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Moog, Inc. (MOG.A)

Q4 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Moog's Fourth Quarter Fiscal Year 2024 Earnings Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr. Aaron Astrachan. Please go ahead, sir.

Aaron Astrachan

Director-Investor Relations & Financial Planning & Analysis, Moog, Inc.

Good morning, and thank you for joining Moog's fourth quarter 2024 earnings release conference call. I'm Aaron Astrachan, Director of Investor Relations. With me today is Pat Roche, our Chief Executive Officer; and Jennifer Walter, our Chief Financial Officer.

Earlier this morning, we released our results and our supplemental slides, both of which are available on our website. Our earnings press release, our or supplemental slides and remarks made during our call today contain adjusted non-GAAP results. Reconciliations for these results to GAAP results are contained within the provided materials.

Lastly, our comments today may include statements related to expected future results and other forward-looking statements, which are not guarantees. Our actual results may differ materially from those described in our forward-looking statements and are subject to a variety of risks and uncertainties that are described in our earnings press release and in our other SEC filings.

Now, I'm happy to turn the call over to Pat.

Patrick J. Roche

President, Chief Executive Officer & Director, Moog, Inc.

Good morning, and welcome to the call. Today, we will share an update on our financial and operational performance, reporting both on the full year and the current quarter.

With matured and strengthened momentum in our pricing and simplification initiatives, we're building on our strong reputation with customers to open new growth opportunities. Consequently, our results show strong sales growth, record 12-month backlog, strong margins and improved cash flow.

Our success is driven by our employees commitment to making this a strong company and a great place to work. And for that, I want to thank all those who have contributed to our performance over the last 12 months.

Before we get into the detail of the quarter, let me first reflect on what has been another exceptional year for our company. We delivered record sales. We have a record 12-month backlog, we expanded adjusted operating margin and produced improved free cash flow. We grew revenue by 9% to \$3.6 billion. Commercial Aircraft led the growth, reflecting strong market demand for our current platforms. Military Aircraft contributed through new programs with the ramp of FLRAA engineering and new production starts.

Space and Defense captured business across a broad range of application domains, with notable success in Europe. Industrial held relatively flat, despite a reduction in our industrial automation business.

We expanded adjusted operating margin by 150 basis points from 10.9% to 12.4%. This is a really satisfying result, given that 110 basis points of the improvement is the direct result of our margin expansion initiatives.

Adjusted earnings per share grew substantially due to our sales growth and our improvement initiatives. And free cash flow was better than the prior year. While it was modest as planned, it was stronger than prior year and on a path to further improvement.

Overall, this was another year of excellent financial performance. From our FY 2022 base year, we have now delivered 9% CAGR growth, expanded adjusted operating margin by an impressive 180 basis points, grown earnings per share, and delivered modest cash as planned this year. These results mean that we're in great shape delivering against our Investor Day goals. We've achieved this remarkable performance through unrelenting focus on our pricing and simplification initiatives. We have made great progress. We continue to learn and we continue to improve our approach. 80/20 has become central to our transformation. It is now widely deployed and it's positively impacting results. We've demonstrated a couple of years of excellent financial results and we're confident that this will continue in FY 2025.

Now, let me provide further detail on our operational initiatives that are driving this exceptional performance. Firstly, customer focus. As an integral part of our 80/20 approach, we've completed an independent Voice of Customer analysis that covers approximately one-third of our business. Over 120 detailed interviews provided us with detailed thematic analysis, customer experience and Net Promoter Scores. It is gratifying that our customers see us as a partner who can be relied upon to apply our breadth of technical capabilities to solve their difficult technical challenges and to consistently deliver quality products.

We're well positioned with our customers and know where to drive improvement to further strengthen our relationships. In this context, it was fantastic to see a successful certification to flight of the United Launch Alliance Vulcan rocket. ULA has already recognized us for our innovation and we are proud to be the supplier of thrust vector controls for Stage 1 and Stage 2. We look forward to Vulcan becoming a frequent flyer.

In addition, I'm delighted that recent ASA 9100 and FAA audits for both Commercial Aircraft and Military Aircraft here in East Aurora completed with no findings and positive comments on the level of staff engagement.

Furthermore, our performance in delivering for our customers has put us in a great position to pursue once-in-a-generation opportunities arising from broad-based defense demand. In the quarter, we made excellent progress in securing our position on several generational pursuits. For example, our Space business secured a letter subcontract for an opportunity of a \$100 million cost-plus development program to design and produce a liquid chemical propulsion system. This is for a specialized defense application that could have substantial production follow-on.

Our ground-based defense business made great progress on significant US and international pursuits. This included additional orders for RCH 155 howitzer, bringing our bookings on that program to over \$40 million. We see significant future demand on this and other European platforms with rising European defense spend.

Next, turning to people, community and planet. Extreme weather events delayed customer shipments and resulted in lost production at multiple locations around the world. In the quarter, our Japanese and Chinese facilities were both hit by typhoons. Our Murphy, North Carolina facility was hit by Hurricane Helene, and our Tewkesbury facility was flooded due to extreme weather.

In the case of Japan, China and North Carolina, we have suffered just short interruptions to production a few days at most. However, the damage to our Tewkesbury Commercial Aircraft facility was severe and we expect that it will take us several months to regain full capacity. In all cases, we have robust business continuity plans and the commitment of our staff to mitigate the impact on our customers is truly remarkable.

Our commitment to the planet includes our goal announced last year to reduce Scope 1 and Scope 2 equivalent CO2 emissions by 40% by 2030. We have a multiyear plan to deliver this goal, and I'm happy to share we are already seeing a positive impact from these initiatives. We will soon release our next sustainability report, which will detail the impact on emissions and further commitments relating to water consumption and hazardous waste.

We're further developing and maturing our business processes and it is good to see that our Taicang facility in China achieved ISO accreditation for energy management, environmental management and occupational health and safety, adding to its existing business management system. To date, seven sites pursued several of these additional certifications.

Finally, turning to financial strength, we are continuing to make excellent progress on driving margin enhancement through pricing and simplification. Pricing activities are now firmly embedded in how we work, and simplification continues to drive transformative change. We're making fantastic progress.

Our commitment to deliver has resulted in strong momentum and a good pace of change. We're executing in line with our Investor Day commitments.

We completed the sale of our Brno motors facility and of our Luxembourg Hydraulics Manifold facility just after year-end as part of portfolio shaping. We exited a couple of small European manufacturing sites as part of our footprint consolidation.

We deployed 80/20 to five additional sites, now covering 70% of our business by sales and trained more than 80 more leaders, bringing the total to over 840. We are maturing 80/20 at deployed sites, shifting from the initial profitability actions to detailed resourcing decisions as we strive for higher performance. We've established clear

links between 80/20 and other continuous improvement activities such as lean and advanced product quality planning, all of which have a role to play in driving sustainable improvement.

A look at multiyear trends helps illustrate the profound impact of simplification on our business. From fiscal year 2022 to fiscal year 2024, we have driven an almost 20% increase in sales, while managing head count increases to be just 6% and reducing factory space by more than 10%. Our simplification work will continue to deliver on financial and operational improvements throughout fiscal 2025.

Now turning to macroeconomic and end market conditions. Given the industry-wide discussion on Boeing, let me start with commercial aerospace. The demand for air travel continues to strengthen and the backlog of aircraft orders is significant. We recognize that there are significant challenges that need to be resolved in industry. Whilst Boeing is our largest customer, our book of business is weighted 80/20 to their widebody aircraft. And therefore, our exposure to the current strike in Seattle and the FAA production rate cap is limited. We have moderated our production rate for 787 to align with Boeing's current plan. As a result, our build rate will be lower in fiscal 2025 than we had first assumed in our Investor Day plan.

Now turning to Defense, the ongoing conflicts in Ukraine and the Middle East continue. Consequently, the US, many European nations and Australia have committed to increase spending on national security. We continue to support existing customers and platforms at an increased rate. We are actively pursuing new opportunities that exploit our unique capabilities as we work to strengthen national security. Fiscal 2025 will be another year of strong growth within our Defense businesses.

Finally, industrial markets continue to be soft. The Purchasing Managers Index for manufacturing has indicated contraction in the Eurozone economies for most of the last two years, and our industrial automation orders have, as a consequence, been soft. We expect industrial automation sales to continue at roughly the current quarterly rate through fiscal 2025.

Turning to 2025, our performance in 2024 was outstanding, demonstrating our effectiveness at executing against our strategy on pricing and simplification. We will continue to drive these activities with the same vigor in fiscal 2025. For that reason, I am confident in our guidance for 2025, which includes continued solid revenue growth, strong adjusted operating margin improvement in line with our plan, and significant free cash flow improvement. Our revenue growth will be driven primarily by broad-based defense needs and commercial aircraft demand, tempered by Boeing's challenges and our Tewksbury recovery. This is offset by a decrease in our Industrial business due to market conditions and divestitures.

Our margin enhancement will be in all segments except Commercial, where there is a mix shift towards original equipment production. In all cases, simplification initiatives, portfolio shaping and pricing are contributing to margin expansion.

Our free cash flow will improve significantly following a couple of years in which physical inventory growth plays to high demand on cash, we will reach a turning point in fiscal 2025. We intend to fund capital expenditures at an elevated level through fiscal 2025 in support of significant business capture now anticipated.

Now, let me hand over to Jennifer for a more detailed breakdown on the quarter and on our guidance.

Jennifer Walter

Chief Financial Officer & Vice President, Moog, Inc.

Thanks, Pat. I'll begin with a summary for FY 2024, followed by a more detailed review of our fourth quarter financial performance. I'll then describe our initial guidance for FY 2025.

Sales for FY 2024 were at a record level coming in at \$3.6 billion. This represents a 9% increase over FY 2023. Each of our segments contributed to our sales growth with our Aerospace and Defense segments driving substantially more growth relative to Industrial.

Commercial Aircraft sales increased 18% as a result of production ramp on widebody, narrowbody and business jet platforms.

Military Aircraft sales increased 13%, largely due to having a full year's worth of FLRAA sales, as their activity in FY 2023 was interrupted by a delay in the contract awards. Sales in Space and Defense increased 7% due to strong, broad-based Defense demand. Industrial sales increased slightly at 1%, with softening in industrial automation being compensated for by growth in other submarkets.

Our adjusted operating margin of 12.4% increased to 150 basis points over FY 2023. We benefited from an employee retention credit, which provided 40 basis points towards that increase.

Operating margins expanded in each of our segments except for Commercial Aircraft. Military Aircraft operating margin increased 300 basis points to 12.0%. We benefited on cost absorption from having a full year of activity on FLRAA in FY 2024.

In addition, we have lower level of R&D expense in FY 2024. Our operating margin in Space and Defense increased 290 basis points to 13.4% due to strong operational performance, including improved performance on our space vehicle program.

In Industrial, our operating margin expanded 90 basis points, largely due to pricing initiatives. In Commercial Aircraft, our operating margin decreased 90 basis points to 11.8% as FY 2023 included benefits from specific aftermarket activities. In FY 2023, we had a number of one-time aftermarket initiatives that contributed nicely to our operating margin, as well as the sale of inventory upon exiting a mature platform. Higher production volume in FY 2024 helped to offset these impacts.

Adjusted earnings per share in FY 2024 was \$7.80. This includes the benefit associated with the employee retention credit that we described in our second quarter. It also includes an adjustment we made in the fourth quarter to capitalize interest associated with major capital projects for FY 2023 and FY 2024. Excluding these two items, adjusted earnings per share was \$7.24, up 18% over FY 2023. The growth in our earnings per share resulted from our operating margin expansion efforts and our sales growth.

For the year, we generated a modest level of free cash flow. Net earnings grew substantially with physical inventories also growing, in part associated with our strong sales growth.

Let's shift over to our fourth quarter results. We had a great quarter. Sales were very strong. Adjusted operating margin was robust and on plan. And adjusted earnings per share, even after removing the benefit of capitalizing interest, exceeded the high end of our guidance range. And in addition, we generated a substantial amount of free cash flow.

We continue to make progress on simplifying our business in the fourth quarter and took some charges as a result. We recorded \$15 million of losses associated with the Industrial businesses that we recently divested. We

also incurred \$12 million of restructuring and related charges associated with other portfolio shaping activities. In addition, we took \$4 million of footprint rationalization charges.

I'll now talk through our fourth quarter results, excluding these charges. Sales in the fourth quarter of \$917 million was 5% higher than last year's fourth quarter.

Military Aircraft and Space and Defense sales were up nicely, while Commercial Aircraft sales were up slightly and Industrial sales were down modestly.

The largest increase in segment sales was in Military Aircraft. Sales of \$216 million were up 17% over the fourth quarter of last year. Activity on the FLRAA program began to ramp in the third quarter last year and has steadily increased since that time, accounting for over half of the increase this quarter.

In addition, over the past couple of years, certain other development work has shifted into production and we're now beginning to see the ramp-up in production that will continue for the next few years.

Space and Defense sales of \$263 million increased 9% over the fourth quarter last year. Defense demand continues to be strong and we're seeing that come through most notably this quarter for European defense needs. In addition, launch vehicle activity continue to grow in our Space business.

Commercial Aircraft sales of \$197 million increased 2% over the same quarter a year ago. Volume increased nicely in the fourth quarter. This growth was muted by sales recorded in last year's fourth quarter for retroactive pricing and the sale of inventory associated with the mature product line that we exited as part of our 80/20 work.

Industrial sales were \$242 million in the fourth quarter. That's down 5% from the same quarter a year ago. Industrial automation sales were down from the very strong fourth quarter a year ago, reflecting the slowdown in orders we've seen in recent quarters. Strength in our medical pump business helped to offset this decline as we benefited from a competitor's challenges. Our automotive test business was also strong this quarter.

We'll now shift to operating margins. Adjusted operating margin of 12.5% in the fourth quarter matched that of the fourth quarter a year ago. Stronger operational performance, including results from our pricing and simplification initiatives, were offset by the benefit from retroactive pricing included in last year's fourth quarter. Adjusted operating margins increased over the fourth quarter of last year in each of our segments, except for Commercial Aircraft.

The most impactful increase was in Military Aircraft with a 450-basis-point increase to 12.0%. This reflects lower research and development expense, a more favorable mix within aftermarket and efficiencies associated with higher volume on the FLRAA program.

Industrial operating margin was 12.8% in the fourth quarter, up 90 basis points. This increase was attributable to benefits from pricing initiatives, offset by pressures associated with lower industrial automation sales and planned product transfers.

In Space and Defense, operating margin increased 70 basis points to 13.5%. This increase is associated with improved performance on space vehicle program, pricing and profitable growth.

Commercial Aircraft operating margin was 11.4%, down 640 basis points from the fourth quarter last year, as the fourth quarter last year included benefits from retroactive pricing and the sale of inventory associated with an exit of mature platforms.

I'll now shift to non-operating expenses. Interest expense was down compared to the same period a year ago related to the capitalized interest adjustment I described earlier. Our adjusted effective tax rate in the fourth quarter was 19.2%, up from 18.5% in the fourth quarter last year, with the increase attributable to lower levels of R&D tax credits this year. Putting it all together, adjusted earnings per share came in at \$2.16, up compared to last year's fourth quarter. The increase is attributable to additional operating profit associated with higher sales. While we benefited this quarter from the capitalization of interest, this is offset by the benefits of the legal settlement and lower non-operating expenses in last year's fourth quarter.

Let's shift over to cash flow, which was particularly strong this quarter. In the fourth quarter, we generated \$109 million of free cash flow. This represents free cash flow conversion on adjusted net earnings of over 150%. The key driver to the strong cash generation this quarter was working capital, in particular collections from customers and timing of vendor payments.

Capital expenditures, after excluding the capitalized interest adjustment, were in line with spend levels in recent quarters. We're broadening our target leverage range to be a full turn of EBITDA, still centered around 2.5 times midpoint. Our leverage ratio was 2.0 times as of the end of the fourth quarter, putting us at the low end of our target leverage of 2 times to 3 times.

Our capital deployment priority in the near-term continues to be investing for organic growth, with the anticipation of several significant programs that will provide long-term revenue growth starting in just a few years. Our investments in our facilities will continue at elevated levels to ensure we're well prepared for these exciting opportunities. Longer term, our capital deployment priorities will be more balanced.

We'll now shift over to our initial guidance for next year. Fiscal year 2025 will be another positive step on our journey towards our long-term financial targets. We'll grow our sales, expand our operating margin in line with our Investor Day targets, and improve our cash flow generation. We're projecting sales of \$3.7 billion in FY 2025, a 3% increase compared to FY 2024. We're projecting sales growth in Space and Defense, Commercial Aircraft and Military Aircraft, and expecting a decrease in sales in Industrial. The largest increase in sales will be in Space and Defense. We're projecting sales to increase 7% to \$1.1 billion. We're seeing strong Defense demand across our entire book of business, in particular in Space and European ground vehicle markets.

Commercial Aircraft sales are projected to grow 6% to \$835 million. Demand for Commercial Aircraft remains high while traffic is growing in key routes. Production continues to ramp on nearly all of our platforms, driving the sales growth. This is tempered, however, by the pressures on our Boeing platforms and production levels at our Tewksbury facility as Pat described.

Military Aircraft sales are projected to increase 4% to \$840 million. We're expecting further growth on the FLRAA program as we accelerate the pace in FY 2025. In addition, aftermarket sales will increase as the military looks to ensure mission readiness across the fleet.

Industrial sales would decrease in FY 2025. We're projecting sales of \$940 million, down 5% from last year, but only 2% when we adjust for the two businesses we sold at the start of FY 2025. While still very strong, sales for both test and simulation will moderate off the record levels.

Let's shift over to operating margin. We're projecting our adjusted operating margin in FY 2025 to be 13.0%, a 60-basis-point increase over FY 2024, or 100 basis points after factoring our FY 2024 employee retention credit benefit. Operating margins will expand in each of our segments with the exception of Commercial Aircraft.

Military Aircraft operating margin will increase 110 basis points to 13.1%. We're transitioning from development to production on several programs, and this reduces our risk and increases our operating margin. In addition, both volume and pricing are positively impacting our operating margin in Military Aircraft.

Industrial's operating margin will increase 100 basis points to 13.4%. Simplification will drive our margin expansion within Industrial. Portfolio shaping, including the divestitures completed at the beginning of FY 2025 and product phase-outs resulting from 80/20 activities will contribute to our margin expansion. We also made progress with footprint rationalization and this is creating efficiencies within our business. Our simplification actions are tempering top line growth in favor of operating margin expansion. In addition to our simplification progress, pricing will continue to contribute to our operating margin expansion in Industrial.

Our operating margin in Space and Defense will increase 80 basis points to 14.2%. We'll benefit from profitable growth and pricing, though we'll feel pressured from the lack of the employee retention credit that we benefited from in FY 2024.

In Commercial Aircraft, our operating margin will decrease 80 basis points to 11.0%. Our product mix will be less favorable in FY 2025 as OE production outpaces aftermarket growth.

We'll also be negatively impacted from our Tewksbury operations as we work to get back up to capacity after the storm damage. For FY 2025, we're projecting adjusted earnings per share of \$8.20 plus or minus \$0.20. That's up 5% over FY 2024 or 11% adjusting for the employee retention credit and normalizing the level of capitalized interest. The projected earnings per share increase reflects strong operational performance. For the first quarter, we're forecasting earnings per share to be \$1.60 plus or minus \$0.10.

Finally, turning to cash, we're projecting free cash flow conversion to be in the 50% to 75% range, a solid improvement from the modest level of cash we generated this past year. This is somewhat below the 75% level that we had previously targeted. A good portion of that change relates to an increased level of capital expenditures in FY 2025. While we had previously expected capital expenditures to begin to decline in FY 2025, we are now increasing investments in anticipation of longer-term business opportunities.

In addition, we're factoring in potential pressure on cash related to volatility at Commercial OEM due to uncertainty and fragility of our supply chain. We'll drive an improvement in free cash flow generation from FY 2024 to FY 2025 by relentlessly focusing on optimizing our planning and sourcing activities. This involves further development of our supply chain, including dual sourcing and vertical integration, as well as having clear accountabilities and increasing visibility to aid in timely and informed decisions. We'll see the benefit of these actions come through in the form of reduced inventory levels. We'll be pressured with regard to receivables though, particularly early in FY 2025, as we come off a very strong collections quarter in the fourth quarter of FY 2024.

Overall, we're really encouraged by our financial performance in FY 2024 and we're looking forward to another great year in FY 2025.

And now, I'll turn it over to Pat.

Patrick J. Roche

President, Chief Executive Officer & Director, Moog, Inc.

Thank you, Jennifer. Our fourth quarter was strong, bringing to close an exceptional year with record sales and expanded margin. Our performance reflects the success in pricing and simplification initiatives that continue to build momentum into 2025, with stronger sales, expanded margins and improved cash flow generation.

Now let's open it up to your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And we'll pause for a brief moment to allow everyone an opportunity to signal for questions. Our first question is coming from the line of Cai von Rumohr with TD Cowen.

Cai von Rumohr

Analyst, TD Cowen

Q

Terrific. Thank you very much. And great results again. So, Pat, you mentioned, you do this quite a bit, generational defense wins and you mentioned two of them. Could you give us any more specifics, and specifically with regard to Europe?

Patrick J. Roche

President, Chief Executive Officer & Director, Moog, Inc.

A

Yeah. Hi. Good morning, Cai.

Cai von Rumohr

Analyst, TD Cowen

Q

Yeah.

Patrick J. Roche

President, Chief Executive Officer & Director, Moog, Inc.

A

Yeah, we had a great quarter. Thanks for the comment. There's a lot of activity going on. I'm able to state that we're involved in a lot of capture and development activities across the whole broad range of defense applications in all of the warfighting domains.

The activities we're talking about in Europe are predominantly aligned around armored vehicles, which has been a strength of ours in Europe, and we're seeing many of the existing platforms pulling through more sales. So, we got significant uplift in sales in Europe. In fact, we've secured a second building at our Böblingen Campus to help accommodate some of that growth of Defense business in Europe.

In terms of new programs in Europe, we're obviously interested in ground-based air defense, and we continue to pursue that. And in the US, there are a number of programs that we're actively pursuing as well. I would say have developed strong commitment, our relationships with the main competitors in those for those programs of work and are working with them. But I don't have announcements to make in this quarter as to any of those particular programs. And also, some of the other activity that's going on would be under our classified activities, Cai, and I can't share the details of them. But I think the key thing is there is really strong demand out there. The capabilities

we have are matching with the problems that are being trying to be solved, and we feel that we're in a really strong position to announce wins in the future, but we just have to wait until they're secured before we can share more detail on them.

Cai von Rumohr

Analyst, TD Cowen

Q

Terrific. And if we can switch to Commercial Aircraft, any specifics on the Boeing strike impact? Because I assume that would hit most heavily in the first quarter. And what are you assuming regarding Airbus? Because they gave this kind of crazy forecast of hitting 770 deliveries, even though they haven't done 500 in the nine months now and they did 50 in October. So, their numbers look excessively aggressive.

Patrick J. Roche

President, Chief Executive Officer & Director, Moog, Inc.

A

So on Boeing, Cai, we don't expect any direct impact from the strike. I tried to indicate in the script that we have a weighting towards the widebody business, because it's such that impact on 737-MAX on our overall sales levels is relatively muted. And so, there's no real impact from the strike on us at this point in time. We're building at a rate that we feel is really now aligned with their current plans. So, I think what we have done for our projection for 2025 is a really well balanced and judged assessment of what we think we can do in the Commercial business in the coming year.

I mean, there's obviously uncertainty in the industry in general and the issues you mentioned with supply chain affecting both Boeing and Airbus. And as a consequence of that, when we were thinking through our modeling for next year, it was one reason for having the wider range on the cash flow from 50 to 75, take into account the challenge that's out there in the industry. But we'll continue to...

Cai von Rumohr

Analyst, TD Cowen

Q

Terrific and – great. And the last one. Could you give us any sort of specifics in terms of what we should look for this year, in terms of how much growth in Commercial and Military aftermarket?

Patrick J. Roche

President, Chief Executive Officer & Director, Moog, Inc.

A

Actually, when you look at our Commercial business into 2025, what you'll see is that the growth in OE production, despite all the challenges that we've just described, the growth in OE production is outpacing the growth in aftermarket in our Commercial business. And so the mix moves – the mix changes slightly as we go from 2024 to 2025 more in favor of OE.

And the second factor affecting us on the Commercial side is we do quite an amount of our aftermarket activity through our Tewkesbury site in the UK, and that was the site that's been affected by flooding. That has reduced our available capacity in that plant for part of this year. And as a consequence, that pulls back our aftermarket content during this year as well.

Cai von Rumohr

Analyst, TD Cowen

Q

Terrific.

Patrick J. Roche

President, Chief Executive Officer & Director, Moog, Inc.

On the Military side – oh, sorry.

A

Cai von Rumohr

Analyst, TD Cowen

Go ahead. Yeah.

Q

Patrick J. Roche

President, Chief Executive Officer & Director, Moog, Inc.

On the Military side, there's not much of a change in the mix as we go into next year, Cai.

A

Cai von Rumohr

Analyst, TD Cowen

Terrific. Thank you very much. I'll let someone else go.

Q

Patrick J. Roche

President, Chief Executive Officer & Director, Moog, Inc.

You're welcome. Thank you, Cai.

A

Operator: The next question is coming from Michael Ciarmoli with Truist Securities.

Michael Ciarmoli

Analyst, Truist Securities, Inc.

Hey, good morning, guys. And real nice results. Thanks for taking the questions. Hey, Pat, maybe we could just stay on Cai's line of questioning there on Commercial. Just on the 787, can you give us a sense then, I think you had been shipping at rates above where Boeing had been. Is there going to be this sort of a one year sort of de-stock situation or how do you kind of see that program moving throughout the year? And I guess back to Airbus, right, their commentary on A350, certainly targeting that longer-term rate of 12%, but it sounded like 2025 was going to be a little bit squishy in terms of getting the rates increasing. So maybe just a little more detail on those two widebodies.

Q

Patrick J. Roche

President, Chief Executive Officer & Director, Moog, Inc.

Yeah. Hello, Michael. Good morning. Thanks for the questions. On the Commercial side, I mean, we've been in a lot of detail discussion with both of our customers. We feel and we have adjusted the plan accordingly. And so, we mentioned in the notes that we had moderated somewhat the expectations we have on rates from what we had 18 months ago. I mean, when we went out at the Investor Day, we had a plan in mind. It was built off of Boeing's rate increases at that time. Obviously, things have changed over the course of the last 12 months or so, and we've built all of that now into the model going forward. So yeah, it is down somewhat on what we thought at Investor Day, but it's still showing for us as a business growth in our widebody, narrowbody and business jet business in fiscal 2025.

A

Michael Ciarmoli

Analyst, Truist Securities, Inc.

Q

Okay. Okay.

Patrick J. Roche

President, Chief Executive Officer & Director, Moog, Inc.

And your comments about Airbus as well, I mean, we've built in that into the model for next year as well. So, I think we're really in line with both of the OEMs at this point in the plans.

A

Cai von Rumohr

Analyst, TD Cowen

Okay. Okay. And then just on the aftermarket, do you actually – I know we'll probably get it in the Q, what was the Commercial aftermarket growth rate in this quarter? And then, I guess, absent Tewkesbury, would you have aftermarket growth in 2025? I mean, it's just – it's such a strong market. I mean, I'm just trying to figure out if there's anything with your business that's a little bit more nuanced. I mean, obviously, you're more widebody exposed, but any other color you can provide there?

Q

Patrick J. Roche

President, Chief Executive Officer & Director, Moog, Inc.

So, the Tewkesbury business does have a substantive piece of aftermarket activity flowing through. And so that is tempering out into next year. I think our mix in fiscal 2025 is something like 70/30 between OE and aftermarket on the Commercial side. This year, that might have been two-thirds, one third. So, the mix shifts over as a consequence of the growth on the OE side, I would say shift over predominantly because of the growth on the OE side and to some degree due to the Tewkesbury capacity challenge.

A

Michael Ciarmoli

Analyst, Truist Securities, Inc.

Okay. Okay. Perfect. And last one for me and then I'll get out of the way. Just on these defense opportunities, thinking more, maybe working with some of the domestic suppliers, are you guys having traction working with some of these newer upstart, commercial-based defense companies, whether it's [indiscernible] (00:50:49) of the world?

Q

Patrick J. Roche

President, Chief Executive Officer & Director, Moog, Inc.

I think I'd prefer not to comment on which customers we're working with.

A

Michael Ciarmoli

Analyst, Truist Securities, Inc.

Okay.

Q

Patrick J. Roche

President, Chief Executive Officer & Director, Moog, Inc.

I would say, we do have an interest in the CCA market in general, and I think we have offerings that can make contribution to any of the players in that space.

A

Michael Ciarmoli

Analyst, Truist Securities, Inc.

Okay. Fair enough. Thanks, guys.

Q

Patrick J. Roche

President, Chief Executive Officer & Director, Moog, Inc.

Thanks, Michael.

A

Operator: Our next question is coming from the line of Jon Tanwanteng with CJS Securities.

Jon Tanwanteng

Analyst, CJS Securities, Inc.

Hi. Good morning. Thank you for taking my questions, and nice quarter. I was wondering if you could detail your CapEx plans for this year, maybe you told us, so there's a little bit of connection trouble, but where does it stand versus what maybe you thought you would spend compared to your Investor Day last year?

Q

Jennifer Walter

Chief Financial Officer & Vice President, Moog, Inc.

Yeah. So capital expenditures, we're looking to be at \$180 million next year. That's 4.9% of our projected levels of sales. So that's on our high end of our range.

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Historically, we've been at 3% to 4%. But in the last couple of years, we've been in that 4%, just over 4% range as we were making some of the changes to support the growth that we were having during the Investor Day period. Pat's just been talking about these once in a generational types of opportunities in the Defense businesses. And we're seeing progress in capturing and going to continue capturing those types of opportunities. And with that includes the need for further capitalization. That capitalization comes in the form of facilities, enhancements to our facilities and equipment for those facilities. So, we're deciding to spend that now in FY 2025, so that we're nicely prepared for these opportunities, which would be in the next couple of years or so before we would need them. So, it's really the ramping up of that.

So, we're certainly taking our capital expenditures up to a higher level than we had planned. We had anticipated that in FY 2025, we were going to be on the start of our journey to reduce our capital expenditures down to our historical norms of 3% to 4%, maybe not quite getting there all the way this year, but that's really the difference.

That's the primary driving factor between our 75% free cash flow conversion from Investor Day to the range that we've got of 50% to 75%. So, it's really another way to deploy our capital. It just happens to be in our free cash flow calculation. And it brings that down. It's the same thing. It's investing for organic growth. And we've seeing incredible opportunities just outside our Investor Day period. And so, we're capitalizing so that we'll be well positioned to make those a reality.

Jon Tanwanteng

Analyst, CJS Securities, Inc.

Got it. That's very helpful. Thank you. And maybe just to dig a little deeper, what is the time, I guess, you expect before you start generating full run rate income on these facilities? You have a variety of projects or end markets that they can have different types of durations on the length of project and the platform. So just wondering how would you characterize these additional investments and when they might come back to in terms of profitability?

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Jennifer Walter

Chief Financial Officer & Vice President, Moog, Inc.

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So, I would say these right now are going to be coming out in the form of cash. They're not going to be depreciated yet, because we won't have them placed in service for the most. Some of them maybe have elements placed in service in FY 2025, but some of them will continue into FY 2026. So, the investment right now is in cash. I would say that we could be in – there's a variety of these types of platforms, but I would say they're outside of our Investor Day period, so beginning in FY 2027 and after, for which we would start having some production revenue.

Jon Tanwanteng

Analyst, CJS Securities, Inc.

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Okay. Got it. And then outside of growth CapEx, just can you give us an update on spending for the transformation and kind of what's on deck this year? What are some of the bigger pieces you have to execute on in 2025?

Patrick J. Roche

President, Chief Executive Officer & Director, Moog, Inc.

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So, we'll continue to drive the 80/20 deployments, Jon, into the business. So, I mentioned that we've deployed it into 70% of the business to date. We just keep driving that through the coming year. We have some work to do on completing our footprint rationalization activities that are already started, but we have an idea of several more to complete out during the course of the year as well. So there's more work to do during the year. The themes are the same as the themes we've been talking about over the prior years, all of it to drive simplification within the organization and therefore take away that complexity and costs associated with it.

Jon Tanwanteng

Analyst, CJS Securities, Inc.

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Okay. Great. And last one for me. I'm just wondering what your forecasts would have looked like, I guess, under the old rate of 787 production, maybe if Tewkesbury had been damaged by the storms?

Jennifer Walter

Chief Financial Officer & Vice President, Moog, Inc.

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It certainly would have been higher. We've reflected what we've got in our current types of – there's different trade-offs associated with this. We want to make sure that we're balancing the different things, the different elements here. We want to make sure that we've got the stable supply chain and everything along those lines as well, making sure that we're not building up inventory. So, our plans are really to put our plans in place that are going to make sense for keeping that healthy supply chain so that we are ready to ramp when our customers are ready to ramp, and not building excess inventory in the meantime. So, we don't have a pre-model as far as where that is that we'll share, but it's really, it's reflective of a lower level of sales activity than we previously had projected.

Patrick J. Roche

President, Chief Executive Officer & Director, Moog, Inc.

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And Jon, just on the Tewkesbury capacity constraint, we're not anticipating that would result in us losing the business. I think it pushes some business out into the start of 2026 and then the amount that gets pushed out is a little bit dependent on the pace at which we can regain full capacity at the Tewkesbury site. So, there's a couple of moving pieces there, but it's not lost business.

Jon Tanwanteng

Analyst, CJS Securities, Inc.

Okay. Great. That's very helpful. Thank you.

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Patrick J. Roche

President, Chief Executive Officer & Director, Moog, Inc.

Thank you.

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Operator: And our next question is coming from Kristine Liwag with Morgan Stanley.

Justin M. Lang

Analyst, Morgan Stanley & Co. LLC

Hey, this is Justin on for Kristine this morning. Thanks for taking the question. I wanted to ask on you mentioned strength in European defense sales. Maybe you could just touch on the trends you're seeing in terms of overall international mix in Defense and how fast you see that growing and maybe how that might impact margins going forward.

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Patrick J. Roche

President, Chief Executive Officer & Director, Moog, Inc.

So, I think the feeling of insecurity in Europe is pretty high with what's going on in the Ukraine-Russian war, and it has certainly changed perspectives there. And that has resulted in increased defense commitments as a percent of GDP in many of the countries across Europe. You're seeing that having an impact on the industry. And the industry in some cases doesn't have the capacity to keep up with that increased spend commitment that's in Europe. And we're seeing it as a pull-through in modernization of platforms and fleet readiness activities. So, we've got a lot more work going through our German operation as a consequence of the readiness requirement.

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I guess in Europe at the moment, I think there is further work and opportunity for newer platforms in the future. That's not what we're seeing at the moment. What we're seeing at the moment is a pull-through in existing platforms, but it is a significant lift-up in the size of that European business.

European business as a percent of our overall is not huge as a percent of our overall Defense business. It's not insignificant but it's not huge, but it has doubled over the course of the last two years. And that's why Jennifer mentioned we've invested in increasing our facility footprint in Germany. We've added another building to be able to accommodate the work that's going on there. So, we see it as really positive. It is at the moment on the ground vehicle activity, but there are more opportunities out there that we're pursuing as well in a wider range of domains.

Justin M. Lang

Analyst, Morgan Stanley & Co. LLC

Got it. That's helpful. And then maybe just to sneak one more in on the Tewkesbury situation. Appreciate it might get – it might be tough to get precise, but maybe just how you're thinking about when you might be able to get that facility back up performing to pre-flood levels.

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Patrick J. Roche

President, Chief Executive Officer & Director, Moog, Inc.

Yeah. So let me give you a little bit more color about that, Justin. I mean, I mentioned in the notes that we had robust business continuity plans. We had just consolidated our operations in Tewksbury into a brand-new facility

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which was – which we took the keys off a year ago. We moved all of our manufacturing equipment in there and we were seven days ahead of an official opening of that site when it was hit by this flood. So, it was a really crushing incident for the staff on-site who had invested so much time and effort in setting that facility up for the future.

However, when the flood happened, we had all hands on deck 24 hours a day. I would say people were totally committed, worked through weekends to see what we could do. And we had installed, I would say, redundant facilities at the site. So, we have two different types of oil that are used in our hydraulic product. We had two separate development labs fitted out and what we were able to do was move what was standard production into those development labs and to get running again within about a week or a week-and-a-half of the flood event in those two development labs. They won't give us full capacity at the site, but we are certainly over 50% capacity with that capability already on-stream.

The work that we have to do during the course of the year is to rebuild the clean room in Tewkesbury, and that will get us back to the full capacity. So, it's not that we're knocked out, we're up and running again. We just don't have the full capacity available and we believe that we can regain that during the course of the fiscal year.

Justin M. Lang

Analyst, Morgan Stanley & Co. LLC

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Got it. It's super helpful. Best of luck on that front.

Patrick J. Roche

President, Chief Executive Officer & Director, Moog, Inc.

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Thank you.

Operator: And it appears there are no additional questions in the queue. I will now turn the call back to Pat Roche for any closing remarks.

Patrick J. Roche

President, Chief Executive Officer & Director, Moog, Inc.

So thank you very much for joining us today on the call. I look forward to talking to you again in January. Thank you for your time. Bye now.

Operator: This concludes today's call. Thank you for your participation. You may now disconnect.

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