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Valmont Industries, Inc. (VMI)

Q2 2019 Earnings Call

CORPORATE PARTICIPANTS

Renee L. Campbell
Vice President of Investor Relations & Corporate Communications, Valmont Industries, Inc.

Stephen G. Kaniewski
President, Chief Executive Officer & Director, Valmont Industries, Inc.

Mark C. Jaksich
Executive Vice President, Chief Financial Officer and Secretary, Valmont Industries, Inc.

OTHER PARTICIPANTS

Nathan Hardie Jones
Analyst, Stifel, Nicolaus & Co., Inc.

Christopher Moore
Analyst, CJS Securities, Inc.

Brian Drab
Analyst, William Blair & Co. LLC

Ryan Michael Connors
Analyst, Boenning & Scattergood, Inc. (Broker)

Zane Karimi
Analyst, D. A. Davidson & Co.

MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to the Valmont Industries Second Quarter 2019 Earnings Call. At this time all participants are in a listen only mode. A question-and-answer session will follow with the formal presentation. [Operator Instructions] As a reminder this conference is being recorded.

It is now my pleasure to introduce your host Renee Campbell Vice President of Investor Relations in Corporate Communications. Thank you. You may begin.

Renee L. Campbell
Vice President of Investor Relations & Corporate Communications, Valmont Industries, Inc.

Thank you, Jesse. Good morning and welcome to Valmont Industries second quarter 2019 earnings call. With me today are Steve Kaniewski, President and Chief Executive Officer; Mark Jaksich, Executive Vice President and Chief Financial Officer; and Tim Francis Senior Vice President and Corporate Controller. This morning Steve will provide a summary of our second quarter results and Mark will provide additional details on financial performance.

A slide presentation will accompany today's discussion and a link to access the document is located on the home page of our website at valmont.com. Please download the slide deck to follow along with today's call. A replay will be available for the next seven days and instructions for accessing it are included in the press release which is also located on our website. Please note that this conference call is subject to our disclosure on forward-looking statements, which applies to today's discussion and will be read in full at the end of this call.

I would now like to turn the call over to our President and Chief Executive Officer Steve Kaniewski.

Stephen G. Kaniewski

President, Chief Executive Officer & Director, Valmont Industries, Inc.

Thank you Renee. Good morning everyone and thank you for joining us. I would like to start with slide 3 and a recap of our second quarter. Net sales of $700.9 million were 2.7% higher than last year. Excluding currency impacts and revenue from last year's divested grinding media business, sales would have grown 5.5%. This growth was led by robust transportation and wireless communication demand in the Engineered Support Structures segment and continued pricing discipline across all four segments.

Moving to segment highlights. Starting with the Engineered Support Structures segment, first quarter sales were $258.7 million, increased 3.2% over last year. We continued to benefit from very strong quarter flow, particularly in North American transportation and wireless communication markets. This demand has resulted in higher backlogs, improved pricing and extended lead times across the industry. Effects from the severe Midwest flooding that occurred in late March and resulted in the one-week closure of our Valley, Nebraska facility continued to impact this segment in the second quarter.

While our teams have worked very hard to return to regular production and shipment schedules, continued strong order flow created a buildup of shipments, causing factory inefficiencies and delayed shipments. By adding resources and implementing process changes in our shipping area, these constraints are expected to be resolved during the third quarter. I want to thank all of our customers for their understanding during this time and all of that worked with us to remedy the situation. Mark will speak in more detail on the flood recovery in his remarks.

Globally, sales of wireless communication structures and components grew 20% over last year, supported by robust demand, particularly in North America. Carriers continued to invest in 4G and FirstNet expansions and momentum for small cell structures in advance of 5G build-outs is also driving sales growth.

During the quarter, we completed the acquisition of Connect-It Wireless, a Florida based distributor of wireless site components. This acquisition is a strategic addition to our Site Pro 1 business, advancing our geographic expansion and addressable market growth strategies. Sales of Access Systems were slightly below last year, due to unfavorable currency translation.

In the Utility Support Structures segment, sales of $209.8 million increased 6.3%, driven by sales from acquisition and improved pricing in bid markets. We have been pleasantly surprised by stronger than expected demand from grid hardening initiatives, which has caused our lead times and others across the industry to significantly increase from approximately 22 to 26 weeks to 30 to 34 weeks. As a result, we have taken immediate steps to add capacity in existing North America facilities, and are developing longer term plans to meet additional capacity requirements.

Sales growth this quarter once again benefited from the solar tracker acquisition that was completed last year. I'm excited to share that later this week, we will officially launch our single access tracker solution into the North American market. While we are very happy with the sales growth this year, as expected we continued to work on supply chain synergies and are optimistic we will begin to see those benefits in 2020.

As we said in prior calls, this business is largely project-based and revenue can be difficult to forecast each quarter. That said the CAGRs in this market remain in the high teens and we expect revenues over time to stabilize as we expand our presence in other markets. Revenues in the offshore wind business were aligned with expected levels and we anticipate higher sales in 2020.

Turning to the Coatings segment. Second quarter sales of $98.4 million, grew 7.5%, led by sales from recent acquisitions and favorable pricing across all regions. Excluding currency impacts, sales would have increased 9.4%. As zinc cost have stabilized, we continue to maintain pricing discipline and are utilizing technology to add value and improve the customer experience. Further, we are currently experiencing growth across all geographies signaling strength in the end markets that we serve.

Turning to the Irrigation segment, global sales of $155.2 million were 4.8% below last year. In North America sales of $102.8 million were 9.7% lower. Macro market conditions continue to weigh on farmer sentiment. Further, historical flooding, a very wet spring across many parts of the U.S. and low net farm income levels all kept growers on the side lines. Despite lower volumes in North America average selling prices were higher due to sustained pricing discipline.

On a positive note, we achieved our third highest month of technology sales in May, bringing our total connected devices to approximately 86,000. Growers are recognizing the value of adopting our advanced easy-to-use technology solutions to improve yield and reduce input costs. Also this quarter, we divested the last company-owned dealership located in Pasco, Washington. This was done as a part of our growth strategy and belief that independently owned Irrigation dealerships support market growth and strengthen our overall presence in the market.

International Irrigation revenues of $52.4 million increased 6.7% versus last year, excluding currency impacts sales grew 11.5%. As expected, the Brazilian market is improving and our team booked a record number of orders at this year's Agrishow, the largest annual farm show in the country. We also recently opened our first aftermarket parts distribution center in Sao Paulo state, to support customers more quickly and efficiently and strengthen our leadership position in this critical market.

Sales growth in Europe and Middle East markets this quarter helped offset lower sales in the Asia-Pacific region, a severe drought in parts of Australia and policy uncertainty in New Zealand have impacted demand in those markets this year.

I recently returned from a visit to the Republic of Kazakhstan, where I met with President Tokayev, Prime Minister Mamin and Minister of Agriculture Omarov, to discuss agricultural investment, productivity enhancements and advanced technology in the region. Market development there is actually very similar to our early market strategy in Brazil. We're very excited to partner with the Kazakhstan ag community on future opportunities in this very important region, building on our geographic expansion strategy. I would like now to turn the call over to Mark for the financial review.

Mark C. Jaksich

Executive Vice President, Chief Financial Officer and Secretary, Valmont Industries, Inc.

Thank you, Steve, and good morning, everyone. My comments regarding the second quarter of 2019 are based on comparisons to the 2018 adjusted results, as outlined at the end of the press release.

Turning to slide 4, second quarter operating income of $63.7 million or 9.1% of sales was 10% below last year, largely due to approximately $6 million of non-recurring expenses this year that occurred in the Utility and Coatings segments. Otherwise, profitability improvements in the Engineered Support Structures and Coatings segments and a favorable LIFO comparison were offset by lower operating income in the Irrigation segment and the international portion of the Utility segment.

I'd also like to note that net interest expense compared to the second quarter of last year was down over $1 million, due to the debt refinancing we completed in the third quarter of 2018.

Second quarter diluted earnings per share of $1.90 decreased 4% compared to adjusted EPS of $1.98 in 2018. Without the impact of non-recurring expenses of $0.20 per share, EPS for the quarter would have increased 6.1%. Operational efficiency continue to be hampered somewhat during the second quarter by the March flooding event in the Valley, Nebraska. Efforts to settle the insurance claim from property and business interruption of losses are ongoing and we expect to recognize those recovery benefits in the second half of this year.

Turning now to the segment operating income results in slide 5. The Engineered Support Structures segment operating income increased 14% over 2018. The improvement resulted from strong market conditions and disciplined pricing in the lighting and telecom markets in North America, along with cost savings associated with the capacity reductions we took in the Asia Pacific region last year.

Turning to slide 6 in Utility Support Structures segment, operating income decreased 28% from the second quarter of 2018. Profitability improvements from pricing actions and improved factory performance in North America were more than offset by approximately $5 million of lower profitability and our developing international operations mainly in solar tracker solutions as well as offshore wind. In solar trackers, while the market activity is strong, the project-oriented nature of the market has been a challenge for us resulting in Q2 sales and profits that were much more than Q1. Profitability of the offshore wind business continues to be weak and challenging market conditions with five smaller competitors exiting the business over the last 12 months. We expect pricing improvements and increasing market demand to result in improved profitability in 2020.

Segment operating income also included a $3 million expense to set for the completion of a settlement of a customer accommodation matter that originated in 2015. Excluding this expense operating profit was $90 million 9.1% of sales.

In the Coatings segment on slide 7, operating income of $15.1 million was comparable to 2018 despite a one-time $3 million expense related to a legal matter that we elected to resolve this year. Segment sales and operating income benefited from continued pricing benefits arising from our technology offerings, as well as the recent acquisitions of CSP Coatings in New Zealand and United Galvanizing in Houston, Texas.

Excluding the legal settlement cost, segment operating income was $18.1 million or 18.3% of sales. The best second quarter performance in the segment since 2014. The Coatings business continues to perform well and we are pleased with its operating results.

Turning to the arrogation segment in slide 8, operating income decreased 22% compared to last year. Lower profitability was primarily driven by lower volumes in North America. Value based pricing due in part to our technology solutions and benefits from lean management and cost control, both played a critical role in maintaining segment operating margins of 13.9% and 13.5% of sales in Q2 and year-to-date, respectively despite the lower sales volumes.

Turning to cash and balance sheet highlights on slide 9. As expected, we recognize strong operating cash flows of $113 million so far this year, including $105 million in the second quarter. Our focus on working capital optimization has been a priority for the management team throughout the year. And we expect cash flow to be strong in the second half of 2019, driven by our ongoing efforts to further improve working capital performance and assuming a stable raw material price environment.

A summary of our capital deployment is on slide 10. Year-to-date capital spending was $49 million, driven by the planned expansions previously mentioned and the construction of a galvanizing facility in western Pennsylvania, all in support of market growth opportunities. We expect the full year capital spending to be between $90 million and $100 million. During the quarter, we deployed $24.7 million related to acquisitions and returned $37 million to shareholders – capital to shareholders through share repurchases and dividends, ending the quarter with $256 million of cash. Our adjusted tax rate for the quarter was 24.8%, in line with our expectations.

Let me now turn to slide 11 for an update on our 2019 outlook. We are benefiting from robust backlogs in our Utility and the ESS segments and expect sales and profitability growth in both segments for the balance of the year. In the ESS segment, we expect margins to continue to improve from a more stable raw material price environment and continued pricing improvements in the marketplace.

In the Utility Support Structure segment, strong North American backlogs are expected to drive sales and operating income growth and we expect modestly better sequential performance in our international Utility business for the balance of year. While Irrigation markets remain challenged, we are seeing some signs of market stabilization and expect current improvements in commodity prices to provide somewhat of a tailwind to farmers sentiment.

Our Coatings business continued to perform well and is driven by the general economic growth in industrial demand across our regions. The second quarter non-recurring expenses are not expected to be recovered. As a result, we have adjusted our full-year diluted earnings per share guidance to a range between $8.10 and $8.70 from $8.30 to $8.90.

We are updating our revenue growth projections to 6% to 7% from 7% to 8% previously and operating margin expansion to a range of 10 basis points to 40 basis points from 20 basis points to 50 basis points previously based on lower international Irrigation sales and foreign currency effects. As the dollar continues to strengthen from earlier in the year, our outlook on foreign currency translation effects is now expected to be unfavorable compared to 2018 by about $40 million or 1.5% of sales with the associated negative earnings per share effect of about $0.13.

Finally, before I turn the call back over to Steve, you may have noticed the announcement of my plans to retire from Valmont. It's been a privilege to spend most of my career with Valmont and our outstanding people across the organization. I will work diligently to help effect a smooth transition to my successor when that is determined to help ensure that Valmont continues to be successful going forward and for the benefit of all of our stakeholders.

With that, I will now turn the call back over to Steve.

Stephen G. Kaniewski

President, Chief Executive Officer & Director, Valmont Industries, Inc.

Thank you, Mark. On behalf of all of Valmont and myself, I want to thank you for your years of hard work and dedication. During your tenure, you have epitomized our core values, leaving a strong legacy of professionalism and class. Thank you again.

Turning to slide 12. Last quarter, we introduced Valley Insights by Prospera, and the launch of anomaly detection as the first critical milestone on the path to autonomous crop management. As a part of that launch, we set an initial goal to monitor 1 million acres by 2020. I'm excited to say that even in limited release we have already exceeded this goal, proving that customers are clearly excited about the technology. In fact, one dealer was able to demonstrate to a grower how Valley Insights detected issues in his field after 30 and 60 days before [ph] NVVI

(00:18:09) could. This momentum has elevated our market presence in the technology space and we will continue updating you on our roadmap on future calls.

Turning to slide 13, to summarize the balance of the year, the revisions to our financial outlook are driven by lower project demand in international Irrigation markets. The impact of non-recurring expenses recognized this quarter and foreign currency impacts. While recent improvements in commodity prices have provided a small tailwind in the Irrigation segment, we are not yet seeing a meaningful turn around in demand, although this should become clear with the outcome of the growing season. We expect continued sales growth of our technology offerings especially with higher labor costs as these solutions will lead to better returns for the growth. We expect margin improvement in our Infrastructure businesses in the second half of 2019.

In ESS strong demand particularly in North American markets plus the benefits of our 2018 operations transformation and a more stable raw material cost environment will drive higher margins. Record backlogs in our Utility business and incremental demand from grid hardening efforts across the U.S. are supporting and through segment performance there. As I've always said, we remain committed to pricing discipline and leadership within all sectors in the markets we serve, and we will continued to perform against our stated capital allocation goals while generating strong cash flows.

I will now turn the call back over to Renee.

Renee L. Campbell
Vice President of Investor Relations & Corporate Communications, Valmont Industries, Inc.

Thank you, Steve. At this time, Jessie, you may open up the call for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. Ladies and gentlemen, at this time we will be conducting the question-and-answer session. [Operator Instructions] Our first question comes from the line of Nathan Jones with Stifel. Please proceed with your question.

Nathan Hardie Jones
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Good morning, everyone.

Stephen G. Kaniewski
President, Chief Executive Officer & Director, Valmont Industries, Inc.

A

Good morning, Nathan.

Nathan Hardie Jones
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Congratulations, Mark.

Mark C. Jaksich
Executive Vice President, Chief Financial Officer and Secretary, Valmont Industries, Inc.

A

Thank you.

Nathan Hardie Jones
Analyst, Stifel, Nicolaus & Co., Inc.

Q

I just want to start at a high level here. I mean you guys had $0.20 of non-recurring charges here and you cut the guidance by a $0.20. You're also talking about lower international Irrigation projects demand. And then that $0.13 of FX impact – negative FX impact. Should we be thinking that you're trending towards the lower end of guidance? So, Steve, I know, we've talked about some of the pricing tailwinds in ESS in the spot market in USS. Are there offsetting things that have improved over the last quarter that offset those kind of other two negatives outside of the non-recurring expenses?

Stephen G. Kaniewski
President, Chief Executive Officer & Director, Valmont Industries, Inc.

A

Nathan the international Irrigation piece, we kind of called out before in the first quarter and said that that was kind of baked into our guidance. But if you look at the way that Irrigation has trended from our expectations from the beginning of the year, it's probably a safe assumption to say that moving towards the bottom end of the range is a more stable position than it would be. We do still have a lot of potential upside to that, but those are still yet to develop.

Nathan Hardie Jones
Analyst, Stifel, Nicolaus & Co., Inc.

Q

And then, so maybe you could talk about the puts and takes that would get you towards the top end or towards the bottom end of that guidance range?

Stephen G. Kaniewski
President, Chief Executive Officer & Director, Valmont Industries, Inc.

A

Yeah. That would be a lot – there's a number of projects on the international Irrigation front, which still could come through. You know there was the – in the Utility segment, particularly in North America, with the way that lead times are pushed out, if we can gain some additional capacity, both here in North America and/or our ability to do some jobs in China, that also would be a help to get us there. And if steel frankly continues to abate, that's probably not fully baked into our guidance at this point. So we're just going based on where steel has kind of been. And so there are some potential tailwinds as much as there are some headwinds that we faced in the early part of the year here.

Nathan Hardie Jones
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. And then maybe just one on ESS, you talked about the disruption from the flooding at the Nebraska campus there. Can you quantify the impact that that had on results in the second quarter? I think you said it's supposed to be sorted out during the third quarter. Do we expect any impact there? I know you guys have been targeting to get to double-digit margins in ESS. Is that still something that's in range for the back half of the year or does this kind of thing push that off a little bit?

Stephen G. Kaniewski
President, Chief Executive Officer & Director, Valmont Industries, Inc.

A

Yeah. There's probably about $10 million of revenue that we were just unable to really kind of get through the system in the second quarter, so that would really kind of move over into the third quarter. And in terms of double-digit for the segment, yes, it's definitely within range based on what we're seeing booked in the backlogs, cost controls and pricing.

Nathan Hardie Jones
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. I'll pass it on and get back in queue. Thank you.

Stephen G. Kaniewski
President, Chief Executive Officer & Director, Valmont Industries, Inc.

A

Thanks, Nathan.

Mark C. Jaksich
Executive Vice President, Chief Financial Officer and Secretary, Valmont Industries, Inc.

A

Thank you.

Operator: Thank you. Our next question is from Chris Moore with CJS Securities. Please proceed with your question.

Christopher Moore
Analyst, CJS Securities, Inc.

Q

Hey, good morning. Yeah, may be just on the Utility side. Can you maybe just talk a little bit further on the international operating margin weakness and kind of why you believe it's going to improve second half of this year and into 2020?

Stephen G. Kaniewski
President, Chief Executive Officer & Director, Valmont Industries, Inc.

A

Sure, Chris and welcome. The international side of the business is kind of a developing piece of our business. The wind part, you know we had moved previously from ESS over to Utility. The wind was anticipated to be weaker this year quarter-over-quarter and year-over-year and that really played out as kind of as expected.

The Convert Italia, in the solar tracker part of the business, really what has taken place there is, we had some orders that as we did the acquisition came over. We didn't really have a chance to optimize the supply chain like we would have on newer quoted orders as we go forward. So that was why we anticipated some drawback there. We also had a couple of project related costs that were unanticipated in some of our South America projects.

And you know just generally having to get the supply chain synergies in line, it has taken a little bit longer than we would have liked. So if you'd look at the wind part of the business, wind particularly in North Europe is anticipated to see an increase in demand in 2020 and 2021. And the pricing environment we believe will improve; one, as a result of that, plus the bankruptcy's of the competitors that have taken place there.

In Convert, in the solar business, as we gain more orders and geographies, we can get better supply chain optimization. And then as we come into North America later this week, we really have the ability to source things like steel and dual production in our Irrigation facilities and do much more of it within our control. So, those are some of the factors that we feel will start to turn this around more in 2020 than through this year, but we should see second half being improvement over the first half thus far too.

Christopher Moore
Analyst, CJS Securities, Inc.

Q

Got it, very helpful. I'll jump back in line.

Stephen G. Kaniewski
President, Chief Executive Officer & Director, Valmont Industries, Inc.

A

Thanks, Chris.

Operator: Thank you. Our next question is from Brian Drab with William Blair. Please proceed with your question.

Brian Drab
Analyst, William Blair & Co. LLC

Q

Hey, good morning, and congratulations, Mark.

Mark C. Jaksich
Executive Vice President, Chief Financial Officer and Secretary, Valmont Industries, Inc.

A

Thanks, Brian.

Brian Drab
Analyst, William Blair & Co. LLC

Q

I just wanted to – first on Utility. And can you just help reconcile what we saw in the quarter with your comments that the lead times are extending and demand is up. Because the revenue level for Utility in the quarter was the lowest it's been in about a year. So, is that demand in backlog kind of is it – did that build in the second half of the quarter and can you just help reconcile that. Thanks.

Stephen G. Kaniewski
President, Chief Executive Officer & Director, Valmont Industries, Inc.

A

Yeah. Some of that Brian was booked two quarters previously. Some of the mix that came through was very heavy in substation and distribution poles as opposed to transmission and some larger structures. There was also at least initially an expectation and we had talked about last year we thought North America would be down slightly. So, some of our capacity that we had adjusted to, we also had pulled down and now we're having to kind of pull that back up. And so it's a little bit capacity related and a little bit market related as to why North America was a little bit softer in Q2.

What we're seeing now and why we're ramping the production hours in the existing facilities is simply to meet this new market demand, again coming primarily from the grid hardening efforts in the West and in the Southeast. So we've been like I said pleasantly surprised at how robust it's actually been in for the money that's being spent in those areas. So, as we look into 2020, we expect that to continue as well as the normal drivers for the business in terms of grid hardening, replacement of lines. And, again, that substation part of the business should continue. So, that's kind of how we feel about North America. And then obviously, my answer to Chris on the international side.

Brian Drab
Analyst, William Blair & Co. LLC

Q

Right. Okay, thank you. And then you talked a little bit about Convert Italia. I'm just wondering if you could give us a little more detail around how you would grade these acquisitions, Convert, Walpar, Derit, Larson is newer, but can you maybe just give us some comments on each of those and like Walpar you expected $0.12 of accretion in the first year and we're about a year into it now. Can you maybe grade yourself and – or grade each of these acquisitions and just give us an update on how you think they're doing?

Stephen G. Kaniewski
President, Chief Executive Officer & Director, Valmont Industries, Inc.

A

Sure, sure. Convert Italia is definitely meeting expectations in terms of market growth. The technology, the product, the ability for us to come into North America and being invited in there and really just having to build the [ph] splicing synergy such (00:29:17) as expected. We knew it would take a year. So maybe we're a quarter to quarter-and-a-half behind in really kind of building some of those synergies.

The Larson acquisition has been a very strong acquisition. We're seeing the case actually be stronger, because people want to camouflage. And with our existing telecom customers it's going very, very well.

The Walpar acquisition is behind kind of where we thought it would be and that's primarily coming from DOT spend in the Southeast that was a little bit abated during 2019, but we see and already have good backlog as we look into 2020 with that acquisition. So probably just a little bit of a delay in where we thought it would come in.

We talked about the Coatings, acquisitions both United and CSP are doing very well and to our expectations, and frankly exceeding slightly. And then the [Derit], which was the acquisition in India, we said it was a Coatings and both, Utility kind of acquisition. The Coating side has done very, very well. And the Utility side, it's taking us a little bit longer to get some of the customer approvals than we'd liked, but we've been able to direct the capacity to domestic India or Middle East customers. And so, that's tracking and frankly with the trackers that will become a very critical solar facility for us as we move forward. So that's kind of the run around the different acquisitions.

Brian Drab
Analyst, William Blair & Co. LLC

Q

Yeah. Yeah, that's really helpful. Okay. Thanks very much.

Stephen G. Kaniewski
President, Chief Executive Officer & Director, Valmont Industries, Inc.

A

Thanks

Operator: Thank you. The next question is from Ryan Connors with Boenning & Scattergood. Please proceed with your question.

Ryan Michael Connors
Analyst, Boenning & Scattergood, Inc. (Broker)

Q

Great. Thanks. Good morning and congratulations, Mark, on your retirement. Also congratulations to you, Renee, on your recent promotion there. I wanted to talk about these two, these $6 million in non-recurring costs. Can you just give us a little more detail? I mean, both are a little bit cryptic, in terms of the description, the legal matter and also this customer accommodation and USS., so can you just kind of give us a little more background on exactly what's happened in each of those cases?

Stephen G. Kaniewski
President, Chief Executive Officer & Director, Valmont Industries, Inc.

A

Yeah, I'll touch on the one, Ryan. The customer accommodation if you recall back in 2015, we had an extremely large customer, where we decided to go into an inspection regime. And we at that time, I think, had called out a $15 million number related to that inspection regime. We had gone through. It was a multi-year agreement. We've worked through that. And in order to speed it up, and to complete it, we decided to settle some things with them ahead of time, where that program would have gone into next year.

On the Coating side, that was a litigation matter in Australia that we had, that frankly probably wouldn't have been settled until sometime maybe the second quarter next year, but there was an opportunity to get some certainty around that litigation. Australia can be a very fickle place, and so we decided that the ability to settle it now gave us a better financial proposition than potentially risking going further into next year.

Ryan Michael Connors
Analyst, Boenning & Scattergood, Inc. (Broker)

Q

Okay. That's very helpful to get the background there. And my other question was bigger picture kind of strategic in nature. You know, you talked about adding capacity, and I guess my question is, you walk us through the decision process on why add capacity here, I mean, why not just sort of auction off the production slots either the company, and I guess the industry has kind of had some – have been bitten by late cycle capacity expansion in the past. So, just interested, given some of the macro uncertainty out there like why add capacity at this stage, rather than just price it?

Stephen G. Kaniewski
President, Chief Executive Officer & Director, Valmont Industries, Inc.

A

It's a great question, Ryan. And I was a part of bringing the capacity down on the last time related to this. What we're doing really is looking at capacity from our existing facilities perspective. So, it's not a very capital-intensive kind of capacity add, nor would it be difficult to pull the capacity out, based on market conditions. And so, really looking more and more like our Irrigation segment that as capacity can build up or go down with the market, we're looking for that kind of flex capacity there. So we're not adding any bricks-and-mortar and it's really just looking at, if we have Jasper we have Tulsa we have Monterrey, Valley and Columbus, you know that we can do more within those existing facilities as it is.

There's also an element of this that's simply just automation. And the automation front makes sense for us long-term anyway, really just kind of pulling it forward. As we look at the long-term capacity planning, you know, we're definitely very aware of the market and how the market can be fickle and change pretty quick, so we're going to be very cautious as we approach any kind of long-term capacity builds.

Right now, this is just – it's very important for us to meet this from a market perspective because of the alliances that we have with our customers. And so we have to come through for our customers in that regard.

Ryan Michael Connors
Analyst, Boenning & Scattergood, Inc. (Broker)

Q

Got it. Okay. Makes a lot more sense in that context. Thanks for your time.

Stephen G. Kaniewski
President, Chief Executive Officer & Director, Valmont Industries, Inc.

A

Thanks, Ryan.

Operator: Thank you. Our next question comes from Zane Karimi with D.A. Davidson. Please proceed with your question.

Zane Karimi
Analyst, D. A. Davidson & Co.

Q

Hey, good morning, guys. First question kind of on that 20% growth highlighted in communication, how much of it was driven by the acquisitions and how should we think about organic growth there in the near-term?

Mark C. Jaksich
Executive Vice President, Chief Financial Officer and Secretary, Valmont Industries, Inc.

A

Yes. Good morning, this is Mark. The acquisition of Connect-It Wireless is a fairly small business that didn't have much impact. The lion share of that growth really came out of North America, both in components and in structures. The international side of that is mostly Asia Pacific and that was fairly muted. It continues to be so, but the real engine there has been North America.

Zane Karimi
Analyst, D. A. Davidson & Co.

Q

Okay great. And then switching a little bit to Irrigation more so. When should the big lift in orders in Brazil begin to materialize into sales for Irrigation, and how should we be thinking about that as well?

Mark C. Jaksich
Executive Vice President, Chief Financial Officer and Secretary, Valmont Industries, Inc.

A

Yeah. I would say that – this is Mark again. That will take place most likely throughout the next few quarters. A lot of these are dependent on getting all the financing in place. And so to some degree, you're a little bit – it's dependent on how quickly the financial institutions and the government moves as far as getting the approvals done. But usually they'll cycle through within probably two to three quarters typically. So we'd certainly expect to see that through the balance of this year and maybe some into next year as well.

Zane Karimi
Analyst, D. A. Davidson & Co.

Q

Great. Thank you for those answers.

Operator: Thank you. [Operator Instructions] We do have a follow-up question from the line of Nathan Jones with Stifel. Please proceed with your question.

Nathan Hardie Jones
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Hey, guys. I just want to follow-up with a couple questions on the pricing dynamics in the market here. I mean you guys are talking about very robust demand in ESS lead time stretching out, very robust demand in USS lead time stretching out, adding capacity to meet that demand. Can you talk a little bit about the pricing dynamics that that's creating for you guys, your ability to cover more than raw material inflation or as steel deflating here, your ability to hold onto those pricing levels, your willingness to use price to gain share or not, just some color there on those kinds of dynamics?

Stephen G. Kaniewski
President, Chief Executive Officer & Director, Valmont Industries, Inc.

A

Yeah. I'll touch on it a little differently between Utility and ESS. You know on the Utility market our alliance customers, those are pricing arrangements. They're a big part of our volume. And therefore they benefit, in and these kinds of time periods from having locked in with us earlier from a capacity perspective. However, there's still a bid market out there and we have to fill that bid market and we've been I would say ultra-selective in the types of orders that we're taking from a bid perspective and we've really been able to push up pricing in an extremely meaningful way like 400 to 500 basis points of just pushing that up, and we continue to push it up as capacity becomes more constrained.

The adding of capacity really is to help alleviate. As I mentioned on the earlier question, our alliance customers and you know just satisfying their needs. In ESS, we're really seeing a nice environment overall develop in terms of declining steel prices, but robust demand. And so, not only are we able to hold the line on pricing, we're still pushing our price, and so we're still looking at areas where we can do that based on capacity constraints, based on just market conditions, supply demand. And you know over the last year, we've done four price increases in ESS segment, the last two of which are nothing to do with material inflation or deflation, right?

So it's simply the ability to pass along additional price, which is why we feel confident with the backlogs that we have in the second half of the year that we'll be able to perform and that should be a good tailwind going into 2020 as well.

In Coatings, even though zinc has abated, again, we've maintained a pricing discipline there based on volumes and really have been able to hold price extremely well in the Coatings segment. And even in Irrigation, we did a small price increase early in the first quarter that we've been able to get to stick and then maintain our pricing discipline across the rest of the market.

So, pricing is a big thing for us here and something we talk about very regularly as a management group. And so, we're encouraged by the overall pricing environment and the capacity, taking out the capacity that we did in ESS also has really allowed us to not have to just try and fill the factory.

Nathan Hardie Jones
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Maybe one – maybe a bit more of a Mark on that front. You talked about rising prices and declining steel and zinc prices. Maybe, Mark, you can talk a little bit about how that flows through the P&L. You know what kind of lower inventory costs you're going to see flowing out in the back half relative to the first half and also the pricing levels, second half versus first half?

Mark C. Jaksich
Executive Vice President, Chief Financial Officer and Secretary, Valmont Industries, Inc.

A

Right. Let me address the cost side of the equation first. You know, raw material prices as you stated have been moderating, we've seen more of that decrease during the second quarter. If you think about it in terms of inventory turns on a FIFO basis, you would expect that to start to manifest itself in the P&Ls, starting in the third quarter and then more so even in the fourth quarter. And then so there's always about a three- or four-month time lag in general terms.

And the pricing depends somewhat on the backlogs as well. So I think usually it's about the same time period, particularly I would say in Utility a little bit longer, because the backlogs are longer. And with ESS as well, it would be a few months and so forth. Irrigation on the other hand, pretty short cycle business, you'll see pricing actions show up more quickly in the P&L just because you don't deal with large backlogs typically.

Nathan Hardie Jones
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Okay. So if...

Stephen G. Kaniewski
President, Chief Executive Officer & Director, Valmont Industries, Inc.
A

...our LIFO. Our LIFO will probably accelerate as we go into the third and fourth quarter as well.

Mark C. Jaksich
Executive Vice President, Chief Financial Officer and Secretary, Valmont Industries, Inc.
A

That's correct.

Nathan Hardie Jones
Analyst, Stifel, Nicolaus & Co., Inc.
Q

So, I think the bottom line here is that, you guys are expecting to have better pricing across the majority of the business and lower input costs coming out through inventory across the majority of the businesses in the second half of the year?

Mark C. Jaksich
Executive Vice President, Chief Financial Officer and Secretary, Valmont Industries, Inc.
A

That's true statement.

Nathan Hardie Jones
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Excellent. Thanks very much for the help.

Operator: Thank you. Ladies and gentlemen, we have reached the end of our question-and-answer session. So, I'd like to pass the floor back over to Ms. Campbell for any additional concluding comments.

Renee L. Campbell
Vice President of Investor Relations & Corporate Communications, Valmont Industries, Inc.

Thanks, Jesse, and thanks to everyone for joining us today. As mentioned today's call will be available for playback on our website or by phone for the next seven days. We look forward to speaking with you again next quarter.

Operator: Included in this discussion are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on assumptions that management has made in light of experience in industries in which Valmont operates as well as management's perceptions of historical trends, current conditions, expected future developments and other factors believed to be appropriate under the circumstances.

As you listen to and consider these comments, you should understand that these statements are not guarantees of performance or results. They involve risks uncertainties some of which are beyond Valmont's control and assumptions. Although management believes that these forward looking statements are based on reasonable assumptions, you should be aware that many factors could affect Valmont's actual financial results and cause them to differ materially from those anticipated in the forward-looking statements.

These factors include among other things risk factors described from time-to-time in Valmont's reports to the Securities and Exchange Commission, as well as future economic and market circumstances, industry conditions, company performance and financial results, operating efficiencies availability and price of raw material availability and market acceptance of new products, product pricing, domestic and international competitive environments, and actions and policy changes of domestic and foreign governments. The company cautions that any forward-looking statement included in this discussion is made as of the day of this discussion and the company does not undertake to update any forward-looking statements.

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

PS: The word in the [] is a correction request from the company.