ASTRONICS CORPORATION

THIRD QUARTER FISCAL YEAR 2024
EARNINGS RESULTS CONFERENCE CALL TRANSCRIPT

NOVEMBER 6, 2024

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Presenters and Participants

PRESENTERS

Peter J. Gundermann
Chairman, President & CEO

David C. Burney
CFO & Executive Vice President

Nancy L. Hedges
Corporate Controller & Principal Accounting Officer

Craig Mychajluk
Investor Relations

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Jon Tanwanteng
CJS Securities, Inc., Research Division

Michael Ciarmoli
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Presentation

Operator

Greetings, and welcome to the Astronics Corporation Third Quarter Fiscal Year 2024 Financial Results. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Craig Mychajluk, Investor Relations. Thank you, sir. You may begin.

Craig Mychajluk
Investor Relations

Thank you. And good afternoon, everyone. We certainly appreciate your time today and your interest in Astronics. Joining me on the call are Pete Gundermann, our Chairman, President and CEO; Dave Burney, our Chief Financial Officer; and Nancy Hedges, our Corporate Controller.

You should have a copy of our third quarter 2024 financial results, which crossed the wires after the market's close today. If you do not have the release, you can find it on our website at astronics.com.

As you are aware, we may make forward-looking statements during the formal discussion and the Q&A session of this conference call. These statements apply to future events that are subject to risks and uncertainties as well as other factors that could cause actual results to differ materially from what is stated here today. These risks and uncertainties and other factors are provided in the earnings release as well as with other documents filed with the Securities and Exchange Commission. You can find these documents on our website or at sec.gov.

During today's call, we'll also discuss some non-GAAP measures. We believe these will be useful in evaluating our performance. You should not consider the presentation of this additional information in isolation or as a substitute for results prepared in accordance with GAAP. We have provided reconciliations of non-GAAP measures with comparable GAAP measures in the tables that accompany today's release.

With that, let me turn the call over to Pete to begin.

Peter J. Gundermann
Chairman, President & Chief Executive Officer, Astronics Corp.

Thank you, Craig. And good afternoon, everybody. I would like to begin this call by saying a few words about a couple of people here in the room with me. Dave Burney will be retiring as our CFO early in 2025 after a tenure of 29 years with the company. 22 years ago, he and I took over the C-suite at about the same time, and revenues for our company at that time were about $33 million, and this year, we expect to again be in the $800 million range. So, it has been quite a ride over these 29 years with Dave, but he's been a tireless leader within our company and a trusted friend and partner for me and he will be missed. Although I do have his cellphone number and I know where he lives, if needed, we'll pull him back in.

Also with me is Nancy Hedges. She is a new name probably for most of the people on this call, but she will be succeeding Dave as our CFO in January. Nancy has been on for a while. She joined in 2014 as Controller & Principal Accounting Officer of our company, and over the time since, has established herself internally as a leader and toptier performer on our team. She's very familiar with our personnel, our operations and the improvement initiatives we seek, and I'm confident the investor community will get to know her and appreciate her talents as time goes on. I'm very confident she will do a very good job as CFO going forward. We'll hear from both Dave and Nancy in just a few minutes.

I want to move to a couple of comments on the top line trends that are affecting our company. Nothing really new here, but we felt operationally that the third quarter was a very good quarter for Astronics. Sales were strong, up 25% year-over-year and in the high end of our forecasted range, once again. Adjusted net income was $12.2 million or $0.35 a share. Adjusted EBITDA was $27 million, 13% of sales, and our trailing 12-month adjusted EBITDA is $91 million.

Our Aerospace segment gets a lot of the credit for the improvement. Sales for our Aerospace segment again were up 25% for the quarter and 19% for the year, and adjusted operating margin was 14.2% in the quarter, up from 3.5% in the period a year ago. We continue to recover with volume and margin improvement initiatives, and they're starting to show up strongly on the bottom line. We have more progress ahead but we continue to make progress.

There are macro tailwinds, which have been helping us over recent quarters and continue to help us. I'm not going to go into any of these in too much detail, but it's worth reminding ourselves kind of where we've been and where we're going. And the first and probably the most important thing is that our supply chain continues to improve and perform. We do regular reviews of our business units, and not too long ago, every problem was attributed one way or another to the supply chain. Today, those comments are fewer and farther between, but there are still issues and there always will be. But in general, the supply chain continues to improve and enables our improved performance.

Similarly, input cost pressures continue to subside. The inflation that we experienced over the last year and a half has gotten much quieter. Our workforce continues to improve and get more efficient. Some of you might remember, on the last call, I mentioned that we had something like 45% of our 3,000 employees have been with us for three years or less. That kind of turnover, which again was attributable to the pandemic, is really hard to operate in. As time goes on and people get more familiar with what they're doing and how to work with each other, our efficiency improves.

Similarly, pricing adjustments, which we negotiated through that period of inflation, are now coming more and more into effect. Some of our major programs are beginning to take on new pricing structures, which will be a contributor as we move forward through 2025.

Finally, demand continues to be pretty strong. We are entering the fourth quarter with a backlog of $612 million. If you look back to 2018 or 2019, when we were last at an $800 million run rate, our backlog was much lower, like in the $400 million to $420 million range. We're entering the fourth quarter at $612 million. That sets us up, we think, for continued results and continued improvement on the top line, as we move forward.

The press release talks a lot about adjusted measures. I thought it would be worth spending just a minute talking about some of the major adjustments in our third quarter. There were a few of them. We did a refinance in July, and as part of that refinance, we had to expense about $7 million of assets related to the old credit facility that are no longer applicable on our financial statements. We also had legal expenses during the quarter of $5.6 million that was ramping up to a hearing that happened in the UK that I will talk about again later in the call.

And finally, one of our eVTOL customers, Lilium, filed for bankruptcy just a couple of weeks ago, and we took a total of about $2.2 million in charges related to that. I wanted to comment that we are involved with a number of eVTOL customers, but we were more heavily involved with Lilium than we are with the others. So for people who are concerned about whether this is the first shoe of many shoes to drop in this segment, I would tell you, I don't think that's the case.

What we have done with most customers is developed a kind of a standard architecture, off-the-shelf products that can be relatively easily integrated into their aircraft without a high degree of customization. So I don't feel we have the same level of exposure, though we are working with a pretty wide range of eVTOL aircraft that are being developed currently.

Finally, we had a rare warranty reserve of $3.5 million. This was related to an electrical power system for a business jet aircraft that was experiencing less than desirable reliability over time. It's something that we introduced a few years ago, and it's supposed to perform better and longer than it has been. So we need to take some actions to fix that. That's part of being a supplier with integrity and living up to our promises to our customers. So it's kind of a long list and it's high dollars. We also broke out a lot of our tables in our press release, more than we usually do, to help everybody understand where the expenses were fitting in and what the adjustments were and how the company was performing absent those adjustments.

That said, I'm going to turn it over to Dave, who's going to talk about our consolidated results and then we'll go to Nancy to talk more a little bit about segment results.

David C. Burney
Executive Vice President & Chief Financial Officer, Astronics Corp.

All right. Thanks, Pete. As Pete mentioned, there's quite a bit of noise in the quarter, so we presented some tables to help show where on the income statement the impacts of these items are reflected and to highlight the performance of the underlying business.

I'll review the operational results on a consolidated basis, and I'll pass it over to Nancy to review the segment results. With higher sales volume, our operating leverage was demonstrated with stronger gross profit and margins. The GAAP gross margins improved to 21%, up 8.3 points over the prior year. On an adjusted basis, gross margin improved to 23%.

Impacting reported results was a $3.5 million for warranty reserve for a product that's been in the field for several years that requires modification. We also recorded an inventory reserve of $900,000 in the quarter related to the Lilium bankruptcy filing. I should point out that last year's third quarter also had an inventory reserve of $3.6 million also relating to the bankruptcy of a contract manufacturing customer. We adjusted both periods accordingly in the non-GAAP comparison.

SG&A expense was also impacted by the bankruptcy in the amount of $1.3 million with $800,000 in outstanding receivables being reserved for and $500,000 in fixed asset impairment for equipment relating specifically to Lilium. Adjusting for the impacts of the warranty reserve, the bankruptcy and the other unusual items that are highlighted in the tables provided in the release, adjusted operating margin for the third quarter was about 9.6% compared with an adjusted operating margin in the prior-year third quarter of 0%. Below the operating line was the $7 million in costs relating to the extinguishment of our previous term loan that we had discussed last quarter.

Our GAAP loss per share for the quarter was $0.34. Adjusted earnings per share was $0.35 for the third quarter this year and compares to a GAAP loss per share in last year's third quarter of $0.51 and an adjusted loss per share in last year's quarter of $0.07.

In the third quarter, we generated $8 million in cash from operations. We expected better, but between the Boeing strike and two IFE-related programs that were moved to the right by a few quarters, our inventory remains above where we would like it to be. The improved cash flow was driven primarily by improvement of our net loss, which was $11.7 million, adjusted for $23.8 million of noncash expenses and lower increase in our net operating assets. And you can see this on the cash flow statement.

Our net debt at the end of the quarter was about $174 million, about even with our second quarter. Thus far in the fourth quarter, we had strong cash flow with our net debt today down to about $168 million and roughly $60 million available to draw on our revolver.

With that, I'll turn it to Nancy to review the segments.

Nancy L. Hedges
Corporate Controller & Principal Accounting Officer, Astronics Corp.

Thanks, Dave. As you have the results available in the press release, I'll just help pull out the major drivers of profitability for each of the segments. Starting with Aerospace, which represented about 88% of the business, the nearly $22 million improvement in operating income was driven primarily by higher sales volume and improved productivity. The comparator period was more heavily impacted by a customer bankruptcy, making the year-over-year comparisons challenging on a GAAP basis. That's why we decided to include adjusted operating profit by segment to clearly delineate the noise of the two quarters.

Adjusted operating profit was $25.3 million in the quarter compared with $5 million in the prior-year period. Adjusted operating margin improved 10.7 points on the same impacts of higher volume and improve productivity, as well as the benefit of higher pricing that's rolling through now. Litigation expenses were more elevated in both the quarter and year-to-date periods as we've been in court more this year, especially as it relates to the UK, which Pete will discuss in more detail.

Turning to the Test segment. The Test business was near breakeven in the quarter, primarily the result of lower legal fees compared with the prior period. We're seeing positive results from our rightsizing efforts, but we were affected by less favorable sales mix in the quarter as well as under-absorption of fixed costs at our current volumes.

We also presented non-GAAP adjustments for the segment that shows a significant decline in litigation-related expenses that were associated with the Teradyne lawsuit, as there were no major developments in the quarter associated with that matter.

With that, let me turn it back to Pete.

Peter J. Gundermann
Chairman, President & Chief Executive Officer, Astronics Corp.

Thank you, Nancy. Moving to this legal situation that we have in the UK. By way of background, we've been in a lengthy patent infringement suit brought by a European plaintiff relative to our in-seat power product line. Hearings have been going on since 2010 and they have moved around in the USA, France, Germany and the UK.

In the USA and France, the subject patent was found to be invalid, though the French decision is being appealed. Germany dismissed some of the claims of the patent, but upheld others and found that Astronics had been infringing. The company paid $3.5 million in penalties and interest in 2020 and has taken a reserve of $17.3 million to cover remaining estimated damages and associated interest. We expect proceedings may commence on the German matter in 2026.

The UK court, however, maintained the entire patent and found Astronics to be infringing. A damages hearing was held last month in October, and a ruling is expected in December or January. We have reserved $7.4 million to cover anticipated damages, but the plaintiff is seeking damages of up to approximately $105 million, excluding interest.

Based on UK legal practices, the company expects that some amount of damages may be due in early 2025. The company is engaged with its lenders to arrange financing to cover the range of possible outcomes and satisfy any potential damages awards as required. The company believes that an appeal to a higher court is likely in the matter brought by one or both of the parties. That appeal would start in late 2025 or 2026, and most importantly, rest assured that all of the subject patents expired years ago and do not restrict the business of Astronics today in any way.

Apart from that and looking ahead, we are expecting our fourth quarter sales to be in the range of $190 million to $210 million. That's a little bit wider than usual, due in part to the Boeing strike situation. The Boeing strike hurt our third quarter revenues marginally by about $3 million as we got shut down in direct sales to Seattle in mid-to late September. The fourth quarter will get hurt more and the turn-on schedule is a little bit uncertain, so we have a wider range than we normally would at this point in a quarter.

Assuming we hit the midpoint, or actually that range of $190 million to $210 million brings our 2024 year-end sales forecast to the range of $777 million to $797 million. At the midpoint, that would show a 14.2% increase for the year, another year of strong growth.

Looking a little further, we are working on our 2025 plan, which looks like another year of solid growth, though maybe not as high as what we're experiencing in 2024 and continued margin improvement. We expect to release a sales forecast to our shareholders in December or January.

I think that ends our prepared remarks, Latanya. Maybe we can open it up for questions at this point.

Question and Answer Section

Operator

Sure. Thank you. We will now conduct a question-and-answer session. Our first question comes from Jon Tanwanteng with CJS Securities. Please proceed.

Jon Tanwanteng

Hi. Thank you for taking my questions, and nice quarter. Congrats also, Dave, on the retirement and Nancy on the appointment. I'm looking forward to working with you. Pete, I was going to ask you if you could quantify the impact from Boeing on a monthly basis and kind of what run rate do expect to see as we ramp through 2025, as that program restarts and kind of what kind of initial levels they'll start shipping out and what you will be shipping to Boeing?

Peter J. Gundermann

We don't have a clear answer to that question at the moment, Jon, but let me explain the situation a bit. Because they shut us down, we accumulated some inventory during the quarter, which will affect our rates going forward. Additionally, they also accumulated inventory as part of the strike process, so there will be some inventory that needs to be worked through. We expect a slow start, but we anticipate that the pace will accelerate as the year progresses. We believe they have internal goals of catching up quickly to the rate they were at before the strike, though we'll have to see how realistic those plans are.

What we expect is that they will maintain a certain rate for us, which will be enough to keep us operational and maintain the supply chain, but not so high that we get too far ahead of them. We'll likely find out more about this plan soon, but at this point, we don't have all the details.

Additionally, it's important to note that the main plane they manufacture in Seattle is the 737. The situation I described primarily involves products Boeing buys directly from us, which we ship to them for 737 line-fit installations. There are also a range of products, primarily related to in-flight entertainment (IFE), which are installed on 737s during production but are not purchased by Boeing or shipped by us to Seattle. These are instead shipped directly to airlines or seat companies. The value of this content is typically around $60,000 to $70,000 per airplane, and shipments have continued through the shutdown and up to today.
We assume that these shipments will continue, and that Boeing will eventually resume the direct shipments to us, but at a lower rate. Before the shutdown, we were shipping about 32 to 33 units per month, but we expect that number to drop to somewhere around 20 units per month, though we don't know that for certain yet. This is a crucial part of our operating plan for 2025, so we need to clarify this soon.

Jon Tanwanteng

Got it. And at the lower ship rate per month, does that impact your margins or can you get that back in pricing somehow?

Peter J. Gundermann

I think it's still a very profitable business. While higher volumes lead to higher profits, I don't believe it will materially affect our margins across the business.

Jon Tanwanteng

Okay. Great. And then just with the inventory situation, I guess, do you see the cash flow or at least the net debt improving in Q4? Do you have to extend that out when you start shipping to Boeing again?

David C. Burney

Yes, I continue to see strong cash flow heading into the fourth quarter. As I mentioned, we're a month into it, and cash flow has been very positive and strong. I believe it will remain solid for the rest of the quarter.

Jon Tanwanteng

Okay. Great. Thank you. I'll jump back in queue.

Operator

Thank you. The next question comes from Michael Ciarmoli with Truist Securities. Please proceed.

Michael Ciarmoli

Hey. Good evening, guys. Thanks for taking the questions. Dave, congratulations. Nancy, as well. Look forward to working with you. And Dave, best in retirement there. Hey, Pete, just maybe asking this another way, just obviously impossible to predict how fast Boeing ramps up, Airbus having their own challenges. If you look at that revenue forecast in the fourth quarter, how much is new production versus retrofit or aftermarket?

Peter J. Gundermann

We've been operating with a 50/50 split between line-fit and aftermarket. The slowdown in 737 production will likely impact that, potentially costing us around $8 million to $10 million if they don't resume operations with us.

Michael Ciarmoli

Okay.

Peter J. Gundermann

The focus will likely shift towards aftermarket. However, overall trends remain quite positive. What's interesting to me is that, for the most part, our airline customers have stayed consistent with their demand schedules. They haven't pushed much out. Occasionally, there are slight delays here and there, but they haven't been a major factor. It seems that, despite Boeing's strike, many of our customers have been able to look past it and haven't gotten too concerned.

Michael Ciarmoli

Okay. Okay. That's helpful. And then could you maybe talk just, I guess, specifically, if there's an opportunity for IFE, power, all of your related products at Southwest, given kind of the major changes and overhaul they're going through? It sounds like the majority of their cabins are going to be retrofitted here. I know they've got a pretty aggressive schedule. Is that on your radar? And is it something you can maybe give us a little bit more detail on if it is?

Peter J. Gundermann

Absolutely. Southwest is already a major customer of ours, and we're doing a lot of work on their cabin refreshes. Looking back, we developed a new in-seat power architecture, specifically designed around USB Type-C power. While this wasn't developed exclusively for Southwest, we worked closely with them on it. We've been pursuing them for many years, and we finally made it happen. This new system is prominently featured in their updated cabins, and you can see it in some of the photos.

Not only is this new architecture, which is USB Type-C-based, lighter and more cost-effective, but it has also been very successful in global sales. It's becoming an increasingly important part of our in-seat power and IFE (in-flight entertainment) offerings. We're certainly involved with Southwest, and the current modifications they're making to their cabins could present further opportunities for us to increase our content. However, there's not much I can share about that at this point.

Michael Ciarmoli

Okay. Okay. Last one for me. I mean, I know, the legal battle has been going on for a long time here. And I hate to get into the hypothetical. But $105 million in damages, given your balance sheet, is a significant percent of the market cap. I mean, how are you guys kind of thinking about this? I know I typically think of you guys as having the dominant position in some of these product categories. I guess the damage is one potential question, but then does this also sort of make your products a little bit more vulnerable? And do you see more competition coming in in some of those in-seat power and other related offerings?

Peter J. Gundermann

The second part of your question is the easiest to answer: No. The patents in question have all expired and have been expired for years. So, in a sense, this is a dispute over history. It doesn't restrict our business in any way today, and, as far as I can see, it's not a material issue competitively.

Michael Ciarmoli

Got you.

Peter J. Gundermann

That's really a non-issue. I could get into speculation about damages, but I'll just say that we're recovering and gaining financial strength very quickly. In that sense, we now have financial options that we didn't have a year and a half or two years ago. So, I don't view it as a major crisis. Additionally, given that it seems the court will allow appeals—or even anticipates them—it's clear that this whole battle, which has been ongoing for 14 years, will continue for at least a couple more. This will be one of those twists in the road that, someday, we'll look back on and be glad it's over.

Operator

We have a follow-up from Jon Tanwanteng with CJS Securities. Please proceed.

Jon Tanwanteng

Thanks for the follow-up. I was just wondering if you could talk about the strength in the Test business in the quarter. What do you see in the run rate going forward? And I think you had another restructuring that you talked about in the press release. Do you expect that to be doing a positive operating profit going forward?

Peter J. Gundermann

I think we're going to get closer. The $25 million figure has increased from the typical run rate of $20 million, but I don't think it will stay at that level. It might retrench. The situation remains the same. We're awaiting the start of the radio test program for the US Army, called TS-4549/T, and the current outlook is that series production should begin at the very end of 2025.

We need to get through the first three quarters of 2025, and this restructuring is designed to make that process as smooth as possible. While I don't expect the company to be highly profitable during this time, we are making progress and doing what's necessary to get the TS-4549/T program underway. This includes shipping the low-rate initial production units so the Army can conduct the tests to ensure everything meets their requirements, ultimately leading to the start of series production.

The restructuring is intended to help us navigate the next nine months successfully, in anticipation of that high-volume program kicking in at the end of 2025.

Jon Tanwanteng

Got it. Thank you. And just wondering if you could just – is there any other bigger legal expense coming? What should we expect from just the litigation expense side, not the reserves, but just paying your lawyers?

Peter J. Gundermann

Well, it's something we do quite well, so I think it should be relatively quiet. However, I’m not sure about the parameters or timing of an appeal in the UK case. If we reach that point, it’s likely to be a late-2025 event. Our experience in Germany has been relatively quiet, and we expect that to be more of a 2026 matter. In France, we have a victory, but the other side is attempting to appeal it. We don’t know where that will go or when, but there is actually a possibility that things could remain quiet for a few months.

Jon Tanwanteng

Got it. Thank you.

Peter J. Gundermann

Thank you, Jon.

Operator

Thank you. At this time, there are no further questions in queue. I would like to turn the call back to management for closing comment.

Peter J. Gundermann

No closing comments. Thank you for your attention. Again, we thought it was a pretty good quarter, a lot of subsequent events and an exciting future going forward. So thank you for your attention.

Operator

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