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Transcript of Astec Industries, Inc.
Second Quarter 2014 Earnings Call
July 22, 2014

Participants
Steve Anderson – Vice President, Director of Investor Relations
David Silvious – Chief Financial Officer
Benjamin Brock – President & Chief Executive Officer

Analysts
Jack Kasprzak – BB&T
Jason Ursaner – CJS Securities
Nick Coppola – Thompson Research
Ted Grace – Susquehanna
Walter Liptak – Global Hunter Securities
Larry De Maria – William Blair
Brian Rafn – Morgan Dempsey

Presentation

Operator
Greetings, and welcome to the Astec Industries Second Quarter 2014 Earnings conference call. At this time, all participants are in a listen-only mode. A brief question and answer session will follow the formal presentation. (Operator instructions.) As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Steve Anderson, Vice President, Director of Investor Relations. Thank you, sir. You may begin.

Steve Anderson – Vice President, Director of Investor Relations
Thank you, Christine. Good morning and welcome to the Astec Industries conference call for the second quarter that ended June 30, 2014. Also on today's call are Benjamin Brock, our President and Chief Executive Officer, Rick Dorris, Executive Vice President and Chief Operating Officer and David Silvious, our Chief Financial Officer. In just a moment, I'll turn the call over to David to summarize our financial results and then to Ben to review our business activity during the second quarter.

Before we begin that I'll 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 results are highlighted in today's financial news release and

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others are contained in our annual report and our filings with the SEC. As usual, we ask that you familiarize yourself with those factors.

At this point I'll turn the call over to David to summarize our financial results for the second quarter.

David Silvious – Chief Financial Officer
Thanks, Steve, and good morning, everyone. Thank you for joining us this morning. Net sales for the second quarter were $277.3 million compared to Q2 of last year of $248.1 million. That's an 11.8% increase or a $29.2 million increase. International sales for the quarter were $92.6 million compared to $85.8 million last year. It's an increase of 7.9% or a $6.8 million increase.

International sales represented 33.4% of the second quarter sales this year compared to 34.6% for the second quarter last year. Those increases in international sales occurred primarily in Russia, Southeast Asia, China and Mexico during the second quarter. Those increases were offset primarily by decreases in Canada, in Africa, Australia and the West Indies.

Domestic sales for the quarter were $184.7 million. That compares to $162.3 million in the second quarter of 2013 or a 13.8% increase or a $22.4 million increase. Domestic sales represented 66.6% of sales this year compared to 65.4% of sales for Q2 last year.

Part sales this quarter were $60.2 million. That compares to $62.7 million in the second quarter of 2013. That's a 4% decrease or a $2.5 million decrease. Part sales represented 21.7% of quarterly sales this year compared to 25.3% in Q2 of last year.

On a year-to-date basis, our sales were $515.9 million. That compares to $496 million year-to-date last year, a 4% increase or a $19.9 million increase.

International sales this year were $155.8 million for the six months compared to $171.7 million for the first half of last year. That's a decrease of 9.3% or $15.9 million. The decrease in international sales this year over last year were primarily in Canada, Africa, Australia, Europe, the West Indies and in Mexico, and those were offset by increases in international sales in Southeast Asia, Post-Soviet states in Russia and in China. International sales were 30.2% of sales for the first half of this year, and that compares to 34.6% of sales for the first half of last year.

Domestic sales for the first half are $360.1 million compared to $324.3 million for the first half last year. It's a $35.8 million increase or an 11% increase. Domestic sales represented 69.8% of sales for the first half this year compared to 65.4% the same period last year.

Part sales for the first half this year were $129.4 million compared to $130.8 million last year. That's a decrease of just over 1% or a $1.4 million decrease. Part sales were 25.1% of total sales this year compared to 26.4% last year.

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Gross profit for the quarter, on a dollar basis, was $62.2 million. That compared to $55.4 million for the same quarter last year. That's a $6.8 million increase or a 12.3% increase. That yielded a gross profit percentage of 22.4% for the second quarter this year compared to 22.3% for the same period last year.

One of the major positive impacts that we had in the second quarter of '14 was a reduction in our unabsorbed overhead. Last year you may recall that it was $7.2 million in the second quarter. We have reduced that down to $2.8 million in the second quarter of 2014.

On a year-to-date basis, gross profit dollar-wise was $118.9 million this year compared to $114 million last year. It's a $4.9 million increase or a 4.3% increase. That yielded a gross profit percentage of 23.1% for the first half this year compared to 23% last year.

The same thing happened in unabsorbed overhead. On a year-to-date basis we've decreased unabsorbed overhead from $13.8 million for the first half last year to $6.1 million for the first half this year, a $7.7 million decrease.

The SGA&E line, for the quarter it was $40.2 million or 14.5% of sales compared to $37.8 million for the second quarter of 2013 or 15.2% of sales. That is a $2.4 million increase or a decrease of 70 basis points as a percentage of sales. On a year-to-date basis, SG&A was $83.7 million or 16.2% of sales compared to $78.2 million for the first half last year or 15.8% of sales, a $5.5 million increase. That increase primarily was driven by our ConExpo expenditure of just over $4 million in the first quarter of 2014. We also had the addition on April 1st of Telestack, and that represented another $1.3 million increase in the SGA&E for the quarter. So that impacted both the quarter and year-to-date periods.

Operating income increased to $21.9 million for the second quarter of 2014 compared to $17.6 million for the second quarter of 2013, a $4.3 million increase or a 24.4% increase. For the first half, it was $35.3 million versus $35.8 million last year. That is a $0.5 million decrease or a 1.4% decrease.

The other income line had some impact during the quarter and the year-to-date is a little larger than it was last year. It was $736,000 for the quarter versus some expense last year of about $29,000, and for the year-to-date it was $1.5 million income versus about a $600,000 income last year. Those numbers are primarily driven by license fee income and investment income in our captive insurance company.

The effective tax rate for the quarter was 35.7% this year and 36.6% last year, and for the year it was 34.4% and 33.1% last year. You may recall that R&D credit can impact our tax rate significantly so this year they have not passed the R&D credit yet. We believe that it will pass at some point this year, but last year that R&D credit passed early in the year and we were able to take advantage of that in last year's tax rate but have not been able to yet in this year's tax rate.

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Our net income line was $14.5 million for the second quarter of this year compared to $11.1 million in Q2 of 2013. That's a 30.6% increase, and that resulted in earnings per diluted share of $0.63 for the quarter compared to $0.48 per diluted share in the second quarter of 2013, a 31.3% increase.

For the first half, our net income was $24 million compared to $24.3 million for the first half last year, a $300,000 decrease or slightly over 1% decrease, which resulted in earnings per diluted share of $1.04 for the first half this year compared to $1.05 for the first half last year.

As a reminder, our backlog has been adjusted in these prior year numbers that I'm going to read to you. Those have been adjusted for the addition of Telestack so the prior year numbers do have Telestack's prior year June 30 backlog in them so it's apples to apples. At June 30 our backlog was $264.1 million compared to $247.3 million at June 30th last year. That's a $16.8 million increase or a 6.8% increase.

International backlog this year is at $106.7 million compared to $106.6 million last year, relatively flat. Our domestic backlog is at $157.4 million compared to $140.7 million at June 30 last year, a $16.7 million or an 11.9% increase in domestic backlog.

To the balance sheet, the balance sheet continues to be fairly strong. We are sitting at $119.7 million in receivables at June 30. That compares to $102.8 million last year, a $16.9 million increase in receivables that results in days outstanding of 39.1 days this year compared to 37.3 days last year. Our inventory is sitting at $364.1 million compared to $322.8 million last year, an increase of $41.3 million. That results in 2.1 turns this year compared to 2.3 turns in the prior year.

We owe nothing on our $100 million credit facility. We have $18.6 million in cash plus some short-term investments. Our layers of credit outstanding are about $6 million, which leaves us a borrowing availability right now of $94 million. Capital expenditures for the second quarter were $5.3 million and year-to-date were $13.6 million. We are forecasting that our capital expenditures for the year will end up in the $32 million to $33 million range.

Depreciation for the quarter was $5.3 million and on a year-to-date basis is $10.5 million. We're still forecasting that our depreciation will come in very close to $24 million.

That concludes my prepared remarks. We'll turn it back over to Steve.

Steve Anderson – Vice President, Director of Investor Relations
Thank you, David. Ben will now provide some comments regarding our second quarter results and talk a little bit about our operations. Ben?

Benjamin Brock – President & Chief Executive Officer
Thank you, Steve. Thanks, everybody, for joining us on our call today. As we mentioned in our earnings release this morning, we're pleased with our results during the second quarter and for the first half of the year.

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Our earnings per share were $0.63 per share versus $0.48 per share in the second quarter of 2013, and our earnings for the first half this year were $1.04 versus $1.05 in 2013. As a reminder from our last quarter's release and discussion, we did have ConExpo expense of about $4 million or a $0.12 per share expense that we did not have in the first quarter of 2013, and the first quarter also this year did not have a $0.05 per share R&D tax credit that we did have available to us in 2013. So adding the ConExpo and the R&D back to the first half, it would've meant $1.21 a share versus $1.05 per share in 2013. So we are pleased for the ConExpo and the R&D tax credit our focus on our operations is resulting in a higher earnings and continuing operations for the third quarter in a row.

Our backlog at June 30th was $264.1 million, which was up 7% versus last year. Regarding the sales environment that we are here in the United States, the reality does continue to be that the uncertainty created by our representatives in Washington continues to make our domestic highway infrastructure customers feel uneasy about major capital expenditures.

The latest effort by Congress to fund the highway bill to May of 2015 is very welcomed. However, it is short sighted for our customers. We will work to support the Tennessee Senator Bob Corker's bipartisan proposal made with Senator Murphy of Connecticut that would increase the gas tax $0.12 per gallon over a two-year period to fully fund the highway bill going forward, along with the provision to tie the tax to the consumer price index.

To give everyone on the call an idea of what the increased gas tax that was proposed by them would mean to the average driver in the United Sates, the average automobile is driven about 15,000 miles per year and gets about 23.6 miles per gallon. That means that the average automobile would use about 636 gallons of gas per year. That's 636 gallons at a $0.12 tax increase would equate to a $76.32 per year per automobile gas tax increase, which equates out to $1.47 per week, about the price of a cup of coffee. There are studies that have shown that the savings in automobile fuel consumption and maintenance would amount to more than two times that amount for each automobile so we do think it makes good fiscal sense for the nation.

We would always welcome a long-term bill with the increased funding, but in the meantime we're going to continue to pursue new business with our new products in the United States, and we're working to grow our international effort. Our customers are containing to see slow marginal improvement in the private sector. As most of you know, the Telestack Company based in Northern Ireland joined our family of companies on April 1st. As a reminder, they engineer, sell and manufacture material handling systems used in ports, large mining operations and quarries. They offer a large port and mining material handling systems that were not available in any of our other 17 divisions.

With the acquisitions, we've added not only new products but also a manufacturing division in Europe that has delivered equipment to six different continents. We're pleased to report that Telestack was operationally profitable during the quarter and has a backlog that takes them into the end of this year. Due to acquisition accounting,

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they did not show a profit in the quarter. We expect them to show a profit going ahead.

As a new products update, the first line of the Hazlehurst wood pellet plant continues to perform well during the quarter, and we'll finish delivering lines two and three in the third quarter. As a continuing reminder, it is a new product that we chose to finance for 24 months, and as a result we'll recognize the revenue for this plant as we're paid. This will have an effect on our cash and our inventory until it's paid in full. As a reminder, the order for lines two and three was for $40 million. The startup of the plant has created a strong interest and we do expect to sell an additional one or two plants by the end of this year.

Internationally we're pleased to see our volume start to come back up and the productivity increase during the second quarter. As an example, we delivered equipment to 36 countries during the second quarter. By comparison we delivered equipment to 28 countries in the first quarter of this year.

On the energy side we remain challenged in our drilling and pumping equipment with regards to shipment in the second quarter, and we're happy to report that we will ship an oil rig and three pump trailers during the third quarter. This, along with continued strength and heaters for gas processing operations and increased sales of wood chippers and grinders has us optimistic on our outlook in the energy group.

Rick Dorris and I were in Texas last week visiting one of our key suppliers, and they made the comment that drilling in Texas had picked up significantly in the last three to four weeks, which had translated into an uptick in order form.

We are working to grow our business in mining through our new facility in Belo Horizonte, Brazil. The progress on this facility took a big slow down during the World Cup. We do expect to have the facility open and operating in October.

Our Osborn division in South Africa does about 90% of their business with the mining industry. Their biggest challenge at the moment is a large strike of workers in the metal working industry in South Africa that has several manufacturers in the country closed. Osborn has been closed for three weeks with no visibility on when the strike will end. We are shipping parts from vendors and supporting our customer service issues during the strike. Should the strike continue, it could slightly affect our third-quarter performance.

Looking ahead to the third quarter in 2014 and the rest of this year, we obviously have maintained a nice backlog and have mentioned an increase in quote activity internationally. From our last earnings release to now orders have been normal for the summer months with the exception of hot-mix asphalt plants, which have continued to lag due to highway build uncertainty. Our market share remains as strong as ever in the hot-mix asphalt plants. As we have mentioned before with the soft hot-mix asphalt plant market, it's been good to have the pellet plant business as an offset at our Astec subsidiary.

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We see growth opportunities in the oil drilling, the pellet plants, large crushers for mining, high debris cycle asphalt plants and still small commercial paving equipment. While part sales remain flat to slightly down for the first half versus last year, we remain committed to improving our part sales volume in the long-term and are working to increase our competitive part sales volume. We are continuing to work on our lean journey with regards to manufacturing and/or our office operations. As an update, as David mentioned, we are happy to report that we remain over 50% better versus the same period last year on our absorption.

Looking to the whole of 2014, we expect to improve on our performance versus 2013. The third quarter is traditionally a slow quarter for us as a whole. With our divisions' current backlog and delivery schedules, we are cautiously optimistic that we'll be able to be ahead of Q3 last year. And again, this is despite the current state of the highway bill in Washington D.C.

Our customers are experiencing an improved product market, and we are focused on selling the existing and new products not only in the United States but also around the globe. We're also growing our business in energy and mining, two industries that are not dependent on the highway bill. Acquisitions do remain a key piece of our growth strategy, along with organic growth through new product introductions and targeted sales growth efforts, both in the US and international markets.

That ends my comments on the quarter and the year and what's in front of us. Thank you for taking the time to be on our call and for your support as we move ahead. I'll now turn it back over to Steve Anderson.

Steve Anderson – Vice President, Director of Investor Relations
Thank you, Ben. Christine, if you could open the lines up, we'd be glad to take questions at this point.

Operator
(Operator instructions.) Our first question comes from the line of Jack Kasprzak with BB&T. Please proceed with your question.

<Q>: First question is just on the issue of federal highway funding. Are you guys saying that this lack of sort of stop gap funding measure that I guess has made some considerable progress in Congress but is yet to be passed is affecting orders such that when it is passed, the $11 billion or so infusion, that it might serve to relieve your customers and perhaps bring them back into the mix in terms of orders?

Benjamin Brock – President & Chief Executive Officer
It really would help move them along. The truth is in talking to our customers in the last month, their business seems to be better than ours, particularly the asphalt side. The more we talk to them there's work out there that they have. The profit is good. They're spending money on the smaller ticket CapEx items, the Roadtec pavers, mills and things like that. Demand has slowly improved for that type of equipment, but there is pent up demand on the large ticket items like the asphalt plants.

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They just want the visibility. We went up to the fly-in for the transportation construction coalition fly-in. We kind of left not feeling very good about it, but the proposal by Corker is somebody stepping out and trying to get something done, which we fully applaud and it would help our customer psyche for sure.

The other thing though is that what Congress has proven is that they will continue to do extensions. So the message we're trying to send our customers with our salesmen is that it's not what we want but it is there. They are spending some money on roads. The baseline is there. The mindset, there's nothing like a highway bill to help their mindsets on big purchases.

<Q>: Is there a sort of average price or ticket for the pellet plants that you're selling?

Benjamin Brock – President & Chief Executive Officer
We sell them in 20 ton per hour lines. The pellet plant at Hazlehurst is a three-line plant so that's about a $60 million project. I think it's just under or right around $59 million. The ones that we're quoting are two-line plants.

<Q>: So at about $20 million a line?

Benjamin Brock – President & Chief Executive Officer
Yes, each one would be about $40 million.

<Q>: On your first quarter call following the ConExpo show, I think you were happy with the attendance and the customer feedback and order potential but maybe the orders would kind of flow in over the course of the year. Are they flowing in as you thought? Are you still happy with kind of the return on investment from the show, if you will?

Benjamin Brock – President & Chief Executive Officer
We are. We have picked up a few orders from leads that we picked up at the show that we didn't have before the show. The biggest example of that would be a polymer plant in Brazil. We're still working a few other opportunities, but yes, we would still say we were happy with the show.

Operator
Our next question comes from the line of Mig Dobre with Robert W. Baird. Please proceed with your questions.

<Q>: Ben, just to clarify something on your coffee cup comment earlier. At most places, coffee costs a little more than a dollar and change. Just for perspective to keep that in mind. I do have a couple of questions on aggregate and mining. Can you provide a little bit of color on the sequential uptick in orders? How much of that was Telestack and maybe try to parse out what's happening from the pure aggregate side versus what you're seeing in mining?

Benjamin Brock – President & Chief Executive Officer
On the backlog side, part of that was them being added in. We're seeing some more bigger project work come towards our Telsmith division. So we're seeing some of that

start to flow through. Like I mentioned, some of our customers, as we're talking to them, seem like they're doing a little better than us, and that holds true on the aggregate side too so we are seeing some of that. Where they've been off a little bit has been on the international side, and we have seen more projects on that side too start to come up on quoting.

<Q>: Is there a way to kind of frame the year-over-year growth in aggregate versus what's happening in mining? I'm trying to figure out is mining down 20 or whatever percent and aggregate is growing? How should I be thinking about that?

Benjamin Brock – President & Chief Executive Officer
Well, most of our mining work, Mig, is at the Osborn division, frankly, as we've mentioned in the past. What we would say is it's probably about equal, although our Osborn group has a good backlog but a lot of that is in traditional aggregates right now. I would be thinking about it as being kind of equal as far as the dollars.

<Q>: And then sticking with Telestack, can you help us with the swing? In profitability, you mentioned that, because of purchase accounting and what not, this acquisition didn't contribute really or rather was a headwind to net incomes this quarter, but you're expecting it to contribute going forward. Can you calibrate that at all?

David Silvious – Chief Financial Officer
Yes, absolutely. The comment was that they were operationally profitable and that due to acquisition accounting that they actually had just a small loss for the quarter, and we don't expect that to exist going forward. We do expect them to be showing accounting profit, reportable profit going forward, and the reasons for that in the acquisition accounting is primarily the biggest chunk of it was the write up of inventory when we bought it and allocated the purchase price. That inventory gets written up, and then it gets sold. Now the vast majority of that that was written up was sold during the second quarter and so that increase in basis has moved through the P&L so we don't expect that to exist going forward at all.

<Q>: I see, I see. But can you provide me with a number on this so that I understand the impact, what the write-up was?

David Silvious – Chief Financial Officer
Yes, I believe it was in the neighborhood of $800,000 to $900,000.

<Q>: Okay. Thank you for that. I'm also wondering if you can give us a little more color as far as additional potential demand for the wood pellet plants. You did mention some folks are looking at the plants and you reiterated the fact that you expect sell some by year-end. Has your conviction increased, unchanged or decreased as far as your ability to get additional orders this year?

David Silvious – Chief Financial Officer
I think for this year, we would say one to two for delivery in 2015. There could be more but they would be next year so we wouldn't say any more than that for now, Mig, really for what we're talking to. We have more prospects than that, but those seem to be the two warmest that we have.

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<Q>: That was last quarter as well, but I'm wondering have you made progress with these plans that you apparently have in your pipeline?

Benjamin Brock – President & Chief Executive Officer
Right. We do have some excitement around the plant. It's exceeded the guaranteed tons. We guaranteed 15 tons on the first one because it was our first one, but we've run over 20 tons an hour on the line. We've gone through our problems. I mean it's the first so we've had issues, but we did get it up running high enough to where we ran them out of their base material. They ran out of chips so that was a good sign.

We've had visitors on site. They're excited about the prospects. A lot of the comments are nobody is close to you; you're doing great. It just takes so long for the projects because of the financing and getting the sites ready, and it's really a transportation business on the pellets so getting all that lined up just takes a long time, but when we can get people to the site we seem like we're moving into a lead position for opportunities to get deals. One or two this year, potentially more than that number for next year but it is really too early to talk, as we have to figure out which guys have the money. That's kind of where we are right now.

<Q>: I appreciate that. Then last one before I jump back in the queue, on energy. Nice bump in orders there sequentially and year-over-year as well. With that in mind and looking at the backlog, how should we think about margin here in the back half of the year for this segment? Is it reasonable to assume a similar run rate to what you've had in the first half or given your backlog mix can we be thinking something else?

Benjamin Brock – President & Chief Executive Officer
Well, part of that backlog is newer rigs, the newer technology and we continue to change that as we go along. I think the way to look at that would be the same type of margins. We think next year we can start raising those a little bit because we're getting a name for ourselves and on the pump trailers, but right now, I would look at it as the same margins for the balance of the year.

Operator
Our next question comes from the line of Jason Ursaner with CJS Securities. Please proceed with your question.

<Q>: First I have a couple of questions on the infrastructure group. Normally Q1 and Q2 were roughly comparable through the company, but sales were up almost 20% sequentially. Would most of that increase relate to weather? I know last quarter you talked about that impact of some of the timing of deliveries. I'm just trying to break that between weather and maybe ConExpo?

Benjamin Brock – President & Chief Executive Officer
Jason, I would probably agree with you on the weather to a point, it was awfully wet in the first quarter. But the other side of that, on the infrastructure, is with Roadtec being in there and seeing the spending on the smaller ticket CapEx items. They're gaining some market share we feel like in the papers. I think that's where you're seeing a piece of that and also our small papers with our Carlson Group. They're doing as well as ever on sales and backlog that they've ever done.

<Q>: Okay. And it may have been inquired, but just on the wood pellet, the quarter included no revenue for any recognition on the initial one, that's on the customer financial arrangements?

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Benjamin Brock – President & Chief Executive Officer
That's correct.

<Q>: Okay. And in terms of the cautious commentary on short-term spending, maybe just a little bit more detail there. Because customers had already been holding off, waiting for the Highway bill, so is the commentary that this is just a continuation of that? Is it trying to signal maybe more of that or is it just signaling kind of normal seasonality that domestically the second half tends to be lower than the first half to begin with?

Benjamin Brock – President & Chief Executive Officer
It's a combination Jason. The hot-mix plant business is just pretty tough right now, frankly. Our market share is really pretty good in a weak market. The fall buying season or traditional buying season, we're starting to quote for that, but we're on the short-term. This is going to take a while to get our customers through the work season and get them into the buying mode. So I think it's a combination of traditional buying season and the fact that we're on another extension to 2015.

<Q>: Okay. And overall parts sales obviously declined a couple of percent in the quarter on a year-to-year basis. There has been an effort to increase the investment in sales there to grow that after-market portion. Was there anything specifically going on in the quarter or the first half that may have skewed that or I guess how are you going to turn that towards growth?

Benjamin Brock – President & Chief Executive Officer
Well, we were frankly a little disappointed because we have been focusing on it, and we've seen a little bit more since then in the quarter, parts coming back a little bit. Our answer from the field is it's just not as many parts have been bought on the Asphalt side in particular. One of our private parts competitors is reducing staff, but as we get into it, we're going to continue. We're going to keep working on the competitive parts side of it. Some divisions have done better than others on that so we have an opportunity there.
We're working through that frankly Jason, we want to increase it and we're going to continue focus on it during the quarter. Part of that will be a little bit better effort on how we're covering the territory with our boots on the grounds because we do have more boots on the ground, and we think we can get that back here going into second half.

Operator
Our next question comes from the line of Nick Coppola with Thompson Research. Please proceed with your question.

<Q>: Can you add a little more color about the activity you're seeing at the state level to get highway projects completed? And then kind of as a follow-up to that, are you seeing substantially stronger pockets of growth where additional funding mechanisms are being put in place?

Benjamin Brock – President & Chief Executive Officer
Sure, the ones that we've talked about, we've kind of talked about them in the past, Nick, the Virginia effort with moving to more of a sales tax set-up. I was up there in late June and July with a customer, and they're starting to see a little bit of that. They were busy. They kind of said we were busy, but part of it is we had a wet first part of the year but the projects that were coming were looking good to them. They were in the Northern part of Virginia.

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The other states, Pennsylvania has done some work on that to try to get more sales tax going. Part of that is to go away from some of the gas tax to go to some of the sales tax side, but those were a couple of examples that are out there that seemed to be working. Now the other pockets where there is work, of course, is kind of where there is oil. We've seen Texas being strong, for instance, and that makes sense for what they've got going down in that part of the world.

<Q>: Okay, that's certainly helpful. And then, in terms of international sales, we saw one of the strongest year-over-year growths we've seen in quite a few quarters. I'm assuming Telestack helped to move the needle there. If there is any commentary that gives us to kind of either quantify that or commentary about broader-based international trends that would be helpful?

Benjamin Brock – President & Chief Executive Officer
Sure. Telestack did have an effect on that, and then also, in the countries that David mentioned in his comments, Russia and Post-Soviet states have been good for us. One of the questions that may come up is, how are we seeing the Russia and the Ukraine situation and is that affecting us? We have not seen it yet. We're keeping a heck of an eye on it, but what we've seen is things are moving as usual. We've had a lot of mobile equipment shipped into Russia. We've had an Asphalt plant that is shipping. We got paid last week. It's on the way over. In the Ukraine we have a project coming out at Telestack that's shipping this week. It started shipping yesterday so we have not seen that affect us in that region.

Operator
Our next question comes from the line of Ted Grace with Susquehanna. Please proceed with your question.

<Q>: I was hoping you could circle back on a couple of items and maybe parts just because it was just discussed. Ben, I apologize if I missed it, but specifically where was the weakness most achieved in the quarter that drove kind of a decline and maybe you could just start there?

Benjamin Brock – President & Chief Executive Officer
Well, we had, on our energy side we were off a little bit with our Heatec parts. They had a pretty significant order last year that was off a little bit for them, and our Telsmith Group was off on their parts a little bit. Those were the two main culprits, if you say culprits, but they're working on getting it back up. We have pockets where they're pretty good, but those were the two main ones.

<Q>: So energy and I apologize to not knowing off the top of my head, but Telsmith is in AMG?

Benjamin Brock – President & Chief Executive Officer
Yes.

<Q>: And the end-markets based specifically on what?

Benjamin Brock – President & Chief Executive Officer
Telsmith is primarily quarry and aggregates. They have some mining equipments and then they're developing the large 900-horsepower cone for the mining. And then Heatec is in the energy side and primarily handles heaters and powder-blending systems/rubber-blending systems.

<Q>: So, to your prior comment that domestic aggregates is okay in international comp, is it fair to say you met your domestic parts business for AMG was up or would that be reading too much in what you are saying?

Benjamin Brock – President & Chief Executive Officer
No, I think it would be maybe reading a little bit too much. I think it's not to that degree.

<Q>: Okay. But when you talk to customers on a domestic aggregate side that they're-I mean, volumes are clearly up nicely, productions up nicely in the second quarter. You just have yet to see that kind of translate into parts and consumables?

Benjamin Brock – President & Chief Executive Officer
Yes, we think we're going to start seeing it.

<Q>:Okay. And you don't think that the market share issue or third parties, you think this is the timing factor?

Benjamin Brock – President & Chief Executive Officer
I don't think it's a market share issue.

<Q>:Okay, perfect. That's helpful. Then the second thing I was hoping to circle back on and I apologize if I missed something, but in terms of the AMG margins, the incremental were softer than trend. I know you had some one-time items related to Telestack, but could we just maybe walk through what those one-time items were just so we understand what the underlying profitability of AMG looks like?

Benjamin Brock – President & Chief Executive Officer
I think what you're referring to when you talk about their margins, frankly they had a couple of large projects that were price competitive and I think that's what you're seeing, Ted. We don't really have anything other than that when we talk. Their product makes us pretty good. They just had a couple of big jobs that were price competitive.

<Q>:Okay, so kind of pricing and mix where you had more OE and that kind of—and the one-time items I know I heard $800,000 to $900,000 of inventory step-up. Was that all realized in the quarter or is that what we're expecting for the year?

David Silvious – Chief Financial Officer
I'd say 90% to 95% of it was realized during the quarter. I'd say the lower end of that range was realized during the quarter. There may be just little bit left. I think they had one piece of equipment left that existed at the acquisition date, and that piece should move out this quarter, we believe, or at some point the remainder of the year.

<Q>:Okay, so the one-time items are behind and things kind of normalize 3Q and beyond?

David Silvious – Chief Financial Officer
That's correct.

<Q>:Okay. And then, clearly on the energy margins comment on the back half are you saying it will be similar year-on-year or the second half of 2014 should be similar to the first half of 2014?

Benjamin Brock – President & Chief Executive Officer
The second half of 2014 should be similar to the first half of 2014.

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<Q>: Great, okay. That's helpful here. The last thing I wanted to ask because I know I've asked a few, is if you just kind of look forward two or three years, with lean and all the other initiatives you have underway, can you just talk about the longer-term opportunity you see to improve margins, structurally, so forgetting volumes and mix and pricing in those dynamics, just in terms of improving your fixed cost structure, how much opportunities do you have left, two to three years? And I'll get back in queue.

Benjamin Brock – President & Chief Executive Officer
Ted, we were working on the lean. Again, as I've said in the past, I think we've been slower than a lot of companies that maybe built one after the other things because of our build to order in most of our businesses set up, but we are making the journey and we're now ranking our divisions against each other, which is a great best practices driver. We're starting to see that take effect. We do on quarterly reviews travel to the divisions and we're seeing some results visibly in the shops, and as they do what the companies that have already done that, as that comes through, we think we're going to see better margins. Part of it will be volume. I mean, we are a volume story sometimes with the margin, but we're getting the things in place to be able to get back, if we can get the volume, to get back to the historical high margins. That would be our goal is to get back to that point. As a combination of the lean effort in volume, that's just too we are in our made-to-order setup.

Operator
Our next question comes from the line of Walter Liptak with Global Hunter Securities. Please proceed with your question.

<Q>: Good morning. Just a couple of follow-ups, first, in your outlook you commented a little bit about third quarter. I think you commented that revenues are going to be challenging. I wonder if you can just kind of review that with us. I think you said, EPS might be up in the third quarter directionally, and I wonder if can get more color there?

Benjamin Brock – President & Chief Executive Officer
I think we'll be ahead of the third quarter last year at the end of this third quarter, and based on what we have in our backlog, and the scheduled shipments, I think that's about where we believe. With our quarters sometimes even we get a little frustrated because of permitting and sites not being ready and that type of thing and we have a little bit of kind of what I call creeping of the quarters over into the next quarter a bit, but what we see right now we think we'll be ahead of last year.

<Q>:Okay. Kind of along those lines in energy for the order, activity was strong. Is that book in ship, can that ship in the third quarter or some of it ship in the third or is it more waited towards the fourth?

Benjamin Brock – President & Chief Executive Officer
Some of it will and we have our Peterson divisions doing quite well, and a good portion of that is in that group and the Heatec Group.

Operator
Our next question comes from the line of Larry De Maria with William Blair. Please proceed with your question.

<Q>: Hi, good morning. Thank you. Couple of questions, first from the sequential infrastructure incremental, they are relatively weak sequentially but obviously they're really large year-over-year. Is there anything to the seasonality, to the cost in that

segment that would affect 1Q to 2Q? And then how should we think about second half gross margins given the run rate we're at now? Thank you.

Benjamin Brock – President & Chief Executive Officer
Larry, I want to apologize on this, I missed the first part of the question, this is Ben.

<Q>: Hi Ben. No, just about the sequential infrastructure margins maybe weren't as hot as obviously they were year-over-year. Is there anything seasonally with the costs, is there anything like that we should think about because they're trying to get a proper run rate to get into the second half so just trying to understand the seasonality and then what the second half might look like?

Benjamin Brock – President & Chief Executive Officer
Okay, thank you. I'm sorry about not hearing the first part. We will see some seasonality. What will help a little bit at the Astec division, for example, is we do have the hours of the pellet plant to help on the hours absorbed. I think we'll see about—with the volume we have some other divisions, I think it will be even to slightly ahead of last year in the infrastructure, probably a little ahead.

<Q>:Okay, that's fair. And then secondly on the pellet plants, I guess, how do we think about strictly within that category, obviously the gross margins probably start off lower than you were hoping and then they obviously grow as they come up the curve and get more orders, but how do we think about the trajectories which gross margins specifically for the teleplants? And then, it sounds like you won't be financing subsequent orders with customers. Is that an issue for you guys, are your competitors thinking about doing that or is it just you need to evolve and that needs to just get better?

Benjamin Brock – President & Chief Executive Officer
Well, the pellet plant margins that we're seeing are in line with our major equipment gross margins so we're happy to put forward that. Going ahead, we'd like to raise them, and we will as we build one after the other. If we can get to where we have our order behind each other, we naturally do better.

Competitor wise, it's really difficult for somebody to come in and be exactly what we are because there is a large investment to get to that point. As we stand right now, we supply everything on the plant, with the exception of two pieces, pretty critical pieces, the pellet press itself, and we've partnered with Call out at Germany and use their unit as our standard unit. And then we have some hammer mills that we bought out from another company that eventually we can design our own hammer mill.

We're in a unique position as a build-to-order one-stop shop for a pellet plant. Most of the other plants are engineering firms pulling equipment from multiple suppliers together to build a plant. Where you have one finger to point at Astec is we take responsibility for everything, and we will handle the other press and the hammer mills because we've gone through the training on them. It's different when you have an EPC contractor or an engineering company that brings in ten different people and they can look at each other and say who is the one causing this problem. That's pretty attractive to the end-user. We are in a unique position right now.

<Q>: Got you, that makes a lot of sense. And then, just finally, how do we think about capacity lines, given that you guys are maybe I guess I like to say a bit more vertically integrated than some of the competitors when we're assembly and contractual based? How do we think about the number of lines we can actually think about getting towards or is there no real limit? How do we think about that?

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Benjamin Brock – President & Chief Executive Officer
If you look at the charts and the projections that we see coming out of meetings and going to association meetings too, general conferences, a 60-ton an hour plant, you think of that as maybe a sweet spot in size, which would be three lines. The market that has projected for Europe, which the pellets go to replace coal for the emissions reductions, so you look at the projection of the number of pellets or the tons that they will need, it would tell you that somewhere in the range of 35 to 50 pellet plants in the 60-ton hour range would be sold in the United States to supply that.

Of course you'll end up having some competition. Latin America will get into supplying pellets. A lot of it comes down to transportation. They have to be first in the fiber bed, around the trees, and second, close enough to a cheap enough form of transportation and get it there economically for the price that they're willing to pay for the pellets. So that's kind of where the limit comes in and where it's not 300 pellet plants.

<Q>: Right. I guess, I'm thinking about your guy's capacity in terms of how many lines you can do in a year, how limited you guys are if this market really takes off?

Benjamin Brock – President & Chief Executive Officer
Right. Well, capacity wise, we could handle six lines to nine lines in a year pretty well. Now, if the hot-mix plant business comes back, we'll have an opportunity but we can add on fairly quickly. We already have the plans should that happen. So six to nine lines in a year right now would be where we'd be.

Operator
Our next question comes from the line of Brian Rafn with Morgan Dempsey. Please proceed with your question.

<Q>: Yes, let me ask—you guys talked a little bit about parts. Are the parts sales levered to utilization? I would ask that if you go with this kind of inept Washington and the Highway bill and if the in-field installation of equipment continues to age and the light spans continue to the longer, I would think that over time that would cause a demand increase for parts or is it strictly on just utilization and usage?

Benjamin Brock – President & Chief Executive Officer
Now, I would agree with your comment. I mean, if the plants continue to age there will be more parts sold. Utilization of those older plants does matter. I mean if a plant's mothballed and it's not working, they're not going to be buying any parts. One of the things we've seen as people have gotten a little more work and gotten busy and as they started up their plants, they realized the cost that that's cost them in the back half of last year, in the first part of this year. I think that helps add to the pent-up demand. If we can get a long-term bill, we could see some movement on the large plants.

<Q>: Yes, okay. Also Ben, you talked about with 17 company subsidiaries, give us kind of a sense maybe from a 50,000-foot view, kind of what you're running shifts and kind of where your capacity utilization might be. You don't have to go through each one but just kind of maybe the high to the low?

Benjamin Brock – President & Chief Executive Officer
Well, as a group, we're probably running about 65% utilization today. Our current volume, we could probably get another—If you say we're a $900 billion company, we could probably get it to 1.5 or 1.6 with our current facilities. That's adding second and

third shifts and that type of thing. Our lean effort will help that a little bit, give us ability to get more through the existing facilities.

<Q>:Okay. And correct me if I'm wrong, I think you had 40 or 41 new products, the ConExpo, is there anything that's tracking better or the reception adoption is better across any of those new products?

Benjamin Brock – President & Chief Executive Officer
Well, at our Carlson group, their new screeds have really taken off. They have gotten a lot of orders. Their small pavers have done extremely well that they announced at the show. So if there was one that I was going to pick out, I would pick that out. There is lot of excitement through a lot of the division's equipment, the new guardian system on the Roadtec pavers, to be able to see what's happening on the road on your smartphone and that type of stuff, is very popular.

We've seen pretty good interest in the people carrier that BTI had at the show, and they didn't expect to get activity on it. The new water drill rig that GEFCO had at the show is the line interest. I would love to talk to you about those for an hour, but we have had some pretty good interest in the new equipment that we showed there.

<Q>:Okay, okay. Just from the standpoint of kind of a global scope for pellet plants, you mentioned Europe 35 to 50, 60-ton plant, is that specifically concentrated in the UK or that's spread all over the European continent?

Benjamin Brock – President & Chief Executive Officer
The primary driver demand is the UK. Now, the pellet plants themselves would be here in the United States and the Pellets would ship to Europe, but we have seen an up-tick with the price of natural gas coming out of Russia at about $16, I guess, a thousand right now. The wood is competitive so we've seen a residential up-tick through the winter last year in Italy and Germany. Our customers are shipping some pellets to that area too, and they get a little more money on the private side, which is similar to asphalt business, but we have seen an up-tick there.

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

<Q>: Yes, thanks for taking my follow-up. Just a couple of clarification items, first is on the SG&A run rate. If I remember correctly, you mentioned Telestack added something like $1.2 million. Is that the right rate going forward or is that number supposed to come down from as the year progresses.

David Silvious – Chief Financial Officer
I'd say that's a good range to use for a while.

<Q>: All right, all right, that's helpful. And then I'm trying to sort of triangulate where we're supposed to be really on—what expectations are on the earnings side for the third quarter. You did mention up year-over-year, which should make some sense to me just given the fact that you've got different absorption than what you had last year. But I'm wondering as we're looking at revenue, as well as earnings compared to say for instance the first quarter of this year, are we talking lower, are we talking flat, how should we frame that?

Benjamin Brock – President & Chief Executive Officer

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Well, hopefully I'm hearing your question right, Mig. I apologize. If the question is on the revenue side, how much up will we be?

<Q>: Right, exactly. You're going to be up year-over-year and I understand that. I'm just trying to understand as to whether you can sort of frame the third quarter performance versus what we've seen thus far this year, either versus the first quarter or maybe the average of the six months or however you can or want to do it?

Benjamin Brock – President & Chief Executive Officer
I have to tell you, it will be up versus 2013's but when I'm saying quarter-to-quarter, third quarter to third quarter, it will be down versus the first quarter this year, if that's the question.

<Q>:Okay. That is the question.

Benjamin Brock – President & Chief Executive Officer
Yes.

<Q>: And the last point here is on the tax rate, which was a little higher than what I was expecting. Is this a good run rate going forward?

David Silvious – Chief Financial Officer
I would use this until they pass the R&D tax credit. If they do that it could, it will impact our tax rate. As soon as they pass it, we account for that whole credit in that period, but I think this higher rate is the new normal right now.

Operator
Mr. Anderson, we have no further questions at this time. I would now like to turn the floor back over to you for closing comments.

Steve Anderson – Vice President, Director of Investor Relations
Thank you, Christine. We appreciate your participation on this second quarter conference call and thank you for your interest in Astec.

As our news release indicates, today's call has been recorded. A replay of the conference call will be available through August 5 and an archived webcast will be available for 90 days. A 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 all. Have a good week.

Operator
Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.