, but in early October we got some large international orders for all three of those companies. We believe that we will continue to see in the fourth quarter and next year a slow improvement in the private market, which will help asphalt, concrete and water well business.

With the dysfunctionality in our Congress we don't see much hope for a strong Highway Bill in the near future. All of the politicians agree that we need to improve our infrastructure. It continues to deteriorate, but no one wants to touch the gas tax and that seems to be the only point of raising revenues at this time.

Some states like Oregon have successfully tried to use a vehicle mile traveled revenue and that has shown positive increases in revenues for them, and we think eventually that will be the way of collecting taxes. But right now, and at least for the foreseeable future, we can't see the politicians doing much to help the Federal Highway Bill.

On another negative side, we see banks continue to be more aggressive against our customers who generally have strong balance sheets, but who have not made profits in the last couple of years. The regulators appear to be very aggressive and forcing banks to take drastic action against what I consider good contractors with strong balance sheet but who have not demonstrated profitability. Historically, this did not occur. This also makes contractors reluctant or unable to spend money to upgrade their equipment.

We continue to grow slowly in the oil and gas business. Most of our prospects in that business are for our higher technology drill rigs and equipment for fracing, our oil service business, and most of those prospects are international. As I said earlier, we expect the fourth quarter to be similar to last year with the removal of the gains that we received from the Underground business sales.

As we look forward for the next couple of years, our management team, as we've set down to plan for the next year or so basically are in agreement that we see basically a generally flat market with little increase in revenues in the market generated by the

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market itself. In order to grow our businesses, however, we're looking at each company more individually for what opportunities for specific growth each of them have. Some of the companies have great opportunity to grow their parts business. Some have opportunities to grow their competitive parts business since many of their competitors have exited the business. Some of the companies can expand their international sales. While a number of our companies have grown international sales, some have not. We expect to continue to build our product offerings and expand our product offerings in the oil and gas business with supporting equipment that goes with the drill rigs, and with fracking and oil service equipment.

We have an opportunity in some of our smaller companies to grow market share in the U.S. as well as international. We see a large potential for the pellet plants for Astec, Inc. and installing these plants in Southeastern U.S. and other areas of the wood basket in the U.S. for shipment overseas. It seems that the entire market is watching the first plant that we are presently building and waiting on the success of that plant.

While we expect the U.S. economy to remain somewhat stagnant over the next couple of years, we're optimistic about the opportunities of our company. Our new management team is young, aggressive and looking for ways to grow our business even in flat markets. Our technology is leading-edge and we continue to look for opportunities. We're improving our products, making them more competitive and giving our customers opportunity to reduce their costs in a competitive market by utilizing our equipment. Our balance sheet is strong and gives us a lot of flexibility, and we continue to look at acquisitions that would be accretive and fit with the company's structure and markets that we presently serve. We're glad to answer any questions.

Operator

Our first question comes from Mig Dobre from Robert W. Baird and Company, Inc.

<Q>: This is Brian Brophy on for Mig. I was wondering if you could give us some color on what drove the decline in Mining and Aggregate orders during the quarter. We've seen you've gained some share in spite of weak mining Capex in the past. So what changed here?

Dr. J. Don Brock - Chairman and Chief Operating Officer

We are growing our business in Australia in Aggregate and Mining. We have one project that was fairly substantial that will show up in the fourth quarter in the Aggregate and Mining. Overall, what we've seen is big projects have slowed down, smaller projects are still okay. There seems to be a lot of requirements that if you have leases on mining properties that you do a minimum amount of mining; that helps some of our smaller track mounted equipment. But in general, we have seen a slowdown in the market. One thing that helps us is we have low market share in that area, and we do have the ability to continue to grow that even in a down market.

<Q>: Got it. And then you mentioned in your comments that you're expecting flat, maybe slightly higher in '14 with some opportunities to grow in certain segments. I

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guess, which segments do you see the best opportunities to experience growth next year?

Dr. J. Don Brock - Chairman and Chief Operating Officer

Brian, it's a different bag or a different mix with each company, and as we've spent a couple of days in our management planning session we look at them. If you look at Astec, Inc., probably growth in Asphalt is not going to happen, but growth in the pellet business looks very opportunistic. It looks very good. The British are going to burn wood pellets and there is a big demand for pellet plants and we see, in that particular subsidiary, their growth is going to be in the renewable energy or wood pellet business.

Some of the companies, Roadtec probably has the greatest opportunity to grow internationally. We have increased market share domestically. It's a very competitive market for our mobile equipment, but we've been able to grow market share there. Some of the businesses have an opportunity to grow their parts businesses more and to go after the competitor's parts business. In the Aggregate and Mining business, we think we can increase market share in the mining side of the business. We think we have an opportunity to really grow our parts business, both our parts business and our competitive parts business. Some of our competitors have gone out of business or are not doing a very good job. So in those, it's niche growth.

In the oil and gas side of it, we're getting very good acceptance of our vertical drilling rigs, but there's an opportunity there to take a \$4 million to \$5 million drill rig and get a \$15 million sale by building all of the equipment around it. Some of it is relatively low-tech equipment, but it adds hours to our facilities and it gives us opportunities, particularly international, to offer complete packages.

Likewise, in the fracking side of it, we're building the trailers for oil service and for fracking. The bins that feed this frack sand in, we have the technology and have, in the past, built those as a subcontractor for some of the big guys. We have the opportunity to build the mixers that go with it. So we have the potential to build in the entire fracking system, and then particularly, the international people want to buy the whole package.

So each of the companies have a little different opportunity, and that's what we basically try to look at, is how do we grow these businesses in a flat market.

<Q>: Got it. That's really helpful. And just one quick housekeeping items. The \$6 million Army plant order, was that recognized in the quarter?

Dr. J. Don Brock - Chairman and Chief Operating Officer

No. And it's probably going to be in the next year. Ben, you may want to comment.

Benjamin Brock – Group Vice President, Asphalt

The Army is maybe a little bit slower than we would like, and it just continues to be slower. But essentially, we have one lift test left to pass, and we've been told that we're in the queue for the lift in January. We are on the waitlist to move ahead with that and that's in Aberdeen, Maryland for the lift. So that's where we are. If it gets

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lifted and we pass, then we could take it in the quarter but the likelihood is that it's going to be first quarter next year.

<Q>: Excellent.

Dr. J. Don Brock - Chairman and Chief Operating Officer

... about the speed of our government.

Operator

Our next question comes from Morris Ajzenman with Griffin Securities.

<Q>: Let me play devil's advocate here. You're looking at the 2014 with kind of a lethargic environment. Revenues still have difficult time expanding. And, I guess, the ... clearly being predicated on infrastructure spending still being weak for whatever reasons that you articulated in the past and today. When I look at your asset base, \$750 million, your return on total assets is probably going to be at best mid- to single-digit, maybe a little higher this year. Based on that outlook, is Astec over assetized? Is there -- unless a rebound does happen in a year or so, is the asset base too large based on the environment we're in?

Stephen Anderson - Vice President, Director of IR and Secretary

As far as the number of facilities that we have, we certainly are running right now, Morris, at about 65% to 70% capacity. So we have some room to grow, but it's a matter of keeping the shops full, which definitely affects the absorption, as you've seen in this quarter. I think going forward, we continue to take a look at the facilities that we have. But certainly it's a fair question in the current environment but we have a little bit more of a long-term perspective on it.

David Silvius - Chief Financial Officer, Vice President and Treasurer

I think to add to Steve's comment too, part of that is the cash and the investments that we would certainly love to put to work. It's not earning all that much. So I think that's a chunk of it and our inventory. Our inventory to us, in the sort of corporate management group, is always too high and at the subsidiaries it's never enough. So there's like constant struggle as well. But we think there's some money tied up in the inventory, but we've done that on purpose. We've put some overseas. We've stocked Australia. We've stocked some in Germany to try to disperse some business in those foreign areas as well.

Dr. J. Don Brock - Chairman and Chief Operating Officer

I think the question you end up with is it's an extremely competitive market. In general, most of our companies sell direct. We are competing with competitors that stock their dealers, and their dealers have the inventory to make quick deliveries. Our Roadtec operation can go into a month with a \$2 million backlog and do \$15 million in sales, and when somebody buys something from them they want it right now. So we have not been as aggressive as we could be on trying to reduce inventory just to be able to generate sales in a weak market. And in regard to the capacity we have more facilities than we have volume right now. There's no question about that.

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<Q>: One unrelated question. The pellet, the Georgia facility, revenue to be booked in the fourth quarter. How much can we expect in the fourth quarter from the ... plants?

Dr. J. Don Brock - Chairman and Chief Operating Officer

It's about \$20 million to \$22 million. We expect, as soon as they sign the contract with the utility in Europe or in England, they've been negotiating this contract for months, but they're down to the final thing. But they will add 2 more lines to it, which will up it to \$50 million, \$55 million.

<Q>: And with \$20 million to \$22 million being booked in the fourth quarter, you're still sticking with the fourth quarter being the same as the third quarter? Top line?

Dr. J. Don Brock - Chairman and Chief Operating Officer

Yes, we are. We've not totally factored that in as far as our internal forecast, but we're expecting to get it.

<Q>: Okay. And any sort of number you want to throw out on what the revenues can be for the pellet division in 2014 based on what you see in hand? Potentially, what numbers we should think as doable?

Dr. J. Don Brock - Chairman and Chief Operating Officer

I will bounce that over to Ben.

Benjamin Brock – Group Vice President, Asphalt

Morris, I think right now, it might be a little too early to call on that, but with the things that Dr. Brock mentioned I think we will be up slightly next year.

<Q>: Last question and I'll get in queue. I think you said this most recent quarter, I have been doing the calculation; gross margin is 21.5% of thereabouts. Should we expect the same sort of gross margins in the fourth quarter? Any changes in absorption et cetera, et cetera?

Dr. J. Don Brock - Chairman and Chief Operating Officer

We kind of expect the fourth quarter to be flat on margins, revenue and earnings.

David Silvious - Chief Financial Officer, Vice President and Treasurer

A very similar profile.

Operator

Our next question comes from Jason Ursaner from CJS Securities.

<Q>: I just want to clarify on the wood pellet question. If it is up and running before the end of the year, you wouldn't need minimum production requirements before you were able to recognize that revenue?

Benjamin G. Brock - Chief Executive Officer, President and Director

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Jason, this is Ben. We factored that in. We know we have a run rate we have to meet on the production tons per hour, and so, we have that factored in trying to hit this year.

Dr. J. Don Brock - Chairman and Chief Operating Officer

Our major problem there is the guy sitting next to us over here, David, is pretty conservative, but we guarantee in this particular plant 15 tons an hour on this first line. We've designed it for 22, and we feel like we're pretty conservative on that. The pellet presses have the ability to run up to 25 tons an hour. The dryer obviously depends on the moisture in the material and that. But based on the factors we have in it, we feel like we're very conservative, and we expect it to perform without any glitches. We probably never built a product we've tested as much as we have the pellet plant.

<Q>: Got it. I guess, I'm less concerned on hitting the minimum than the timing of recognition for Q4, that there wouldn't be a delay.

Dr. J. Don Brock - Chairman and Chief Operating Officer

Yes, I think our biggest problem is that it is out of our control. We're handling the mechanical installation and the purchaser is handling the electrical and the site preparation and all of that, and the delay in this thing has been on their side due to the extreme wet weather we had earlier in the year.

<Q>: Okay. And just overall in terms of seasonality of orders, as you start to look out to next year for the asphalt business, I guess, in particular, when do orders typically need to come in by to really start filling the order book and at what point do you start to lose any flexibility on adjusting planned man-hours to match the orders coming in?

Dr. J. Don Brock - Chairman and Chief Operating Officer

I think that we have seen a pretty good inrush of orders in the last, during the early part of October here, both domestically and internationally. We got a couple of big orders internationally that have been very helpful. We are out in delivery, out into the first quarter of the year, and we went from, frankly, nothing to a bunch here just in the last few weeks. So, I guess, if it wasn't for just looking at overall economy, I think we would be a little bit more optimistic. But to answer your question, I think the inrush of orders generally is in the fourth quarter up through February.

<Q>: Okay. And just, I guess, it may have been asked on Underground, I jumped on late, that included the \$15 million project in Kazakhstan?

Dr. J. Don Brock - Chairman and Chief Operating Officer

Yes it did, and frankly, about nine to ten of that was just priced through. The customer over there wanted to buy our drill rig, but he wanted all of the surrounding components included in it. And we outsourced all of those, and they were at very low if no margin. So just the money we've made on it was on the vertical rig that we built, and that will not happen in the future. I mean, the future of packages we hope to build the whole thing ourselves. It was included in September.

Operator

Our next question comes from Ted Grace with Susquehanna International Group.

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<Q>: So I wanted to come back to the orders. And, Don, it sound like you've seen somewhat of an inflection kind of month-to-date but I was curious if you could maybe just walk through the order progression through the third quarter. I know on a revenue side you mentioned that July was tough and then you saw a sequential improvement in the August and then September. But could you maybe just—from your tone, it's hard not to think your customers are generally conservative regardless of what's going on with the weather, the timing of ConExpo. But could you maybe just walk through the quarterly progression of orders and just maybe flesh out sentiment more broadly?

Dr. J. Don Brock - Chairman and Chief Operating Officer

July was awful. August was awful and September got quite a bit better and October's been better than that. Our customers are fighting. They fought the weather in the first part of the year, and I hate to talk about the weather. We can't do anything about that, but that was one thing. The second thing that they're fighting is these regulators and the banks that are on their tail, and I visited with a number of them. I've had a number of them come in to see me for advice. I had one recently that does \$300 million a year, has a net worth of \$130 million. He owes the bank \$30 million, and he's lost a little money in the last couple of years and they have him in the workout group. It was just absolutely ridiculous.

And so, they're having to refinance and some of them are just not going to make it because the banks are insistent that they pay off the debt, and so, they're having to do distress sales, and that's not good long range. It's going to lead to a heck of a consolidation in the market. But with the inability to borrow, the tough construction season, and just the lack of work and it being extremely competitive, it's a tough market out there. And the outlook of what they're going to do in Washington doesn't give us a whole lot of a positive going forward. The last thing I want to be is negative, but this is the market we're in, and the thing we're looking at is how do we continue to grow some in this market and continue to make money in this market. We think we can do that, but it's a little different from what we've done in the past.

>Q>: I think that sentiment is probably shared by quite a few of your peer CEOs, so that itself is not too surprising. So one of the things you've mentioned is you're encouraged by some of the up-and-coming management team members, trying new initiatives to more aggressively to drive sales. Could you maybe walk through some of those? And then, on a related basis, you guys have a wonderful balance sheet, an excess capital position. Is there any thought to using the balance sheet to potentially fund dealers and/or customers, and I'm not suggesting maybe you'll set-up a captive financed business, but could that be a competitive disadvantage that you don't have one if the banks are pulling back from lending to your customers and how do you offset that?

Dr. J. Don Brock - Chairman and Chief Operating Officer

Well, the first thing in our management group, they're younger. They're more progressive and not afraid to try some things that maybe Norman and I are a little more cautious. One of the things we are doing basically with some of our dealers is some consignment inventory within our own company, with Australia. The other subsidiaries are consigning equipment to Australia to have it available, which they end

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up taking it on their capital employed at the manufacturer subsidiary, but they help Australia, and again, to be able to move equipment. I think that's the main thing we've try to do.

We have done some financing of strong customers that could not get financing. We've looked at their balance sheets, and we're doing some things like that that we feel like are—we don't want to be in the finance business, but we will give them extended terms. Even some of the big guys that have capital restraints, we're doing some extended terms in order to get deals and in order to get them the equipment that they need. We feel like this will build some loyalty and it helps them, and we have the ability to do that and it helps us move the equipment.

<Q>: Okay. That's helpful. And then the last thing I'll ask before I jump back in queue. It sounds like maybe R&D was pulled back in the quarter just given the broader environment. Was that transient? Does that comeback in the fourth quarter? I know you talked about flat margins, and so, we do the math, it's pretty simple. But how should we think about R&D in the fourth quarter and then looking forward to '14? And, I guess, my recollection is the last ConExpo was 3.5 million net. Is that the kind of a number we should be thinking about this March?

Dr. J. Don Brock - Chairman and Chief Operating Officer

Yes, I think that's probably the number, and how many new pieces of equipment do we have, Ben?

Benjamin Brock – Group Vice President, Asphalt

Thirty-seven.

Dr. J. Don Brock - Chairman and Chief Operating Officer

Thirty-seven new pieces of equipment going to ConExpo. And so we do not see R&D being more similar to what it's been this year.

David Silvius - Chief Financial Officer, Vice President and Treasurer

Right. And we've talked in the past on the call and to some folks individually, the run rate for R&D in the past, in the most recent past year, say, 2011 and 2010, especially was in that \$9 million to \$10 million. It was around \$9 million, I guess. We're sitting right now about \$4 million of R&D compared to a hair over \$6 million last year. So you can see that number has come down a little bit, and that would project out to about a \$6 million run rate for this year, which is where we have R&D would head back toward and normalize. Our 10-year average, if you take out the pellet plant anomaly of R&D, then you wind up in that sort of \$4 million to \$5 million R&D range, and we're headed back down towards that direction.

Operator

Our next question comes from Nick Coppola with Thompson Research Group.

<Q>: Looking for a little more color on Aggregate and Mining revenue in the quarter, and it sounds from some of the opening remarks that the businesses is dependent on international markets performed not quite as well. How do you segment that out, and

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really, how are sales domestically, particularly in Aggregate and Mining? Is there any way to quantify that or talk about what you're seeing?

Dr. J. Don Brock - Chairman and Chief Operating Officer

Yes. It's a little bit in product mix. The companies that did very well were the companies that build track mounted equipment, smaller crushers, those that go out, some of them go out on rental and then are converted, but it's more of the smaller, gravel-type crushing equipment, and recycle-type crushing equipment. The bigger plants that Telsmith, BTI and Osborn build, basically, were the ones that were really down. But fortunately, those are the ones that we got some substantial orders in one week at Telsmith. In October we picked up \$20 million in orders, in two orders. And we have another deal, it's about, I think, it closes another \$15 million orders. So some of those big orders just take a long time to close, but we did well in the third quarter, to answer your question, in the smaller equipment track-mounted, self-contained units and less good in the bigger stationary units.

David Silvius - Chief Financial Officer, Vice President and Treasurer

To give you just a number on that, the domestic sales for Aggregate and Mining on both a quarter and year-to-date basis is relatively flat. It's the international sales that's driving the decrease. Their part sales in that group were up in sort of the high single digits for both of the comparative periods. So it's all international.

<Q>: Okay. That's very helpful. And then, a second question here, I heard as well that Capex in 2013 is going to be lower than initially budgeted. Can you talk about the components of that? Does it have to do with progress of the manufacturer facility in Brazil? Or what are the drivers there?

Dr. J. Don Brock - Chairman and Chief Operating Officer

I think the facility in Brazil, we've run in to some soil problems where we're putting the plant and a number of things that have delayed that. It's probably going to be the end of the year or the first quarter before we're operating there, and that's been the biggest slowdown. Some of the other is as the market has slowed, I think, basically, the managers have decided to pull back a little bit. So it's been both Brazil and just the lack of having the stomach to spend the money when things are not great.

<Q>: Sure, sure. Okay. And last question for me, Asphalt Group saw, I think it was 540 basis points of improvement in gross margins year-over-year on really very modest kind of flattish revenues. Can you talk a little bit about the mix there or some of the reasons for the improvements in margin?

Benjamin G. Brock - Chief Executive Officer, President and Director

This is Ben. We had a few things that happened. One, our parts business was up a little bit and not as far as the margin itself. And then, a couple of the bigger orders we had, had some hard deadlines on them to get out in September. And that always helps us to get the run rate through on our margins side. So those are couple of big things that happen to us and not only were there bigger projects, they were just core product, good product mix. I mean we've mentioned that a couple of times today but that really did help us on the Asphalt side.

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Dr. J. Don Brock - Chairman and Chief Operating Officer

I think the other thing, as you make a comparison with the earlier quarters, we made the conscientious decision of not cutting back as much as we probably should in a number of our facilities, and particularly at Astec, Inc. They have gone through a lot of plant rearrangement to go to more continuous top manufacturing, which in the first two quarters had a lot of indirect labor and less direct labor. And that affected their margins in a negative way the first two quarters. They finished those projects in the third quarter, and I think that added probably 200 basis points of that swing.

Operator

Our next question comes from Larry De Maria with William Blair.

<Q>: Okay. I'm just curious what you guys think about the impact of Section 179 on your business, how important it is and what your thoughts are as far as whether it comes back next year. I'm really just curious about that first.

Dr. J. Don Brock - Chairman and Chief Operating Officer

My personal opinion, Larry, is they've worn it out. Put it that way. Our customers are going to buy if they need the equipment but initially doing that for a year or two is helpful. It's lasted so long that our customers have had a tough time making money. So I would say its impact is much less than it normally would have been.

<Q>: Okay. And any thoughts on whether or not it comes back? Or, I guess, as you pointed, it's relatively irrelevant? And then, particularly, you talked a few times on this but just the timing effect of ConExpo, usually, you guys have a very strong fourth and first quarter from an order perspective even in ConExpo years. So just trying to understand how big the impact might be and if it's just really nominal impact and on the margin on the seasonal basis.

Dr. J. Don Brock - Chairman and Chief Operating Officer

If I understand what you're asking, Larry, I think that last ConExpo is probably the first one in my career that we really received a lot of orders. Typically, we didn't. We had a lot of tire kickers and people looking and you'd want to come back and double the size of the factory but then you start looking for the orders to come in and they didn't come in. We did get a lot of orders at the last one, which makes us optimistic that we might get a lot this one. It's more of an international show than it's historically had been. I think a lot of the orders that you get internationally are from South America and Latin America, and that market continues to be one of the better markets now. Ben, do you want to make any other comment?

Benjamin G. Brock - Chief Executive Officer, President and Director

I would agree with that. I think it's interesting that being at Bauma, which is typically an order show, that became more of a looking show with orders later. And so if it holds true the last year, we could see some orders at ConExpo this year. And our sales guys, I was with them this morning, we have them here, they tend to think that could be the case, too.

Operator

Our next question comes from Dan Walker with Heartland Advisors.

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<Q>: So I had a question on the backlog in the Asphalt Group. If I look at the last four years, the backlog in the third quarter has gone from 74 to 95 to 103, and now to 120. And so you had 17% improvement year-over-year in the Asphalt Group backlog, and I think I heard you say, Don, that you're not expecting improvements in 2014 there. We know about the funding situation. We know about the confidence, but given that you've seen that backlog growth, why do you think you won't see improvement in 2014?

Dr. J. Don Brock - Chairman and Chief Operating Officer

The \$20 million of that backlog is at pellet plant, and I think the growth that we will have next year—Ben, you can comment—but I think the growth will be strictly in pellets.

Benjamin Brock – Group Vice President, Asphalt

Yes, I would agree with that. The pellets are really where the growth would be in the Asphalt, particularly Astec, Inc. and the leads there. I mean, their association meeting is this coming Sunday through Wednesday, but like was mentioned earlier in the call, there's a lot of our customers that are watching what's going on at Hazlehurst. And the successful startup there will really be a key to how we proceed in the next year, but that's where the growth would come. We see the plants being flat relative to this year.

Dr. J. Don Brock - Chairman and Chief Operating Officer

The other thing that we struggle with, that we confuse you guys a little bit on, is Heatec. Rick Doris is sitting across from me here, but probably, 60% of their business is oil and gas, and they sold nine heaters yesterday, and I don't think a single one of them are construction heaters. So, it's basically the energy side. The Asphalt business is part energy and part asphalt when you really look at it, and that's what we want from a diversification standpoint. But we've gotten orders from all over for big heaters going in to oil and gas for gas platforms, for processing plants, for all kinds of things. What were those heaters on yesterday?

Rick Dorris – Group Vice President, Energy

Five were gas processing and four were water heating frack.

Dr. J. Don Brock - Chairman and Chief Operating Officer

Okay. So all of it, again, is in the energy business.

Operator

Our final question comes from Brian Rafn with Morgan Dempsey Capital Management.

<Q>: Give me a sense, you know, Don, you talked about kind of a tepid outlook, how do you guys look at the R&D and the Capex for designing new products? You're bringing, I think you said, 37 new products to the ConExpo. How does that—over the next couple of years with flat markets, do you look at product development being less radical, more slight extensions or design iterations? Or do you really try to create demand by coming out with brand new kind of cutting edge technology designs?

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Dr. J. Don Brock - Chairman and Chief Operating Officer

Probably 80% of them are just product improvements, Brian. When we talk about spending \$5 million, \$6 million, we don't capture all of that product improvement. Generally, they're just niche improvements in the equipment. So the wood pellet plant, the vertical oil drilling rigs, the water heaters for fracking and some of those that are just totally different products, we do capture the R&D related to that. But as you make improvements on the first of those units we generally don't capture the R&D.

<Q>: Okay, okay. Fair enough. You also made a good statement. Given, historically, the road-building cyclical nature of the weather, the Highway Bill, the competitive margin structure, the shift from private construction to the public projects, how do you look at the compression from the Washington driven regulating on the banks? Would you say that credit problem is as large or more onerous than some of the more normal cyclical nature?

Dr. J. Don Brock - Chairman and Chief Operating Officer

It's more onerous than I've ever seen it. As I've talked with our customers Brian, Norm, three other guys and I started Astec. I did all of the borrowing of the money and the selling, and I can tell you, we could not start this company today like we did 40 years ago. We had a local bank that trusted us and loaned us the money, and today, the regulators are ridiculous. A con artist can borrow more money than a legitimate contractor that really knows how to build projects and to do it, and generally, a lot of our customers are unsophisticated borrowers. The thing that seems to happen is—and I advise most of our customers, don't get all of your eggs in one basket. If you buy an asphalt plant, get it financed with a different company not your local bank, if you can, and let it stand on its own. If you buy a paver, go get it financed somewhere else. And what happens is that over the years, you have a friendly banker, and he says we'll just do everything and then they end up with collateral of \$100 million and \$20 million in debt. And the banks have them tied up in a knot because they say payoff the \$20 million, and that's a real dilemma. It's strictly the regulators are looking at earnings, and in this kind of climate we're in, they have to be awfully lucky to not break even or just to break even in a down market. And when they're looking at strictly earnings and not assets it puts them in a terrible position.

<Q>: Yes, okay. Are you seeing any differences as with the contracts? Are you seeing any changes in purchasing, a shorter cycle, as you mentioned in the past, but some of the road builders wanting to get the best, state-of-the-art new equipment? Are you seeing any changes between purchase and rental given this kind of difficult market?

Dr. J. Don Brock - Chairman and Chief Operating Officer

Yes, there is much more demand for rental. They would all rent if they could. And that has another negative effect in that you can have a lot of companies that really don't have many assets, and if they can rent a sufficient fleet of equipment to build a job, they can go in and do it with all rental equipment, and the guy that's sitting there with an established fleet that's nearly paid for is really at a disadvantage. So, yes. And you see it more in the big ones. Some of our bigger competitors, they're not even spending Capex. Most of them are spending less than half of Capex, and their poor

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operating guys have got to have the equipment so they want to rent. They're doing a lot more rental.

<Q>: Okay. You also talked about, by business line, looking at some ways that grow revenue. You mentioned Roadtec, I think, going a little more international. But as you look at the international markets be it South America or Europe, I think Europe's—a lot of their roads tend to be built on old Roman road beds, they're much deeper, so you do have some differences in the markets versus the old legacy U.S. Is the function of Roadtec doing business internationally significantly different than it is in the U.S. or is it pretty homogenous across the world?

Dr. J. Don Brock - Chairman and Chief Operating Officer

It's different in each one. If you go to South America, their roads typically have started out like in Australia and New Zealand and South Africa. The African countries started out as chip seals. They probably were better at making good bases out of the local material that they had than we were. So it's generally a smaller tonnage for hours, smaller paving machines, not as much demand for milling machines because they don't have as much asphalt down there. They don't have it to recycle.

Countries like Russia are spec'ing in a lot of our modern equipment like our Shuttle Buggies. Same way with Germany, they've spec'd in certain parts in Germany. We've opened that branch over there. They're requiring the Shuttle Buggy on a lot of the work. The European roads are more like the American roads, probably do a little better job than we do of putting down thicker pavements and things like that. The Russian roads have a long way to go, but their pattern is more like ours.

But to answer your question, it does require us to reconfigure the equipment, less features on it, less sophistication and it's required us to, the same way on asphalt plants, build a stripped down plant to go into a lot of these markets. It's not exactly what they want in the U.S.

<Q>: Yes. Okay. When you talked—you also mentioned too about—I think, you're your talking about selling some turnkey packages on the fracking side. You mentioned the trailers and sand bins and mixers. Is there much margin in those ancillary? I know you're trying to drive, certainly, absorption and capacity utilization through your plants. But are you getting any margin on some of the extra stuff for the whole package?

Dr. J. Don Brock - Chairman and Chief Operating Officer

If you can offer the whole package you can get a margin. If you got cherry picked on skid mounted air compressors and skid mounted tanks and a few things like that, no, there wouldn't be a lot of margin. But what we look at is internationally, we see people that come in and give us a package and that is our way of getting some margin. If you were trying to go out and just compete with the little shops in South Texas building skid mounted air compressor, forget it. But offering the whole entire package that is already piped up to together and everything is there, you can get the margin out of it.

<Q>: Okay. And then just one final. You guys, the cash balance is obviously not real accretive on the ROE, but where do you have your cash invested?

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David Silvius - Chief Financial Officer, Vice President and Treasurer

We have our cash invested, we have certainly some just regular accounts, overnight sweeps, money markets, things like that. We have some invested in some blue-chip mutual funds and some fixed income portfolio as well.

<Q>: Okay. And did you guys mentioned Capex for next year, 2014?

David Silvius - Chief Financial Officer, Vice President and Treasurer

No, we didn't mention Capex for 2014. We did for 2013. We said 2013 would be about \$30 million, but we did not mentioned 2014.

Operator

There are no further questions at this time. I would like to turn the floor back over to Mr. Steve Anderson for closing comments.

Stephen Anderson - Vice President, Director of IR and Secretary

Thank you, Ron. We appreciate everyone's participation on our third quarter conference call, and thank you for interest in Astec. As our news release indicates, today the conference call has been recorded. A replay of the conference call will be available through November 5, 2013, and an archived webcast will be available for 90 days. The transcript will be available under the Investor Relations section of the Astec Industries' website within the next seven days. All of that information is contained in the news release that was sent out earlier today. This will conclude our call. Thank you, and have a good week.

Operator

This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.

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