

**Operator:** Greetings, and welcome to the Astronics Corporation Second Quarter 2016 Financial Results Conference Call. As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Debbie Pawlowski, Investor Relations for Astronics Corporation. Thank you, Ms. Pawlowski. You may begin.

**Deborah Pawlowski:** Thanks, Devon. Good morning, everyone, and thanks for joining us here today. On the call, I have with me, Pete Gundermann, our President and CEO; and Dave Burney, our Chief Financial Officer. Pete is going to go through his prepared remarks and then we will open up the call for questions and answers. You should have in hand a news release that went out this morning, and it's also available on our website at [astronics.com](http://astronics.com).

As you are aware, we may make some forward-looking statements during the formal presentation, as well as during the Q&A portion of this teleconference. These statements apply to future events that are subject to risks and uncertainties, as well as other factors that could cause the actual results to differ materially from where we are today. These factors are outlined in the earnings release, as well as in documents filed by the company with Securities and Exchange Commission. You can find those documents both at our website and at [sec.gov](http://sec.gov).

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

**Pete Gundermann:** Thank you, Deborah, and good day, everybody. We are going to discuss our second quarter results and our outlook for the rest of the year; and then, take questions as usual.

The headlines for the quarter that we're reporting today are the following. The first is, it's a tough comparator quarter, obviously. Those of you who have been following us for a while know that, at the beginning of the year, we realized our Test sales were going to be down substantially. That shows up strongly in the comparison numbers this quarter. As a sneak preview, it's going to look even worse next quarter, because our third quarter last quarter was the high watermark so far for our Test business.

But once we get past that, in many respects, we feel the second quarter was a pretty good quarter, especially for our Aerospace business, which set all kinds of records in terms of revenue and operating profit and bookings. It was a really great quarter for our Aerospace business, and actually, on an operational basis, a very good quarter for our Test business also. We'll talk a little bit about that when we go through the segments.

A final headline, our expectations for the remainder of 2016 have softened a little bit. We feel it's more a reality based on the scheduling of our backlog and some of our product development plans, rather than a fundamental softening of our markets, and we'll talk about that too.

So the quarterly review. Revenue at \$164.4 million was our highest in three quarters. On that, we felt our bottom line results were pretty reasonable. Net income was \$15 million, or 9.1% of sales. That's \$0.57 per diluted share, down from \$0.67 in the comparator quarter a year ago. Our E&D spending was \$21.9 million, 13.3% of sales. That's a little bit higher than where we would expect to see it on a running basis, but again, our Test business is running at a lower than average volume these days. We would expect to see E&D continue to be in that 11%, 12%, 13% of sales range.

Certainly, one of the real highlights of the quarter were bookings. We had bookings in the quarter of \$181.5 million. That is our highest level ever outside of the fourth quarter of 2014, so we were pretty pleased with that. That was pretty much all on the Aerospace side; \$164 million of the \$181 million was Aerospace related. That is by far an Aerospace record for the company.

Year-to-date revenue was \$324 million, down 3% from \$335 million last year, and net income of \$26.5 million, 8.2% of sales, down slightly from 8.5% last year, translates into \$1.00 per diluted share through the first two quarters versus \$1.08 last year.

2016 bookings year-to-date, again, we feel were pretty strong at \$343 million. That's 106% of sales. And our backlog at the end of the quarter, again, was \$294 million.

So looking at our segments. Aerospace segment first. Quarter two revenue was \$142.5 million, up almost 8% from last year, and made up 87% of our total revenue for the quarter, so 87% Aerospace, 13% Test. That Aerospace revenue level set a solid record for the segment. Operating profit also was a record \$24.9 million, 17.4% of sales. And to keep the records going, bookings were \$163.5 million, again a new record for our Aerospace segment. Ending backlog was \$235.8 million. Year-to-date Aerospace revenue was \$280 million, just shy of \$281 million, up 2.3% from last year. Operating profit of \$43.5 million was basically flat with last year.

If you look at our market or sales by market and sales by product line, you see a few things. 71% of our sales goes to the commercial transport market. That's up marginally over last year, but there are some real shifts going on there. Our seat power and motion sales are up substantially, compensating for a drop in antenna system sales, which we talked about in our last conference call at some length. Our military sales are up quite a bit, only 8.1% of total, but up 32% over the first two quarters of last year. There is a range of products that go into that effort. Business jet on the other hand is down pretty substantially, down 17%, amounting to almost 4.5% of total sales.

If you look at our sales by product line, electrical power and motion sales through six months was \$151 million. That's up just shy of 10% and made up around 47% of our total sales. Lighting and safety was \$82.5 million in sales, up 3.2% and 25.5% of our total sales. The sore point in our product line continues to be Avionics, which includes our IFE systems for VVIP airplanes and our antenna systems, both of which are having a difficult year with \$16.8 million in sales through two quarters. That's down 42% and 5.2% of sales.

Looking at a couple of significant customers, Panasonic through six months was 22% of our total, with just shy of \$70 million of revenue; Boeing was 15% of total, just shy of \$50 million in revenue.

We also have some announcements that came out during the quarter. We announced some important continuation of program wins in our in-seat power product line in China and we announced an F-16 night vision conversion win in the Republic of Korea.

Let me qualitatively talk a little bit about our Aerospace business. Clearly, we are not hitting on all cylinders. We talked in our last call quite a bit about our antenna system travails and we continue to invest pretty heavily in new products and we continue to be pretty excited about where that business is going to go, but we're not there yet and it's moving more and more towards the end of the year. It's one example of where our business is a little bit on the light side.

We have some other issues in VVIP products, where the world situation is tending to slow the flow of business for economic reasons, but overall, we continue to be pretty well positioned. We think the quarter is very reassuring for the strength that shows in our Aerospace business. Even with those sore spots, to have record revenue and record profits and record bookings to us is very encouraging.

Moving to our Test business. I talked about it being a very tough comparator. That's pretty clear when you look at the numbers. Revenue in the second quarter was just shy of \$22 million, down 46% from where they were in the second quarter last year and making up 13% of our consolidated sales. Again, this isn't really a surprise or it shouldn't be. Last year's news is pretty old news at this point as are our expectations for this year. We've been dependent in our Test business, especially on the semiconductor side, on a single program with a large customer, and that means that we're pretty dependent on that program driving us forward. We knew at the beginning of the year that volume was going to be down quite a bit this year.

Still, on that revenue drop, we had operating profit of \$1.1 million. That's a lower operating profit level than we had in the first quarter, but to go through two quarters like we have at roughly that revenue level and maintain profitability, I think is actually a pretty good effort and transition being managed by our Test team.

Year-to-date revenue was \$43 million, down 28% from \$60 million last year. And again, the third quarter comparators will continue to be quite tough as the third quarter last year was pretty strong. Bookings year-to-date were \$39 million and book-to-bill was 0.91, leaving us with a backlog at the end of the second quarter of \$58 million.

As we've talked before, the important thing to grasp and to understand about our Test business is, it can be a little bit lumpy and it has certainly lived up to that billing, but to be successful, it has to also be lumpy on the bookings side. Bookings are a result of current programs doing well in the future, which we have hoped for, but also getting new programs.

The encouraging news today is that we are very actively involved in our Test business in a range of new programs, none of which are solid enough to talk definitely about next year, but at this point, we have pretty high expectations for where this big business is going to be next year. We can't quantify it exactly at this point, but we're making a lot of progress with our important customers and they give us a lot of credit for our effort generally and the progress that we're making.

At this point, our expectation is that we will see a big recovery in our Test business next year. We would expect to fill you in on more details on this as the year progresses and as we're able to make more specific announcements, but the good news is that we do see kind of a light at the end of this tunnel. We think we're just in a trough year this year.

The balance sheet pretty much looks the same, still healthy at the end of the second quarter, with cash on hand of \$20.4 million; total debt of \$166 million; and net debt of \$146 million. During the quarter we purchased approximately 231,000 shares at a cost of \$7.9 million. Year-to-date, that's 360,000 shares for a total cost of approximately \$12.2 million. You'll remember that, in February, we announced the repurchase program authorization of \$50 million to be used, as we saw appropriate, in the repurchase of our shares.

Looking forward, if you read the press release, as I'm sure you did, you saw that we're dropping our revenue guidance. My comments so far have been pretty robust, and it's kind of strange to sit here and talk positively about our performance and positively about the quarter we just had, and yet, at the same time, tell you that we're lowering our guidance slightly, especially on the Aerospace side. The Test side, we're leaving alone at this point.

A reasonable person might ask, why is that? I think the best answer is, if you review the last page of our press release, the table on our order and backlog trends, and if you look back to Aerospace bookings the second half of last year, they were particularly light. We had these conference calls, we have them every quarter, and this came up in a number of different ways. We said, at the time, that we didn't see anything systematic in our weaker bookings in Aerospace, but they certainly were weaker. We had \$130 million in the third quarter last year and \$122 million in the fourth quarter, and true to our expectations, those bookings have bounced back pretty dramatically, with \$140 million in Q1 and \$164 million in Q2. That's positive, and those increased bookings have done a lot to fill in our production schedule.

But, as it happens, we're still sitting here with a little bit of a hole going into the second half, especially in the current third quarter. We are expecting the third quarter to be a little bit lighter, but we think that there is upside potential if we get strong bookings in the current quarter, which we're only one month into. We're, obviously, going to watch that pretty closely, but we had those difficult

booking quarters towards the end of last year. We've had some slower product launches than we were hoping for, so realistically we need to trim in our Aerospace expectations for the year.

Again, I'd like to emphasize that we don't view it as a fundamental change in our markets. We remain pretty enthusiastic about what we're seeing, both for new aircraft production and also for retrofit opportunities. It's a pretty dynamic time and a lot of our businesses are reporting very robust conditions in their markets, so we're pretty optimistic, but the reality is, we have this little lull in our backlog that's going to slow us down a little bit.

So we're expecting the third quarter, for those of you who build models, to be on the top consolidated line pretty much similar to where we are this quarter, but we're expecting it to shift a little bit. Aerospace will be down a little bit; Test will be up quite a bit; and we'll, obviously, report on bookings again in the third quarter, which will be a good indicator as to where we're going to end up by the end of the year in the fourth quarter.

So with that as comments, Devon, we'd like to open it up for questions.

**Operator:** Thank you. Our first question comes from the line of Jon Tanwanteng with CJS. Please proceed with your question.

**Jon Tanwanteng:** Hi, Pete. Thanks for taking my questions. Very nice quarter.

**Pete Gundermann:** Thanks, Jon.

**Jon Tanwanteng:** Can you talk about which specific business or end-market is actually seeing that booking or scheduling gap in Q3?

**Pete Gundermann:** I would say it's a little bit across the board. Certainly, in order to have a lull like that, our bigger products have to have a lull, so we're seeing a temporary reduction in our in-seat power products, our seat motion products, but it's kind of across the board. Again, I guess we view it as just situational, just the way the schedule falls, and nothing systematic in how the market is performing.

**Jon Tanwanteng:** Okay, got it. Margins were actually pretty impressive in Aerospace in the quarter. I know you're thinking revenue is probably going to be down sequentially. Is that margin run rate going to continue? Should we expect to be down significantly compared with historical? What's the sequential expectation?

**Pete Gundermann:** It's probably reasonable to expect margins to see some pressure with a drop in volume, but thanks for noticing the performance last quarter. There was really no special lifting there. I think that's what our business performs at when we get to those volumes, so we're hoping to see another couple quarters of bookings and lock in at that production level or better even next year, which should be pretty good for the bottom line.

**Jon Tanwanteng:** Okay, great. And then, can you just revisit the exclusivity agreement that you had on the semiconductor side? Where does that stand now and when do you think you'll see perhaps a second customer?

**Pete Gundermann:** It's a little bit of a tricky question, but let me answer it. I guess, generally, to say that, from our perspective, there is a code of ethics about protecting customers' proprietary information and proprietary data even when there are loose arrangements or contracts controlling that kind of information. We've been careful to stay on the right side both legally and ethically. At the same time, we've been able to more accurately or more specifically define what exactly is of concern in that situation, and we think that, today, we have a very clear understanding of it and we don't view it as a restrictive issue in the sense that we're coming out with a fourth generation product.

We've been at this for quite a while. There is system level test, and we think that unique customers have unique needs and, certainly, we've been able to bring that to bear with our named customer to-date. But we think there are other derivatives and other adaptations that may be attractive to other customers. The restrictions that we face with our named customer, we do not feel inhibit the derivations of our capabilities that we can bring to market for other people. That's probably the best way to answer it at this point.

**Jon Tanwanteng:** Okay, great. Thank you very much.

**Operator:** Thank you. Our next question comes from the line of Dick Ryan with Dougherty & Company. Please proceed with your question.

**Dick Ryan:** Thank you. Pete, E&D spending looks like \$45 million year-to-date. Is that in line with what you had in 2015, \$90 million total, or should it stay in that range?

**Pete Gundermann:** Yes, that's what we're expecting.

**Dick Ryan:** Okay. Moving to Test, you said a bump-up in Q3. Is that more the typical seasonal pattern we see in back-end and then it would moderate in Q4, or is there something else at play for your Q3?

**Pete Gundermann:** No, it's the normal seasonal trend that we've observed with that program over the years. The volume is way down this year as you're very well aware and most of the delivery should occur in Q3.

**Dick Ryan:** What timing would you think you'd have for follow-on orders to see a ramp in 2017?

**Pete Gundermann:** Our typical expectation is that we would see orders by the end of the year. There is a lead time involved with a lot of this equipment and, typically, the customers understand that lead time and would expect to place orders by the end of the year. Going into the New Year, there may be increased expectations, even for the existing product line, so that may get off its low volume and get something to a little bit of a higher expectation. That's our hope, in addition to new programs, which we may bring on board.

**Dick Ryan:** Okay, thanks. I missed the first question, so maybe you addressed this already, but, when you talk about the strong orders for Aerospace, what markets or products really drove that, and how are you looking at the pipeline for new orders right now?

**Pete Gundermann:** As I walk around our company and talk to the various business units, I think it's broad-based. We certainly have the weak spots again, but, in general, I think we're pretty enthusiastic about the opportunities that lie in front of us. There is always a chance of a hiccup in bookings, but we certainly like the trend over the last three quarters in Aerospace, going \$120 million to \$140 million to \$164 million. We're not sure that will continue, but if we could stabilize somewhere around where we are, that would be okay with me for a while.

**Dick Ryan:** And real strong performance in in-seat power. Can you talk about the retrofit new build dynamic that you're seeing out there?

**Pete Gundermann:** No real changes. It's business as usual. Another strong quarter of growth. A good mix between OEM and field sales with increasing emphasis on narrow bodies. We announced that our China programs are largely narrow bodies. It continues to be a very good environment.

**Dick Ryan:** China, is that direct, or are you with OEMs there even though it's narrow-body versus wide-body platform?

**Pete Gundermann:** It's a little bit of both, but it's, certainly, a lot of direct sales.

**Dick Ryan:** Okay. Thank you.

**Operator:** Thank you. Our next question comes from the line of Kevin Ciabattoni with KeyBanc. Please proceed with your question.

**Kevin Ciabattoni:** Thanks. Good morning. Nice quarter.

**Pete Gundermann:** Thank you.

**Kevin Ciabattoni:** Pete, just looking at the outlook in Aerospace, it seems like the weaker 3Q is tied to bookings in the back half of last year. It's just a little confusing as to why that's driving the lower guidance today versus why you wouldn't have baked that into your initial outlook. Is there any color that you can offer there? Just give a guide on bookings.

**Pete Gundermann:** To a large extent, that hole has been filled in. The reason I'm hedging a little bit is, compared with a lot of aerospace businesses, we feel that we are weighted a little bit more towards the aftermarket than most companies. While it's relatively easy to predict production rates at the OEMs, they may change once in a while, but they don't change dramatically quarter-by-quarter, aftermarket programs can and do change. So, we have that big lull and we were thinking and hoping and expecting that it would get filled in, and it largely has, but it hasn't completely. I guess, that's the answer.

Our business is a little bit harder to predict, at least the bigger parts of it, to the extent that they are aftermarket-related. Some parts of our business simply are largely OEM and we can get plus or minus 3% predicting out two or three quarters without much trouble, but unfortunately, some of our bigger product lines are much harder to predict that far out. That's part of why we end up, compared with most companies I suspect, with a wider revenue range at the beginning of the year in terms of forecasting and we narrow it down as we go. Our thought, when we had those thin quarters, was we didn't see any shift in the market. We thought that the business would come in. It has largely come in, but it has come in with a schedule that is going to make things a little thin in the third quarter.

We don't do a whole lot of management of our revenue stream that way. If our customers want products, we ship them; if they don't want them, we don't ship them; so by nature that probably serves to accentuate our financial results just a little bit. But you know that; you've been following us long enough. I think the answer is simple. The short answer to your question is that the aftermarket element of our business is a little harder to predict than the OEM part.

**Kevin Ciabattoni:** And that was pretty broad-based. That's helpful. It was across in-seat power, lighting, military, commercial, kind of across the board.

**Pete Gundermann:** Yes, but in those products, especially, that are aftermarket related.

**Kevin Ciabattoni:** All right. Keeping with the outlook, it seems like you lowered the CapEx expectations for the year. Were there specific materials or specific projects there that didn't materialize or did you just set the bar high to begin with and are bringing it down now?

**Pete Gundermann:** I would put it in the category of fine-tuning. We go through a budgeting process at the beginning of the year, and I think we're generally pretty accurate in this area. Certainly, there is a tendency to put something on the list thinking we may want to do it, and then, we get halfway through the year and realize we're not going to get there. We don't have the resources to do it or whatever, and the number tends to get sharpened. In this case, this year, it's coming down a little bit.

**Kevin Ciabattoni:** Okay, but nothing specific you can call out there?

**Pete Gundermann:** Not really. No.

**Kevin Ciabattoni:** Okay. Last one for me, obviously strong Aerospace bookings in the quarter, but are you starting to hear anything from, I guess, most specifically the European airlines in terms of the way they're thinking about retrofit going forward? Given the economic situation, we've seen a number of European airlines look at slowing their capacity growth. I was just wondering if you're seeing the impact of that at all in terms of cabin retrofits. Maybe not right now, but are you starting to hear any discussions around that?

**Pete Gundermann:** No, we're really not, Kevin. The discussion about managing capacity is clearly an issue in the industry, but when you start talking about hitting some of our products, what you're talking about is cutting back on amenities and that's a very different discussion. I think there is an onward march, a steady drumbeat towards expectations of the flying public to want more amenities, not less, regardless of what the capacity is of the airplanes in the sky, so we're continuing to see promising market conditions, even if there is some rationalization that potentially could happen on the capacity side. There are two different discussions from our perspective.

**Kevin Ciabattoni:** Okay. Thanks, Pete. That's all I have.

**Pete Gundermann:** Sure thing.

**Operator:** Thank you. Our next question comes from the line of Ken Herbert with Canaccord. Please proceed with your question.

**Ken Herbert:** Good morning. It's actually John on for Ken. I have a question on Test margins and how we should expect margins to progress through the second half of the year as volumes step up.

**Pete Gundermann:** That's a good question. The revenue level there has been jumping around enough that it's pretty hard to predict. I said in my comments that, given the drop-off in revenue, just to maintain profitability at any level we think is actually a pretty good effort. What you don't see there is that, even with revenue drop off, there has been a sharpening and an improvement of skills and capabilities in that business, so it really is a pretty impressive story. We would expect that, with volume increases, more so next year maybe than this year, we should see strong margin increases also. That is basically one of those stories where you cover your fixed costs and the contribution margin on incremental dollars gets very attractive very quickly. It has been a good business, though we've obviously been dealing with the lumpy aspects of it this year, and we would expect it to continue to perform pretty well next year.

**Ken Herbert:** Great. As far as partnership for success from Boeing, have you felt any of the impact? It has been a cause for debate in some of your peers, but I wanted to know if, specifically, you have felt any of that?

**Pete Gundermann:** Not really. We went through it to some extent when we were in our 777 negotiations back a year-and-a-half ago. And, when you say our peers, I'm guessing, in general, that you're talking about companies that are substantially larger. There aren't many public companies our size doing business directly with Boeing, so I'm guessing they are focusing their efforts elsewhere. I read about it and we hear about it in the corners, in various conferences and things, but for the most part, we're being left alone.

I would comment more qualitatively that we continue to enjoy very good relationships with Boeing. A couple of years ago, we did next to nothing with them on an OEM basis. We do quite a bit now, primarily through our PECO acquisition. We continue to make progress in terms of getting new pieces of business looked at, so we're pretty excited about that. We think we're on a good track with them.

**Ken Herbert:** Great; and then one last question. How do you view the impact of some of the wide-body production rate reductions out in 2017 and 2018?

**Pete Gundermann:** Well, they don't help. I mean, more airplanes are better than fewer airplanes. That's what I would say, especially those big ones. I mean, our products are the kind that scale substantially in those big airplanes, but realistically, the super wide-bodies, the A380s and the 747s, have been at such a low rate that they never really were all that substantial for us. I'm guessing that any drop-off will be more than compensated for with increases in other models, including 350 and 777X and 787 and so forth, so we don't view that as a substantial challenge to the business.

**Ken Herbert:** All right, that's all I had. Thanks.

**Operator:** There are no further questions at this time. I'd like to turn the floor back over to management for closing comments.

**Pete Gundermann:** And our closing comments are simply to say thank you for attending and we look forward to talking to you next quarter. Have a good day.

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