

Operator: Greetings and welcome to the Astronics Third Quarter 2022 Financial Results Call. Please note this conference is being recorded. I would now like to turn a conference over to your host, Deborah Pawlowski. You may begin.

Deborah Pawlowski: Thanks, Shamali, and good afternoon, everyone. We certainly appreciate your time today and your interest in Astronics. On the call here with me are Pete Gundermann, our Chairman, President and Chief Executive Officer, and Dave Burney, our Chief Financial Officer. You should have a copy of our third quarter 2022 financial results, which we released just after the market closed 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 some 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 release and with other documents filed with the Securities and Exchange Commission. You can find those documents on our [website](#) or at sec.gov.

During today's call, we will also discuss some non-GAAP financial 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 it over to Pete to begin. Peter?

Pete Gundermann: Thanks, Deborah, and good afternoon, everybody. Thank you for tuning in to our call. Our agenda, as usual, will be focused on a discussion of the recent quarter, the third quarter of 2022, and we will close with some forward-looking predictions for both the fourth quarter and an initial look at 2023. I will start, and then I'll pass it over to Dave, and then I will finish up again.

When I look at the third quarter, at its most basic, there's a bad negative headline and there's a pretty good headline. The bad headline is that the revenue ramp that we expected to begin in the third quarter was delayed. We did not get the ramp that we anticipated. The good news is that demand during the quarter in terms of bookings continues to be strong, which sets us up again for the step change that we think is underway in the fourth quarter here in terms of volume and will carry into 2023.

First, about the delayed revenue ramp, the negative headline. In my view, the third quarter was a misfire, like a false start in a race. We thought we would see revenue of about \$150 million. Instead, we ended up at \$131 million. That delay led to a reset of our second half expectations and was driven by a combination of supply chain problems and program delays, about 50-50. It also had the effect of delaying the expected ramp from the third quarter into the current quarter, the fourth quarter of 2022.

As a little detail on supply chain problems and program delays, the supply chain struggles are well documented; everybody is experiencing them. From our perspective, there are a couple of bright spots. One is that, when the supply chain problems became apparent in our economy, especially in our world of electronics during the middle and late second half of 2021, lead times stretched out dramatically. Demand has fluctuated for us over the pandemic. Basically, when demand came back in the second half of 2021, we started ordering parts that, typically, would have lead times of 8 to 12, 14 weeks and, all of a sudden, we're getting quotes back at 52 weeks, which served to retard our ability to handle the surge in demand.

Well, 52 weeks has come and gone and those parts are now starting to come in. If you look at our inventory levels, in the most recent quarter, you will see that we've had a real buildup of inventory that, obviously, is bad news in terms of working capital, but it's good news in terms of getting the parts that we've been waiting for, for about a year, which will set us up for the increased level of shipments that we anticipate in the current quarter, next quarter and the quarter after that.

The other thing is that we're maybe a little bit of a contrarian here, but our perspective is that, while supply chain has been a major disruption to our business and to many other businesses over the last 1.5 years, we see signs of promise. We run a handful, 12 or 13 different operations, and we do systematic reviews and follow up with them. One of my regular questions is what does the supply chain look like? Is it getting better? Is it getting worse? For the first time in many quarters here, the feedback and the sentiment is that it's not getting worse, maybe getting a little bit better, but not across the board.

We are not out of the woods by any means, but it seems to have plateaued, and we are hopeful and optimistic that we're going to continue to see lead times come down. In some cases, pricing comes back to a more normal realm. That's a fundamental kind of expectation, not that things are going to snap back to perfect in the coming quarters, but that they're not going to get any worse.

I also want to talk a little bit about program delays. We have experienced a number of award delays that we thought were going to drive our second half which now look like they are going to be delayed into 2023, maybe even into late 2023.

One example of that is the FLRAA award, which I've talked about in previous calls, Future Long-Range Assault Aircraft, the Army's planned replacement for the Black Hawk. We're teamed with Bell on their version of that and Bell is competing with a team led by Sikorsky. This is a program that most of the world expected to be awarded in the May, June, July time frame, but then it flipped to October and here we are in November and maybe now it might happen by year-end. If Bell wins this program, we expect to play a major role in their team and it will be probably, if not the largest, one of the largest programs that's ever come to our company, and it will require a significant amount of engineering and development work. Originally, when this thing was supposed to be awarded in May or June, we had a risk-reduced amount included in our budget and forecast for the second half of 2022. Obviously, that, at this point, has slid out into 2023.

Similarly, we made kind of a strange announcement on August 24 about a program called 4549/T, which is a radio test down select that we won from the U.S. Army. The U.S. Army operates about 20 different radio types in their arsenal, with a total of over 600,000 radios, and they ran a technical performance-based competition between a number of suppliers, including us, to pick a platform to go forward with as their standard tester. We were selected, but we originally thought that this down select would happen early in the year, like in March or April, and then June or July. Finally, we were selected in August. Even after being selected, we can now negotiate, basically, a directed procurement contract with the Army, which will take some time and means that what we had expected would be a solid contributor for the second half of 2022, will slide into 2023 and beyond. It's a significant program. It is all preliminary. We don't know exactly how many and how many years this thing will go, but indications are that it will be a significant test contract for us to the tune we think of somewhere between \$150 million and \$200 million. Between supply chain and program delays that, in some cases, were material, we had to reset our second half expectations.

The third quarter also included atypical costs of \$4.6 million. Dave will talk about these in some more detail, but we exited or are exiting a long-term lease to a building, which required departure costs, a customer accommodation and a legal settlement, some of which we expect will be reimbursed in the fourth quarter, but the accounting rules say we take the cost in the third quarter. If we get reimbursed, it will happen in the fourth quarter.

Finally, in the third quarter, like many companies, we are dealing with the effects of inflation on our production inputs. We are heartened by the recent news that the inflation expectations are softening a little bit going forward. Over time, we'll be able to work this out, like everybody else, and stock price will come down, pricing and opportunities will go up to match the increase in costs, but it definitely had a negative impact on margins in the third quarter. This results in margin pressure, the lower volume, the elevated input cost, the atypical expenses, we ended up at the end of the day with an adjusted EBITDA of a negative 0.6%.

The positive headline, and it was a significant headline, was continued strong demand in the market for our products. We had third quarter bookings of \$184 million. Against shipments of \$131 million, that's a book-to-

bill of 1.4 and almost back to pre-pandemic levels. Pre-pandemic, the way the company is structured and was structured then, we would expect to book in most quarters somewhere between \$190 million and \$200 million. That was the trajectory we were on to come into \$184 million, if you look at the chart on the last page of our press release, you'll see 3 out of the last 4 quarters, we're right around \$180 million. In fact, for the last four quarters, we had bookings of \$685 million against shipments of \$493 million. That's a book-to-bill of 1.39 and leaves us with another record backlog of \$547 million, our highest ever.

We get questions every once in a while about how we count bookings, how do we define a booking? It is a pretty conservative measure that we use. We need a delivery order with a firm price and a firm delivery date before we call it a booking. We exclude blanket orders or long-term agreements that don't have specific pricing determinations or delivery deadlines. I use the 737 MAX, as an example. Historically, it's one of our largest production programs and is coming back, thankfully. We put a certain amount of product on every airplane and we have long-term agreements with Boeing for that book of business that stretches out for years.

One way to count bookings would be to look at the term of the agreement, say, the 2027 or 2025 or whatever the case may be and look at their skyline production chart and multiply the two together and call that backlog. That is not how we do it. In that case, with 737 and Boeing, for example, they give us delivery orders on a regular basis, each quarter for delivery for the next quarter. That amount defines exactly what the product is and what the pricing is and what the delivery deadlines are, that's what we include as a booking, nothing more. We're pretty consistent with that. That helps people understand what true demand is for our business without getting messed up with long-term agreements and long-term assumptions that might go along with it in some cases.

We had great bookings for the third quarter, a continuation of great bookings for the last 5 quarters, and that sets us up for a good short-term future here as we wrap up 2022 and go into 2023.

At this point, I'll turn it over to Dave to go over some of the specifics of the third quarter. Dave?

Dave Burney: Thanks, Pete. While our sales continue to improve, we continue to experience margin and cash flow headwinds as well as \$4.6 million of what I call atypical costs in the quarter. Consolidated sales increased to \$131.4 million and was led primarily by continued growth in the recovering commercial transport market, which was up 36% compared with last year's third quarter and up 13% sequentially from the second quarter.

General Aviation sales increased by \$2.6 million to \$14.8 million, due to increased volume, primarily of our antenna sales and enhanced vision systems into that market, while military aerospace sales decreased by \$4.6 million to \$12.5 million, due primarily to a reduction in nonrecurring engineering revenue compared with the prior year. Test segment sales increased by \$3.2 million to \$19.3 million and was driven by increased instrument test and transit test volume.

Despite this top line growth, we continue to struggle with our margins. The sales increase of \$19.6 million compared with the previous year's quarter. Historically, we would expect to see 40% to 45% of that sales increase, or about \$8 million or so, drop to operating profit. We didn't see that. We saw our operating loss from operations actually increase by \$9.8 million from a loss of \$4.5 million to a loss of \$14.3 million. Here are some of the items and the headwinds that happened during the quarter compared with a year ago.

The continued high level of spot buys to source inventory is estimated to cost us about \$4 million during the quarter. We expect these types of buys to continue, but to wind down as we move through the next 12 months as supply chain improves. We have several atypical costs that we do not expect to continue to be recurring in the future, including \$4 million to settle an ongoing legal dispute and customer accommodation. We do expect that will be indemnified for a portion of these costs in the future.

Additionally, \$450,000 in lease termination costs were accrued as we're relocating our Irvine test operation into a different location in Irvine. Inflation's impact relating to material and labor cost is estimated to be in the

range of 7% to 8%, or about \$8 million to \$9 million, for the quarter compared with a year ago. We expect, over time, we'll be able to pass these costs to our customers as we enter into future contracts, but there will be a lag. Some contracts have been renewed with more favorable pricing and some are in the works. Some will not open up for another year or two, but we are working on those.

Additionally, we have not been realizing customary margins on several of our newer test segment development programs. We do expect higher margins on the follow-on orders relating to those development programs that we've received or expect to receive in the future. Finally, in last year's third quarter, we did recognize \$1.1 million of grant from the AMGP program, offsetting cost of goods sold that we don't have this year.

Switching to the balance sheet. We had a difficult quarter with respect to cash. Our net debt was \$156 million at the end of the quarter, up \$133 million at the beginning of the year. Cash flows from operations in the third quarter were negative \$28.8 million, caused by inventory, which increased \$16.1 million during the quarter, driven once again by our growing sales backlog and the move to the right of some sales programs and complicated by supply chain inefficiencies.

Receivables growth also increased by \$16.7 million during the quarter. This was compounded by the negative EBITDA margins that we had in the quarter or breakeven EBITDA margins in the quarter. We do have some progress to report in terms of an amended credit facility that we completed yesterday. With the cooperation of our bank group, we extended the expiration of the revolving credit facility, this time, to the end of November 2023. The extension will provide more time to get a long-term credit arrangement in place as the process has been moving slower than expected.

You may recall that three months ago when we reported, we were targeting having this done by now. While we're not finished yet, once again, we're maybe still in the final stretch and expect that we'll have a new facility in place before the end of the year. Select changes to the terms of the revolver, the revolver will remain at \$180 million through December 20th, 2022, then decrease to \$170 million. The SOFR pricing spread will increase to SOFR plus 550 basis points through January 16, 2023; then increase to SOFR plus 850 basis points thereafter.

We are required to maintain trailing 12-month adjusted EBITDA of \$15 million for the quarter ending December 31 and March 31; then \$25 million for the remaining quarters thereafter. Minimum liquidity through December 31, measured monthly, is required to be \$10 million, increasing to \$15 million thereafter. And there was a 10-basis points amendment fee.

Pete, that's all I have.

Pete Gundermann: I'd like to suggest that you turn your attention to the bar chart on the last page of the press release. I'm going to talk about this a little bit to explain where we've been and where we're going as a company through the COVID period here.

Hopefully, you're looking at a color version rather than a black and white version. For each of the quarters from the first quarter of 2020 through the third quarter of 2022, the bar on the left, or the green bar, is our bookings for that quarter and the blue bar on the right is our shipments.

I am going to first focus on the left bars, or the green bars, the booking trends. You can see that, when the lockdown happened in the first and second quarter of 2020, our bookings went off a cliff, and we basically went from \$165 million, \$166 million down to \$60 million. Then, it climbed back kind of quickly, but to a reduced level and a plateaued right around \$120 million for 3 quarters, largely a period of restricted travel and lockdown work from home, all that stuff. You might remember from COVID.

About a year ago, in the third quarter of 2021, when those lockdowns lifted, demand took off; first with narrow body. We are not talking about it a whole lot on this call, but we're seeing many signs of increased wide body travel also these days, which is very exciting. Bookings took off up to \$160 million, \$180 million and, in the last quarter, \$184 million. Bookings, again, are bouncing back quickly, especially over the last year. The blue

bars, the bars on the right, reflect our shipments. We fell and followed bookings down for a couple of quarters, bottoming out in the third quarter of 2020; and then, kind of plateauing at about the \$100 million to \$120 million level up until two quarters ago, when we broke through \$130 million, but still, obviously, over the last year, lagging demand significantly. That is when the supply chain problems with the world happened.

That all happened around the second quarter of last year. Demand took off and we had a tough time matching it, and we're still struggling to do so. We were ordering materials way back then and those materials are only starting to come in now. Dave talked about the inventory ramp, and it gives us confidence that we can execute on the orders in front of us going forward. Again, if you look at the last four quarters, we had total bookings of \$685 million against sales of \$493 million. Sales must catch up. That's our mission. That's our challenge. What are our expectations? We are expecting that fourth quarter revenue, the quarter we're in right now, will be in the range of \$140 million to \$150 million. We're aiming for the high end of that range. We have some challenges but think that's a safe range. As of our most recent reading, we are on track to do that from a volume standpoint in the current quarter.

Looking forward, as is typical at this time of the year, we take a first look at the year that's coming. We are working on and finishing up our budgeting process for 2023. Based on bookings that we've experienced to date and the record backlog that we have of \$547 million, we think that we're going to be in the range of \$640 million to \$680 million next year. That would represent a significant level of growth over where this year is going to end up, which will be in the \$525 million to \$530 million range. That's a big challenge and is dependent on getting the parts that we need. Our indications are that the supply chain is loosening up and, in any event, is not getting any worse. We think that we have the planning in place to bring those parts in house and then convert them into revenue. We think it's going to be a really good year.

We will update more on that as we get closer and get into it. There are vital details to get nailed down like FLRAA and 4549/T. We think we have the pieces in place to make that year a reality.

That ends our prepared remarks. Shamali, I'd like to open it up to questions at this point

Operator: Our first question comes from Jon Tanwanteng with CJS Securities.

Jon Tanwanteng: I was just wondering, does the inventory that you've built give you that confidence to shift to your revenue guidance or are you still waiting on parts that could push out things towards the end of the fourth quarter?

Pete Gundermann: We think we have a fairly good line of sight to inventory for the fourth quarter. There are a couple of hotspots. There always are. We're working those pretty aggressively. Our internal target is at the high end of that range or just beyond it. By putting that range in there, we think we're giving reasonable allowance for material problems that could still pop up. At this point, we're, obviously, pretty well into the quarter and we're encouraged that we're on track so far. We think we're all right.

Jon Tanwanteng: Okay, great. Dave, I was wondering what your new estimate of when you might achieve breakeven is, just on a pretax income or a cash flow basis, given the inflation underlying, the push out of the ramp and, obviously, your expectations for how the refinancing might play out?

Dave Burney: I think our quarterly GAAP pretax breakeven point is in the neighborhood of \$160 million, when the spot buys go away. We experienced \$3 million or so in spot buys this quarter. With those, I'd say our GAAP breakeven point is probably about \$165 million right now with those spot buys.

Jon Tanwanteng: Any best estimate for what's left to complete the refinancing? What are the items left and the time that you think it will take?

Dave Burney: Well, our target is to get something done before year-end here. We're working with a couple of options there. but it's still, basically, the same structure we talked about before with a combination of an asset-based loan that's supported by working capital, receivables and inventory and the term loan that would be supported by real estate and machinery and equipment, same basic structure there. Our target is to get it done as soon as possible. I'm confident that we'll get something done in the first half of December. If you read through the amendment we just did, it's highly in our benefit to get something done sooner rather than later. I'm confident we'll get something done in December here.

Operator: Our next question comes from the line of Michael Ciarmoli with Truist.

Michael Ciarmoli: Dave, maybe just to stay on the credit facility, when you mentioned the EBITDA levels on a trailing basis, it sounds like you won't be EBITDA positive in the fourth quarter. What was the bank-defined EBITDA this quarter? It sounds like there's going to be a challenge to get to a sustaining EBITDA level here.

Dave Burney: I would say that we will be cash or EBITDA positive in the fourth quarter. Our forecast has us being compliant.

Michael Ciarmoli: Even though you just said you were looking for breakeven?

Dave Burney: Michael, we wouldn't have entered into an amendment that we were forecasting to not be compliant with.

Michael Ciarmoli: I just haven't seen one of these take this long. I would imagine the EBITDA levels are a bit of a challenge, but okay. And then, Pete, you gave a detailed analysis of the color within the bookings. What are you seeing for near-term production rates, that underlying to 2023? I mean, supply chain, obviously, is a little bit better, but there are still challenges. We have some other big suppliers, say the engines and supply chain, which are going to last all year. What are the underlying rates that are anchoring this guidance?

Pete Gundermann: Do you mean for the OEM production rates?

Michael Ciarmoli: Yes.

Pete Gundermann: They're pretty much as published. I mean, Boeing has us running on 28 to 30 units a month on 737 MAX. Business Jet volumes are not going down; they're going up. Military volumes are pretty easy to predict. The take rate on a lot of our cabin electronics product lines, like In-Seat Power and wireless access points, things like that, which are optional in the narrow-body world, are strong. They're trending to like 70% or so of new aircraft production, both at Boeing and Airbus. That helps.

I hinted that the wide-body resurgence is actually greatly beneficial for us. I mean, before the pandemic, half of our commercial transport sales were wide body versus narrow body. Narrow body has bounced back with the resumption of domestic short-haul travel. Predictions even 10 months ago were that a lot of the wide bodies that were parked in the desert would never come back, but they are. They are, because demand is coming back, too. I'm particularly encouraged by some of the recent news out of China, but a major driver of international long-haul travel and half of the world's largest airlines are Chinese, and they have been running at like 5% of their pre-pandemic international route structure.

We think those trends are positive. The products of ours that go into wide bodies are definitely picking up. It is not just production rates that drive our business. Half of our commercial transport sales pre-pandemic were aftermarket. We're encouraged by 737 MAX getting back up to rate. We're encouraged by, hopefully, 787 getting back into production, but we're not dependent on those necessarily to see some kind of resurgence in demand. Certainly, what we're seeing, at least in the wide body world is more aftermarkets driven than line fit.

Michael Ciarmoli: Okay. Got it. And then, just last one, for Dave again. Free expectations and just thinking about, I guess, it sounds like there's, obviously, working capital, which a lot of companies are experiencing. Some of that should unwind. But I was just thinking, I guess, about the puts and takes. I mean, it sounds like that facility is going to be over 11%, I guess, if you draw on that. So just how should we think about free cash flow or even conversion as we investigate 2023?

Dave Burney: We will turn to cash flow positive as we move through the year. We saw this big buildup of inventory through the last 6 or 9 months. We do expect the inventory build to wind down and decrease our inventory levels as we move through next year. That's going to provide a little bit of a tailwind there, along with the top line growth and the margin that comes from the top line growth there. We are forecasting to move through the year. The first quarter will probably be our weakest quarter next year. As the sales grow and we wind down the inventory, I expect the cash flow from operations to pick up significantly, especially in the second half of next year.

Operator: Our next question comes, again, from the line of Jonathan Tanwanteng with CJS Securities.

Jon Tanwanteng: I was just wondering, within the guidance that you have laid out for next year over those brackets, how much on FLRAA and Army radio business have you included in there? If you haven't, how quickly could those start becoming a tailwind for you, if you win FLRAA, of course?

Pete Gundermann: It's a risk-reduced number. I would say between the two of them, it's somewhere in the \$20 million to \$25 million range for next year. We think there's pretty significant upside potential there, especially on the 4549/T, depending on how the Army chooses to execute the program.

Jon Tanwanteng: Okay. Understood. And just a question on pricing. You mentioned that there are some of these programs out there that are one to two years away from having your contracts reset. Is there no chance of going back to your customers and repricing those just based on the level of inflation that you've been seeing. I have to assume that you're, basically, taking a negative margin on these projects at this point, which doesn't sound very sustainable?

Pete Gundermann: The long-term contract nature of our business in general isn't that big a concern with repricing. There, obviously, are some products that are better priced than others and we are working to address that. A fair amount of our product portfolio turns relatively quickly, like a year or 1.5 years, something like that. In some cases, we're being quite successful with repricing them. We have a situation where we can make a delivery, but, to do so, we have to pay a big premium for a certain component. In many cases, we are going out to customers and asking them to cover that and they're doing so.

In other cases, we're choosing to bite the bullet and do it ourselves or in the interest of keeping customer relationships cordial. It's going to take time for all of that to work itself out and we're definitely not ahead of the cost increases. We're responding to them like most companies. It's downward pressure, but we are doing what we can, where we think we can, to get out in front of it and respond to it.

Operator: Our next question is a follow up question from the line of Michael Ciarmoli with Truist.

Michael Ciarmoli: Pete. Just to stay on the pricing, what are you seeing with the current bookings on the aftermarket side of the business? Pick an airline customer, do you have some flexibility to increase the price on whether it's break-fix-type work or if they are doing some retrofits? Are you getting some reasonable pricing there?

Pete Gundermann: I would say we're pretty comfortable with the prices that we're getting. Most of what we're dealing with, where we have pressure, are older price levels that have been in place in the system for a while. A lot of the more recent demand, we think, comes at reasonable pricing levels. The other thing I would say about our backlog and the range of bigger programs that we've announced is, they're not in there yet. I mean, they're just not there. We talked about a major award with Southwest. I think at the end of the third quarter, we had like ten ship sets in there or something like that.

There's a lot of that to come. 4549/T is obviously not in there and some of the others without going through the whole list. I guess we feel like, if we can get the volume up and get the new programs into production, our margin profile will look quite a bit better than it does today, where we're stuck with these inventory premiums

that we have to pay, spot buys and pricing from 6 months or a year ago when things were different. Obviously, we must cycle that through and I think we'll get that done. It's just a matter of time.

Operator: We have reached the end of our question-and-answer session. I'll now turn the call back over to Peter Gundermann for closing remarks.

Pete Gundermann: Okay. Thank you, and thanks, everybody, for tuning in. We look forward to talking to you when the fourth quarter is over, probably in early February. Have a good day.

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

Note: This transcript has been edited slightly to make it more readable. It is not intended to be a verbatim recreation of the Astronics Corporation (ATRO) financial results teleconference and webcast that occurred on the date noted. Please refer to the webcast version of the call, which is available on the Company's website (astronics.com), as well as to information available on the SEC's website (sec.gov) before making an investment decision. Please also refer to the opening remarks of this call for ATRO's announcement concerning forward-looking statements that were made during this call.