

**Operator:** Greetings, and welcome to the Astronics Corp. Second Quarter 2017 Financial Results Conference. At this time, all participants are in a listen-only-mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Ms. Debbie Pawlowski, Investor Relations for Astronics. Thank you. Please go ahead.

**Deborah Pawlowski:** Thanks, Donna, and good morning, everyone. We appreciate your time today and your interest in Astronics. On the call with me are Peter Gundermann, our President and CEO; and Dave Burney, our Chief Financial Officer. Peter's going to go through his prepared remarks, and then we'll open it up for questions and answers. You should have in hand the news release that went out across the wire this morning, which is available also on our website at [www.astronics.com](http://www.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 actual results to differ materially from where we are today. These factors are outlined in the earnings release, as well as in the documents filed by the company with the Securities and Exchange Commission. You can find these documents both at our website and at [sec.gov](http://sec.gov).

So, with that, let me turn it over to Pete to begin the call.

**Peter J. Gundermann:** Thank you, Debbie, and good morning, everybody. We're going to talk through our second quarter results, which were a little bit lighter than we hoped for and expected. Many of the trends that we hinted at and talked about in our first quarter results call continue to affect us, and we'll talk about those in some level of detail.

But I also want to balance it with a general sense of enthusiasm that we have within the company. We're in one of these unique periods where the market is a little bit soft in ways that we haven't seen it recently or before, and yet at the same time, we continue to believe that we're very well positioned. We continue to believe that we're working on some very worthwhile projects, and there's a real sense of enthusiasm going forward. So, it's a little bit of a strange connection between the current results and what our expectations are going forward. So, I'll try to cover both those topics in some level of detail and relay our perspective as best I can over the remainder of this call.

For the second quarter revenue was \$151 million. That's below our comparator quarter of 2016, when we had revenue of \$164 million, by 8.1%. Our performance in the most recent quarter was at the lower end of the last four sequential quarters, when we had revenue of \$155 million, \$154 million, and \$152 million. Our Aerospace sales in the second quarter were \$129.5 million, which was 9.1% below the comparator quarter of 2016, but keep in mind that the comparator period was a record aerospace quarter for us, when we had best ever revenue of \$142 million. In the last four quarters, our most recent quarter was ranked about in the middle. Test sales in Q2 were \$21.6 million, about even with last year, but a big improvement sequentially of 39% over the first quarter of this year.

Given the lower volume, our bottom line results predictably enough came in pretty light. Net income was \$7.7 million, or 5.1% of sales. Diluted earnings per share were \$0.26, down 50% from where they were last year in the second quarter. Our effective tax rate was 27.3% compared with 30.5% in the second quarter of 2016. Our engineering and development expense for the quarter was just shy of \$30 million. That's 15.1% of sales, and includes our recently acquired CCC operation. We expect that percentage to be marginally lower, but in the 15% range for the rest of the year.

Bookings in the quarter were \$159 million, up about \$10 million from the first quarter and our highest in the last four quarters. Book to bill of about 1.05, leaving us with a backlog of \$266 million at the end of the second quarter.

Year-to-date that gives us revenue of \$303 million, that's down about 6.3% from \$324 million last year. Net income was \$19.3 million, down from \$26.5 million. Our net income percentage was 6.3% of sales, \$0.64 per diluted share. The margin declined, largely driven by the drop in volume. 2016 bookings year-to-date were \$306 million, roughly equal to sales with a book to bill of just over 1.

Turning to our segments, Aerospace revenue in the second quarter was \$129 million, again down substantially from our record period of a year ago when we had Aerospace sales of \$142 million. Operating profit was \$14 million, or 10.8%. Bookings were pretty strong at \$134.8 million. That's our strongest Aerospace booking performance in the last four quarters, leaving us at the end of the second quarter with a backlog of \$215.6 million.

Year-to-date Aerospace revenue of \$266 million made up 88% of our total, but were down about 5% compared with 2016. Operating profit of \$33.7 million was 12.7% of sales, down from \$43 million, or 15.5% of sales, last year. Bookings year-to-date were \$257 million with a book to bill of 0.97.

Looking at the tables on page 9 of our press release tells a little bit of the story that we're dealing with. The top table on that chart shows Commercial Transport year-to-date sales of \$208 million. That's 69% of our total, obviously, a big part of our company, but down 9.5% compared with last year this time. Military, on the other hand, was at \$31 million, or 10.2% of our total, was actually up 18%. Business Jet was at \$18.3 million, 6% of our total, and was up 28%. The Business Jet portion was helped significantly by the CCC acquisition.

The lower chart or lower table on page 9 of the press release cuts the data a little bit differently. It looks at our sales by product line, and you can see our Electronic Power & Motion sales year-to-date were \$135 million, down 10.5% over last year and 45% of our total. Lighting & Safety, \$85 million, up 3.4%, and Avionics, \$20 million, up 19%. That was therefore our major product lines. So, in the Commercial Transport and Electrical Power & Motion, you can see sales declines that is being driven by one of our biggest product lines, which is our In-Seat Power product line.

So, stepping back from the data a little bit and talking about market trends and what we're seeing, it's a continuation of things we talked about before. The widebody situation is definitely affecting us. That's both widebody new production rates and widebody retrofit rates. That's something that realistically we expect to continue until 777 gets through its hurdles and 350 gets through in a full rate production. It's being complicated by some schedule slides and there are a couple of things going on in the schedule part of it.

We've talked about some initiatives that we have underway for Business Jet connectivity systems, and we're making good progress in this area in some respects, but a chain is as strong as its weakest link and every link has to be strong for this program to be successful. So, the good news is that we continue to believe that we've got a winning product that will be heavily desired by the market when it gets there, but the bad news is that it's not there yet. So, this is an example of a program slide where we were counting on pretty solid and growing revenue through this year, that looks like it's sliding into next year, picking up late this year, much later than we anticipated. So, we still think it'll be pretty good, just not here yet.

Similarly, with some of our airline customers, who have been big customers on the in-seat power side, our in-seat power product is closely linked to airline decisions regarding passenger entertainment and passenger amenities. Our sense is that there's a lull in the market for whatever reason in airlines making decisions and moving forward with new programs. We think that's a temporary thing. We certainly don't think that power is going out of fashion, and we are not aware of any substantial market share loss or competitive change in our position. It's just the way the market is shaping up at the moment. And when combined with a widebody, the float on the widebody production rates, is throwing us for a little bit of a double whammy in this particular product line, which has been a big driver of our results for many years.

The good news, though, is that we view it as a pretty interesting market out there. Our sales and bidding activities are as strong as ever or stronger, and we believe that that interest turns into orders, and we expect that the lull in activity will fix itself in the foreseeable future. It's a question of when and a question of how

fast, but we believe we're pretty well positioned. We're optimistic with where we are. There's just not much we can do to respond to the lull that we're facing in the market right now.

Moving to our Test side, revenue in the second quarter was \$22 million, about even with our comparative quarter of a year ago and about 12% of our consolidated sales. Operating profit was \$1.4 million, 6.6% of sales. As I mentioned earlier, the second quarter was a pretty decent recovery, up 38% from our first quarter revenue, which represented a low watermark for our Test Systems business. Revenue year-to-date for Test was \$37 million, down 14% from where we were in 2016. Bookings, however, were \$48.2 million. That's a book to bill year-to-date of 1.3 and lends support to our expectation of building sales, especially on the A&D side, the aerospace and defense side of our Test business, in 2017.

Like our Aerospace business, we continue to feel like we are operating in a target rich environment here. We have some pretty exciting programs going on, and we continue to get some positive support from prospective customers and prospective programs, and we are optimistic about where this business is going to go. But as with Aerospace, for various reasons, there's evidence that things are just sliding to the right a little bit. Again, not a competitive situation, not a market share situation, just unique dynamics related to customers that we have and programs that our customers are trying to execute. So, our job is to do what we can to support them. We're doing a pretty good job in that, but we're at the mercies of where the market takes them in their efforts, and those will trickle down to us in due course.

Our second quarter backlog for Test was \$50 million, leaving us in pretty good shape to execute to our plan for 2017. Balance sheet, we think, remains pretty healthy. Cash at the end of the second quarter of \$8.3 million, total debt of \$163 million, leaving net debt of \$154.7 million. That is less than a couple turns of EBITDA. So, we think we're comfortably financed, but our net debt level is up from \$131 million at the end of the first quarter. The difference largely went into share repurchases. We repurchased 302,000 shares in the second quarter at an aggregate cost of \$9.1 million. Since the inception of our share buyback program in the second quarter of 2016, we've bought back, as of the end of Q2, a total of 973,000 shares at \$31.1 million, leaving available about \$19 million to go.

Looking forward, we are lowering our guidance for 2017 to the range of \$625 million to \$645 million. The midpoint of \$635 million would be about flat over where we ended up in 2016. That total breaks out to Aerospace to be \$535 million to \$550 million, the midpoint suggesting marginal growth over 2016; and Test being \$90 million to \$95 million, the midpoint down marginally from 2016.

We expected the second half to be stronger than the first half and to build sequentially is still our expectation. The forecast suggests that we should average in the second half of the year \$165 million in revenue. We would expect Q3 to be on the lighter side of that and Q4 to be compensating on the heavier side of that, getting us to the midpoint or so of our revised range.

So, again, it's a little disappointing to sit here and talk about these kinds of numbers when we feel like we're pretty optimistic about our prospects internally. Usually, when you have a range of things that you're looking at, as a business, to achieve in a certain period of time, some come in a little faster and a little better than you might expect and some come in a little slower and a little smaller than you expect. I can't say that I've ever been in a situation in this company where we've so consistently seen things drawn out or slow down as they have. Maybe there was a crunch back in 2009 or so that we'd prefer not to think about too much. It's nothing like that, but we continue to believe that we've got pretty good programs in sight, and we think they're going to be real needle movers when they hit. It's a question of when they're going to hit.

But as we're sitting here now in August, we are getting clearer and clearer insight into where we're going to be for the end of the year, and part of our job is to relay that as accurately as we can, and enhance the forecast we're talking about. So, that's where we are, \$625 million to \$645 million for the remainder of the year.

I think that concludes my prepared remarks. Donna, if you want to open up the lines for questions.

**Operator:** Thank you. The floor is now open for questions. Our first question today is coming from Dick Ryan with Dougherty & Company. Please go ahead.

**Dick Ryan:** Thank you. Hey, Pete, it's probably similar to your opening comments of soft current market, but optimistic, but when you look at just the optics of E&D, stepping it up with revenue forecast to come down, can you maybe delve a little deeper in the spending. I know we're including CCC in there, but is there heavy STC work that can eventually go away, or is there an inflection point for revenue to reflect this spending maybe next year?

**Pete Gundermann:** I would certainly expect so. We've been targeting 12% to 13% of revenue. We're now running around 15%, and I think that will fix itself, largely with revenue increases, like you've suggested, Dick. As far as where it's going, I guess I'm thinking through my mind, we just have a lot of activity going on, really, across the company in major new platforms like 777 or major new antenna and connectivity systems, and we're doing a lot of work on both the A&D and the semi side and Test. It's really, from our perspective, it feels like a market of investments, and not painful investment, but I guess the kind of investment you like to do, serious programs that customers are really interested in.

The combination of the two obviously hurts the financials a little bit. But like in the past, our priority has been and continues to be that we want to make sure we perform well on those opportunities and not shortchange what we think is likely to pay back handsomely in the near future. So, we've let those programs run, and we, for the most part, are strongly supportive of where our customers are taking us, and that's how it plays out. So, for people who make models, we're running around 15%. We'd expect it to drop a little bit with the revenue increases in the second half, but for the year, that's probably in the range of where we're going to be.

**Dick Ryan:** Okay. And on the in-seat power side, you commented on the widebody, is there anything you can talk about on narrow body? And I think Panasonic can have some softness in Q2 with their fiscal year coming in March, but can you comment how that business is flowing?

**Pete Gundermann:** Just in-seat power business, generally?

**Dick Ryan:** Yeah. I mean with narrow, maybe on the narrow body side, and then also how is Panasonic doing?

**Pete Gundermann:** Sure. Well, I can't necessarily speak for them, specifically, but they're obviously a big customer of ours, an important customer of ours, and I would say that as they go, we go to some extent. So, there's not a real disconnect there, although their business is obviously much broader than what we do with them, and ours is too, to some extent.

We feel that the narrow body side continues to strengthen and get bigger for us. The challenges with narrow bodies or smaller airplanes are with less seats and fewer seats, and therefore a smaller revenue target. So, it takes three or four of those to compensate for one widebody. So, when the widebody world is plummeting like it, or not plummeting, but declining like it has, it makes it hard for us to compensate on the narrow body side.

But again, overall, our perspective is that there's increasing enthusiasm. It's no longer a luxury. It's a basic requirement to have WiFi and have IFE of various forms, and pretty much all those forms require power, which is what we specialize in, and we don't see that going away. I think there is a little bit of a lull in the industry, having to do with widebody production rates and widebody operators, but there's also a sense that the services offered to passengers need to and will continue to get better and better, and I think airlines are trying to figure out how to do that right now.

They're trying to recalibrate their thinking based on what they've done over the last decade, and I think that's resulting in a little bit of a slowdown for us and for other participants in the industry, in general. And yet, it's a

huge opportunity, because if systems need to get better, if services need to get better, companies like us are going to be looking for a way to fill that void and help out, help the airlines out, and that's what we do. So, we think that long term, the picture, the thesis still holds and the opportunity is there. It's a question of getting through this current period and positioning ourselves to do what we need to do to be successful long term.

**Dick Ryan:** Great. Thank you. I'll get back in queue.

**Operator:** Thank you. Our next question is coming from Jon Tanwanteng of CJS Securities. Please go ahead.

**Jon Tanwanteng:** Good morning, Pete. Thanks for taking my question.

**Pete Gundermann:** Hey, Jon.

**Jon Tanwanteng:** Is there any possibility that saturation is occurring in the in-seat power market, or do you 100% believe it's just a temporary speed bump or a pause here?

**Pete Gundermann:** No. I wouldn't say saturation. Obviously, it's a little more mature market than it was five years ago, but at the same time, it's changing. There are new technical requirements, particularly in the world of USB power and the personal device industry continues to change, and it's pretty vibrant. So, we believe that there's ongoing demand and technical change, driving what we want to do.

If you look at the penetration numbers, particularly in the narrow body side, but also on the widebody side, the widebody market has been one that we've been primarily operating in for almost 20 years, and yet, we feel it's somewhere in the 60% penetration rate on a seat basis. Not in airplane basis, but a seat basis. So, that market, all by itself, when the old airplanes are taken out of service and new airplanes are brought in, represents substantial business opportunities for us. But the narrow body side is much younger, much more room to run. And, no, we would not say that we feel like there's a saturation point there at all.

**Jon Tanwanteng:** Okay. Great. And just a question on CCC. Did they have positive operating margins in the quarter?

**Pete Gundermann:** No.

**Jon Tanwanteng:** Okay

**Pete Gundermann:** But I will say, you didn't ask it, but let me take that entrée. CCC is involved in the VVIP cabin management, cabin entertainment market, as is our PGA operation. And our sense is that that world is starting to change a little bit and it's been pretty dry, but there seems to be more and more activity, particularly driven by the A320neo, Boeing BBJ MAX. So, there's more activity, and I think we're cautiously optimistic about where that business is going to go for both PGA and CCC, particularly next year. So, excited about it.

**Jon Tanwanteng:** Okay. Great. Would you disclose how much of a drag it was, at all?

**Pete Gundermann:** Dave, is there something in the press release we can expand on?

**Dave Burney:** Yeah. It was about \$800,000 drag.

**Jon Tanwanteng:** Okay. Great. That's helpful. And then, just on the Business Jet connectivity, I assume that's a new antenna product. When do you expect that to launch now, and how does that ramp in terms of units or profitability, and how it contributes to this year?

**Pete Gundermann:** This year, is a little bit up in the air. It's going to be weighted towards the fourth quarter, second half of the second half. And you know we're a little bit gun-shy based on our experience to date of

predicting it. What we believe is that the demand continues to be strong, there's a really good window to get this going, and it's a real enticing market. A lot of airplanes out there that fly with very limited systems, and systems that aren't as good as the average commercial airplanes, actually for most of these guys. So, we think if we can get that going with our partners, it'll be good. But we're obviously discounting quite a bit over what we originally anticipated for this year. My hope is it starts to contribute solidly in the fourth quarter, and we can talk about it specifically, but it well may be 2018 at this point.

**Dave Burney:** On the drag from CCC, it was actually rounded to \$900,000.

**Jon Tanwanteng:** Oh, okay. Thank you. And then, just on the Test side, you mentioned in the press release getting an order from your legacy semiconductor customer. Can you give us a bit more color as to the size of that, and what's going on there?

**Pete Gundermann:** Sure. We have a business that, on the semiconductor side, has been largely driven by a prominent customer from a few years ago, and that is still an active program. In other words, the test is still the chosen piece of equipment. So, we will sell some of those on occasion, depending on demand. It's basically capital equipment. So, if they need to build more, they need more tools to support that effort. And we obviously don't have insight into what those demand expectations are, but we know when we get an order, and we did get one. I'd say it was not substantial in size. I'll give you a range, it was more than \$5 million, but less than \$20 million.

**Jon Tanwanteng:** Okay, sir. And just the relative size of the other opportunities you're pursuing in that market, how do they compare to this legacy program you have, and what's your confidence level in some of those being signed this year or the next year?

**Pete Gundermann:** I would say that some of the programs that we are involved in have the potential to be substantial. Substantial, being potentially even as large as the last legacy program. Timing wise, again, it's a little bit out of our hands. We do what we're asked to do, but beyond that, we don't really know how the chips are going to fall. But there's certainly potential for this to affect us next year. If it is going to affect us next year, positively, you'd expect to see orders this year that obviously has not happened yet, but we're hopeful that it will. It's too late for new programs to affect us this year, but if you see orders this year, that's a solid indication they're going to be good for next year.

**Jon Tanwanteng:** Okay. Great. And Dave, just any thoughts on the tax rate going forward?

**Dave Burney:** Yeah. I think it's going to be consistent with where we've been running within a couple of percentage points.

**Jon Tanwanteng:** Okay. Consistent with Q2 or just the average in last two quarters?

**Dave Burney:** The average for the last two quarters, year to date.

**Jon Tanwanteng:** Got it. Okay. Thank you very much, guys.

**Pete Gundermann:** Sure.

**Operator:** Thank you. Our next question is coming from George Godfrey of C.L. King & Associates. Please go ahead.

**George Godfrey:** Thank you. Good afternoon. Thanks for taking my question. Pete, I just want to begin on the revenue changes by the product line, and then if we can talk about the narrow body. If we look at the Electrical Power & Motion for the six-month period here, it was down 10% in the six months, but if I look at Lighting & Safety, that's up 3.5%. I would have thought that in Avionics, we had results a year ago, so the growth there is explained by easy comparison, but I would have thought that those growth metrics would

attract more closely. Why is Electrical Power & Motion so much weaker than the Lighting & Safety, specifically?

**Pete Gundermann:** A couple of reasons. Lighting & Safety is a relatively broad product line for us. It goes on everything from the smaller Cessna, to the fastest jets and rotary wing, military airplanes, and all the way up to the 380s and 747s. So, it's a little more comprehensive that way, and you can see our Business Jet sales, in general, are up pretty strongly. So, it's benefiting from strength in areas where our Electrical Power & Motion area doesn't touch as much. Our Electrical Power & Motion is largely skewed towards commercial transports, and largely skewed towards widebody. So, that's probably the biggest difference there. If the widebody segment gets hurt, it hurts Electrical Power & Motion more than Lighting & Safety.

**George Godfrey:** That makes sense. And the widebody issues are well documented, but narrow body continues to be robust. I think in the past, you've talked about a 20% penetration rate on just the narrow body, excluding the widebody, is that right?

**Pete Gundermann:** That's correct.

**Pete Gundermann:** Yeah. I know where you're going. Production rates are up there, so you'd expect there to be some compensation, and there is to some extent, but most of our narrow body installations these days are not line fit, they are aftermarket. And the reason for that is that most of the airplanes being built today were ordered a couple years ago. A couple years ago, we were not as offerable, and not as many airlines had picked our systems. So, asking Boeing or Airbus to change an order in process, is a relatively painful experience compared to doing it aftermarket, when an airline typically has to set up an aftermarket installation scheme to get their fleet done anyway, when they decide to put our product on.

**George Godfrey:** Got it. So, if Boeing is producing 42 planes now and they're taking up production on the 737 to 47 planes per month, and that 20% delta, just for easy math, would suggest 8 planes at 42, we really wouldn't see necessarily another 1 plane or perhaps 2 planes, an incrementally higher penetration rate as that production rate increases. It likely just stays at 20%, and there's no incrementally greater penetration on the production.

**Pete Gundermann:** Right. For Electrical Power & Motion, I would say you're correct. But to stick with your question, when Boeing picks up 737 production rates, our Lighting & Safety products do go up, because we do have some standard line fit products, like passenger service units on every 737. So, that's an example where our Lighting & Safety business would pick up based on that pick up in production rate. But our Electrical Power & Motion sales, to that same production rate increase, really depends on which airlines are buying the airplanes.

**George Godfrey:** Right. And then, my last question, just looking at the growth trajectories on the Test business, looking at semiconductor versus the aerospace and defense and going at midpoint, it looks like it's setting up to be about a \$27 million semiconductor test business this year and \$65 million in aerospace and defense test. Is that a reasonable place to be right now?

**Pete Gundermann:** That's directionally accurate, and to add color to that, we're seeing some pick up in volume for aerospace and defense. It was up something like 20% last year, and it's continuing to do pretty well this year. So, we're thinking that if we're going to detail in some of the needle mover programs, as I think about them in my head, we've got a number of them in that A&D side of the Test business. So, we've been a little frustrated with program slides in that area also, but we're still hoping that some of the things will shake loose in time, to give us some contribution yet this year. In fact, if you look at internally our fourth quarter expectations, some of the increase is dependent on A&D orders shaking loose between now and then.

**George Godfrey:** Understood. In the aerospace and defense growth, this quarter was very good. I just wanted to hone in on that semiconductor piece you talked about. You don't control the timing, but what do customers within that semiconductor test space push back on? Do they want more data, better results, lower price? What causes the deal of the pipeline not to close quicker? I'll leave it there. Thank you

**Pete Gundermann:** Sure. Well, it's a complex set of equations. These are very competent, capable, fast moving organizations, and they can do pretty much anything they want as quickly as they want, but they've got plenty to do other than just work with us. So, a lot of the timing of our programs depends on what else they have going on, which we obviously don't have insight into. And they've got products to ship and a business to run day to day too, and usually what we're involved with is a little bit more longer term in terms by nature. So, their first priority is to, like any business, keep on top of the real hot issues, and when the hot issues die down a little bit, then they can work on things with us. So, I think that's the answer, and we don't have insight into where the priorities lie all the time. So, we just do what we can to support the effort and hope that the payback becomes evident, so that they proceed.

**Operator:** Our next question is coming from Michael Ciarmoli of SunTrust Robinson Humphrey. Please go ahead.

**Michael Ciarmoli:** Hey. Good morning, guys. Thanks for taking my questions.

**Pete Gundermann:** Welcome.

**Michael Ciarmoli:** Pete, just back to maybe what George was asking on the Electronic Power & Motion, the run rate for this quarter took a big step down. It was probably at a level not since 2014. Do you guys have any sense in the widebody market, we know it's under pressure, rates getting cut on the 777 again, and right around now the A380 is going to see another cut. Is there a sense that there's maybe broader destocking of some of your products going on, just inventory levels in the supply chain were too high?

**Pete Gundermann:** I wouldn't. No. I don't think so. I think that, frankly, the experience that we're seeing is being somewhat shared by other participants in the industry right now. It's just, if you're involved in cabin entertainment or cabin systems for widebody airplanes, it's a little bit of a tough slog right now. But we don't have a distribution system that's dependent on a bunch of inventory sitting around. It's usually, I'd say pretty lean, actually, both in our major IFE customers and with airlines or the OEMs themselves. So, I don't think it's destocking. I think it's just current demand.

**Michael Ciarmoli:** Got it. So, obviously, the only widebody, maybe, that could see a little bit of a ramp is the A350. You still have a pretty significant step up here in the back half of the year and you're still going to have, based on what's shippable in your backlog, a pretty good amount of book ship business you're going to have to go out and get. You have confidence, just given the trends you're up against here, that you will see this snap back in 3Q, 4Q?

**Pete Gundermann:** We are pretty confident. There are a couple of things, though, that we are dependent on. I talked about some A&D test business that we expect to be stronger in the second half, similarly with the semiconductor side of test, and we have some antenna expectations for the second half, which are needed to achieve those results. So, there is some risk in those numbers, but when you look at our backlog and you look at what the shipping level has been to date, and you look at the other upside opportunities that could offset some of the downside opportunities, we feel like we're pretty comfortable with the range that we're putting out there today.

**Michael Ciarmoli:** Okay. Just last one for me, I know you don't guide to it, but the margins here could be pretty volatile and we saw that in the current quarter with the lower volumes. You've got some higher A&D spending. Any expectation or any color on what we could think of as margins. If you're looking at – I think you said somewhere in a slightly higher quarter, should we look back at prior quarters to see a similar revenue run rate where the operating margins can get to? Anything you can maybe share about the profit expectations in the back half year?

**Pete Gundermann:** I think the idea of looking back in recent quarters, as to where the volume was, is probably as good a guidance as I can give you. I would also just remind that when we run our business, we try to think of ourselves as, what do we need to do today to be successful next month or next quarter or even



next semester, but where do we need to be to answer the bell when our customers call a year from now or two years from now. What are we signing up for, and how do we execute on that as well as we can?

We sat down this year and we had certain expectations for where the year was going to roll out, and we balanced that against product development and investment opportunities that we think are appropriate. And over the course of the year, this year, our experience has been really in an unprecedented way that the opportunities that we saw coming through on our income statement, short term, are largely delaying or lying down. It's not as though we're losing them. It's not as though they're going away. They're just delaying. But the corollary investment opportunities or demands that we see continue to be very much appropriate. So, we're pursuing that path as though it's not affected by the first path. It's the way we've typically run things.

Obviously, there are limits for that and if the market were to go dramatically south, we would more actively reconsider our opportunities. But at this point, based on where we think our customers are and where we think the market is going, we really think there are some really good opportunities. So, I'm excited to see the current dynamics in the market change. We're confident they will. But if they weren't, for some reason, then we'd have to re-visit that investment scheme and react accordingly, and we can do that if we have to.

**Mike Ciarmoli:** Got it. Okay. Good. That's helpful. Thanks a lot, guys. I'll turn back on queue.

**Pete Gundermann:** Thanks. Okay.

**Operator:** Thank you. Our next question is coming from Ken Herbert of Canaccord Genuity. Please go ahead

**Ken Herbert:** Hello. This is Jamaine Aggrey calling in for Ken. First question, Aerospace operating margins were a bit weak. So, just wondering how do you think about your cost structure going forward? Is there anything specific that you're looking to do to improve this, besides, looking for volume growth?

**Pete Gundermann:** Well, when we have that kind of revenue drop relative to our comparator period, we're going to take a big hit on the operating profit line. So, as you indicated, that is the big short term issue. We do live in a world that's price sensitive, and we do have customers that are pushing constantly for price reductions, and we compensate for that by looking for efficiencies in our own supply chain or in our own cost structure, and it's a bit of a balancing act, and we fight that fight every day on both fronts, and it's the way the industry works.

But I wouldn't say that there are major changes anticipated. Our emphasis, in general, has been one towards innovation and on product development, and that's been where we focus, and that's been where we differentiate ourselves. Someday, there could be an opportunity to significantly and comprehensively review our cost structure and the way we do things and change our focus. But today, that's not on our decision. So, I would tell you that the cost structure is what cost structure is and we intend to run it. We think we've got a lot of room to run with our existing allocation of assets, that way.

**Jamaine Aggrey:** Okay. All right. Thank you for that. And on the Test business, you lowered the upper end of the guidance range, and now at a pretty tight range, which essentially implies basically a flat second half of the year in terms of Test sales. Can you talk about your confidence in the second half on the Test segment, and how you're seeing orders coming in?

**Pete Gundermann:** Yeah. If you look at what we did for the first half, what we have in backlog, I think we're in pretty good shape to execute on that tighter range in 2017. We have to get a few orders, for sure, but I think we're reasonably confident that we can do that. I think the bigger question and the thing people should be asking about on Test, is where we're going to be next year. And I think that the aerospace world is our primary business, but I think the Test side has the potential to be a very pleasant surprise for us next year, based on orders that we would again have to get this year. And I'm talking about both the A&D side and the semi side, so 2017, to me is, I don't want to say in the bag, but it's not the big risk item. I think 2018 is where the bigger interest lies.

**Jamaine Aggrey:** Okay. That's fair enough. That's all I had. I'll go back to the queue.

**Pete Gundermann:** Okay.

**Operator:** Thank you. Our next question is coming from Dick Ryan of Dougherty & Company. Please go ahead.

**Dick Ryan:** Thanks for the follow up. Hey, Pete, back on semi test, when you look at next year and some of these programs, can you give us a sense of having success and moving beyond testing, just the current components that you have with the existing customer? Does this mean you're moving into other customers who's going to come on board next year, or expanding into testing additional components with Apple?

**Pete Gundermann:** Well, we think in terms of programs more than customers, and definitely we are looking at expanding beyond our legacy programs, and we have more than one. But our goal is to expand our capabilities and expand what our customers need. And I'll tell you that it's really interesting to me that the profile that customers want, based on various types of items under test, can be dramatically different.

So, one of the things, which I think we have done a pretty good job of, is building an organization that can think outside the box and come up with certain solutions that are highly customized for specific applications. And I think one of the things that we're doing is developing a following of customers who know us, that respects, and recognizes that as a real asset. Tying our engineering capabilities and creative capabilities with their product knowledge can be a pretty dynamic powerful combination. So, in answering your question, I guess we recognize that there's a wide range of requirements out there, and I think we're developing an organization that is very capable of responding to those requirements and being valued as a real partner on the part of our customers. So, we're pretty excited about that.

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

**Pete Gundermann:** Sure.

**Operator:** Thank you. Our next question is coming from Scott Lewis of Lewis Capital Management. Please go ahead.

**Scott Lewis:** Thanks. Good morning, Pete. How's it going?

**Pete Gundermann:** Good. And you?

**Scott Lewis:** Good. Hey, for 2018, you talked about some projects that you're hoping to get orders for or expecting to get orders for. But can you talk a little about maybe some of the programs that are built in for 2018? I'm thinking of a couple of the Business Jet programs, like the PC-24 and that Bell 505, and maybe the 737 MAX. Are these going to add up to anything material in 2018?

**Pete Gundermann:** They'll begin to. PC-24 should be in production certainly in the second half of the year. The 505 is a small aircraft, less volume to it. And the MAX should also start to ramp next year. So, yeah. I'd expect those to continue. And, Scott, I can always count on you to bring up our flight critical or electrical power distribution capabilities for GA and smaller aircraft, and I think it's something we don't talk a whole lot about, but we're really making a lot of progress and becoming the key industry provider to those types of aircrafts.

I don't think it happens anymore, where an airplane gets developed without our involvement, at least in the bidding stage. In some cases, we may opt not to pursue it, in some cases, an OEM may decide that they want to go a more traditional route, than what our higher tech solution entails. But there was a time when we had to knock on all the doors to just introduce ourselves. Now, they call us, and I think we're really on our way to becoming the preeminent supplier to that business. And unfortunately, as you know, the gestation period for a new aircraft can be really, really long. So, it's one of those things where you work today for an

airplane that might give you a contribution in five years, but I think there's going to be a sneaky fast snowball effect.

If we get enough airplanes down and the science is getting better and better, the architecture is getting more and more reliable, and as we go around the block, every time we go on the block, we learn a new trick that we can apply, put in our tool box for the next airplane. I'm not sure 2018 is going to be one that's going to bring a whole lot of headlines, but certainly, that's an area that we've invested heavily in, and I think it's one that's going to pay off over the long term, by creating a real strong market position for us. And as a pilot myself, like you, I'm pretty excited about it.

**Scott Lewis:** Okay. Great. Thanks for that, Pete.

**Pete Gundermann:** Okay.

**Operator:** Thank you. At this time, I'd like to turn the floor back over to management for any additional or closing comments.

**Peter J. Gundermann:** Very good. Thanks for your attention. We're hoping the second half is stronger than the first half, but we're pretty confident again, overall, that we've got some pretty good trajectories, and we just need to get through the current period. And I am expecting we're going to see substantially better results in the near future. Thanks for your attention. Talk to you next quarter. Have a good day.

**Operator:** Ladies and gentlemen, thank you for your participation. This concludes today's conference. You may disconnect your lines at this time, and have a wonderful day.

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