

**Operator:** Good afternoon, and welcome to the Astronics Corporation Second Quarter Fiscal Year 2023 Financial Results Conference Call. All participants will be in listen-only mode. [Instructions] After today's presentation, there will be an opportunity to ask questions. Please note this event is being recorded.

I would now like to turn the conference over to Debbie Pawlowski, Investor Relations for Astronics. Please go ahead.

**Deborah Pawlowski:** Thank you, Anthony, and good afternoon, everyone. We certainly appreciate your time today and your interest in Astronics. On the call here with me are Peter Gundermann, our Chairman, President and CEO, and Dave Burney, our Chief Financial Officer. You should have a copy of our second quarter 2023 financial results, which just crossed the wires after the market closed today. If you do not have the release, you can find it on our website at [astronics.com](http://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 earnings release as well as with other documents filed with the Securities and Exchange Commission. You can find those documents on our website or at [sec.gov](http://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.

So, with that, let me turn it over to Pete to begin. Peter?

**Pete Gundermann:**

Thank you, Debbie, and good afternoon, everybody. Thank you for tuning in. We are here to talk about our second quarter and our prospects for the rest of the year. And in sum, we think our second quarter was a pretty strong step forward for our company, easily the best quarter we've had since COVID took over in early 2020. There are three prominent themes that are going to come up over and over again as we talk through our results, and you'll catch them, no doubt.

One is that volume continues to ramp. We're recovering our production rates and that has a lot to do with our supply chain, which is the second theme. Our supply chain, while certainly not perfect, is getting quite a bit better as time goes on. That's pretty evident in the volume that we've been able to produce. The third prominent theme is that demand for our products remains very strong. This gives us confidence of continued recovery as we move through the near-term quarters in the future.

Digging into the specifics, sales of \$175 million were up 35% year-over-year and 11% sequentially. It continues a pretty strong pattern of recoveries set out over the last four, five, six quarters. The last four in succession saw revenues of \$131 million, then \$158 million, then \$157 million, and now, \$175 million. Our Aerospace segment was the key driver of our results with sales up 45% year-over-year to \$158 million. Our Test segment by comparison had a pretty difficult quarter. Sales were down 19% year-over-year to \$16.1 million.

Jumping to the bottom line, we had a net loss of \$12 million, but an adjusted EBITDA of \$15.8 million, which was 9.1% of sales. Dave will talk through the major EBITDA adjustments in a moment, but it was a pretty clean quarter compared to many we have had recently without any earn-outs, AMJP grants or etcetera. A tax line that jumps out was the strangest entry in the numbers and it was that way the last quarter too, and it will be for the near future. Again, Dave will explain that briefly in a minute. All in all, we think an adjusted EBITDA of \$15.8 million is a nice improvement from a year ago when we had an adjusted EBITDA of \$129,000 or just 1.6% of sales.

On the demand side, bookings of \$207 million are basically pre-pandemic level. I mean that's where we were back in 2018, 2019, a book-to-bill of 1.19, even with relatively strong shipments, once again setting a new record backlog, this time of \$611 million. Of the \$611 million, \$330 million is scheduled for second half shipments. We'll come back and discuss the second half in a minute, but that's a number we're hanging on to. Aerospace orders in our second quarter were particularly strong again at \$189 million, a book-to-bill of 1.19. Test also had decent bookings of \$18.3 million with a book-to-bill of 1.14.

There were four press releases of note that went out over the last quarter, and I wanted to hit each one kind of briefly to talk a little bit about where our business is coming from and to give a little bit of the breadth of our activities these days.

Test had a big order from something called HHRTS. We've talked about this before. It's the Handheld Radio Test Sets program with the U.S. Marine Corps. It's a radio test program, an IDIQ program that we won earlier in the year that we think is going to be about a \$40 million program over three or four years. The big delivery order that we received in the second quarter was for \$10 million. There were some other smaller things that happened on HHRTS earlier on, but the \$10 million is the first significant delivery order, which we are working on now.

Another radio test program that we have talked about in the past, 4549/T, is for the U.S. Army. Those who have been following our company for a while may remember, about a year ago, actually, we were named the winner of a technical competition for the U.S. Army for their next radio test platform. We anticipated, at that time, a pretty prompt march into contract negotiations on a directed procurement to our company. Long story short, we're still waiting for that directed procurement, but it is moving forward. And the reason I'm bringing it up here is that the architecture and the theory of operation between HHRTS and 4549/T are complementary, and the armed forces are recognizing that.

So, the Army program is moving forward. We are of the opinion or the understanding that this contract should be awarded by year-end at the latest. That will be, if it happens that way, a very positive boost to our fourth quarter results.

Second press release I'd like to briefly mention is something we came out with very recently. It had to do with electric aircraft, commonly called eVTOLs. One of our specialties is basically electrical power distribution and generation for small aircraft. And as most of you presumably know, there's a wide range of eVTOL aircraft under development right now. We have developed a family of products or capabilities that can be employed by these OEMs developing these airplanes in any of a number of ways. We had previously announced an arrangement with Lilium, a German company, that is one of the leaders in the eVTOL movement, but we've also attracted attention from a number of other companies.

We, in that press release, talked about ten of them and we put a contract or order value of approximately \$20 million to these ten customers. These are, obviously, not big orders today, but they are development orders, and they are good getting our foot in the door, so to speak. People can disagree or differ over the prospects for the electric aircraft market. We think it's interesting. Our approach is to develop commercially available, nearly off-the-shelf kinds of products that they can employ and that they need for the safe and certifiable operation of the aircraft. So, we're pleased with that development. We think it's going to be an interesting market to watch and we're excited to be a part of it.

We also put a couple press releases out in early June. One was on the Airbus A220 Passenger Service Units, or PSUs. That's one of our product specialties. If you sit in a commercial airplane that unit above your head that contains a bunch of different things: a couple of probably reading lights, some air handling systems, some emergency oxygen system – hopefully, you've not tried that one before – and some communication, usually a call button – that's a pretty major product for us. This A220 award from Airbus is the first time we have done this kind of work on an Airbus airplane.

So, we're pretty excited about it. We think it's going to be a pretty significant program. If you've flown on an A220, you've probably noticed it. It's a different kind of airplane, it has a different kind of feel, and it

seems to be gathering pretty good success in the market. It is in production now. Our products are scheduled to ramp into production late in 2024, about a year from now, or early 2025.

Finally, we put a press release out about a next-generation in-seat power system, this was a while ago. Specifically designed to deliver USB Type A and Type C 60-watt power for narrow-body airplanes. This is a system that we developed primarily for our friends Southwest during the pandemic. We were very tickled to win Southwest about a year ago. Since then, we have been marketing it to the world. We own the technology and we own the IP and it's been very successful. The press release talked about twelve or more airlines committing to about 1,100 narrow-body airplanes, with options for a couple hundred more.

What we're really happy about is that we've taken a franchise that we kind of developed and grew up with in the wide-body world and transferred a major competitive element into the narrow-body world. Now, a lot of narrow-body airplanes out there that are candidate aircraft for this product and for these systems. And all these products that I'm talking about here, HHRTS, the eVTOL systems, the A220 PSUs and what's called the UltraLite G2 ISP, in-seat power system for narrow-body airplanes – all of these were pretty much developed over the course of the pandemic. So, I'm happy with how this worked out.

A lot of companies who got caught up in the pandemic, like us, had to make some decisions about where do you cut costs? Where do you keep investing? And we, in many cases, decided to keep investing in programs that we thought had exciting futures. All of these are examples of those decisions that have worked out well.

So, they're not really helping our income statement yet, but they are starting to show up prominently in our backlog. And I expect over the next months and years that these things will become major elements of our business base going forward.

So, enough from me for the moment, I'll turn it over to Dave to talk through some of the specifics of our income statement and balance sheet.

**Dave Burney:**

Okay. Thanks, Pete. Sales came in at the top end of our range, as we had some good supply chain cooperation in June that allowed for a really strong finish to the quarter. Our operating income for the quarter was \$2.4 million, which was our first positive operating income since 2019, and a \$4.8 million improvement compared with our first quarter of this year, \$10.8 million improvement compared with last year's second quarter. The improvement was somewhat muted by high legal costs for the quarter, which were about \$4.9 million, not including an adjustment that we had because of a lower interest rate that will be applied to the penalties that we've accrued for the German lawsuit.

Driving the margin improvement was a 47% contribution margin on the incremental aerospace sales as compared with the sequential first quarter. It's highlighting that the top line growth is a key piece of our recovery. And we're seeing that the strong order levels over the past three quarters and the record backlog are translating into increased sales and improving margins.

Test margins remain depressed as the segment continues to struggle with high-cost relative to its revenue levels. To address this in the short term, on the first quarter earnings call, we announced a restructuring and head count reduction that will begin to result in cost savings of about \$1 million per quarter starting in Q3. Still, the cost structure is staffed in anticipation of a revenue growth that we expect will begin once the 4549/T Army radio test program contract is awarded, and the Marine Corps HHRTS radio test program, which we recently received the first task order for, that Pete mentioned, begins.

SG&A continues to be high due to legal costs for the lawsuits we're involved with. Legal costs were \$4.9 million in the quarter relating to those and they were partially offset by a reduction in our legal reserve that I mentioned of \$1.3 million relating to a slightly lower interest rate. Tax expense was \$8.1 million for the quarter. As I've said for several quarters, this is not really representative of a normal tax rate or cash tax rate. Because of our three-year cumulative pre-tax loss, the guidelines require us to record a valuation allowance for our deferred tax assets, creating a strange effective tax rate. We expect our full year cash tax this year to be in the range of \$6 million to \$8 million. That's \$6 million to \$8 million, not \$68 million.

All of it is a result of new rules requiring R&D costs to be amortized over five years rather than deducted as incurred. This would normally create a deferred tax asset, reducing the effective tax rate, but because we take a valuation allowance against that asset, it creates this odd tax rate. There's been some discussion by Congress to defer or eliminate that particular part of the code, but so far, nothing has moved forward.

Regarding debt on the balance sheet, as you can see from the balance sheet, liquidity remains tight as our investment in inventory continues to grow to support our growing backlog. Cash flow from the operation improved significantly from the first quarter, but still not where we need it to be or expect it to be. Cash used by operations during the second quarter was \$2 million, which was a significant improvement from the first quarter, where cash used by operations was \$19.2 million.

Our income statement has improved significantly over the last few quarters, driven by our sales growth. Unfortunately, despite seeing supply chain improvement, there remains some inefficiency and long lead times, resulting in higher inventory levels and stranded inventory that's waiting for the final pieces to complete in order to ship the product.

This, combined with 35% year-over-year growth, has increased our investment in inventory by \$22.6 million this year and about \$9 million in the second quarter. The large sales increase in the second quarter, and specifically sales in the quarter being heavily weighted toward the last month of the quarter, caused an increase in receivables of \$18 million. These inventory and receivable increases were partially offset by increases in payables and accrued expenses.

We are forecasting that our inventory has peaked and expect our inventory levels to begin to drop as we move through the second half of the year. We continue to be compliant with our debt covenants and are forecasting continued compliance and positive cash flow for the remainder of the year.

Turning to the reconciliation of net loss to adjusted EBITDA on page 8 of the release, you can see it was a pretty clean quarter, really the only two items, I would say, that were unusual were the high legal expenses of \$4.9 million that were offset partially by the adjustment to the legal reserve relating to a lower interest rate based on a ruling in the German court, which lowered the legal costs by \$1.3 million. So again, it was a solid adjusted EBITDA quarter for us at \$15.8 million, which is a significant step up from where we were running last year at \$2.1 million.

That's all I had, Pete.

**Pete Gundermann:**

Okay. Looking forward, we are holding our 2023 revenue forecast. We're now at \$640 million to \$680 million, but we are very much focused on the high end of that range, the \$680 million part. We had first half sales of \$331 million and we entered the second half with scheduled backlog of approximately \$330 million. And these two together get us to \$660 million, the midpoint of the range. Scheduled backlog for us means that we have a firm order, we have a firm delivery date and we have a high level of confidence in our supply chain in order to execute the program. If any of those things are untrue, we don't call it a scheduled backlog in the current period. It would go out into some future category.

So, \$331 million in the first half, \$330 million scheduled for the second half. Then, on top of that, we expect in any period, but especially in any six-month period, a certain amount of pull-in, pop-up, or book-and-ship – there are different names for it – orders that will add to the total, especially in the fourth quarter as time goes on. But some of these changes, the pull-ins, or the pop-ups, can be difficult to predict, but a \$20 million net number over a six-month interval is pretty modest, and we would consider it very achievable. So, we think that we are directionally going towards the high end of that range.

Breaking the two quarters apart, we expect the third quarter to be relatively similar to the second quarter. It could be a little higher, it could be a little bit lower, but it's going to be in that neighborhood, we think. And the fourth quarter is the one that has the potential to be a step-up or a step-down. We don't have real foresight into what the net changes are going to be yet, and that's a large part of why we are leaving that range the way it is.

Another reality is that because of supply chain inefficiencies that we've been talking about, it's getting better, but it's not perfect. We have developed a pattern where we ship a disproportionate amount of our product in the final days or final week of any particular quarter. In this last quarter, it was somewhere in the neighborhood of like 20% that came in the last week. So, that obviously puts it right down to the wire in terms of any kind of misstep right at the end can really change what our final number is relative to our forecast.

We expect continued margin improvement going forward, also lower material input costs, primarily in the reduction of spot buys and special purchases, and because the supply chain is getting a little better, that's helping out. Also some of the price increases that we've been able to implement across the business in contracts that permit it are also starting to have a benefit. So, some of the margin improvement Dave talked about, we think, has room to run, and it will be a long-term project to get it implemented across the business, but we are pretty pleased with how that's shaping up across our operations.

So, with all this said, we think the rest of 2023 will be an exciting time for the company with revenues approaching pre-pandemic levels, finally, and significant improvement on our income statements. At this point, Anthony, if there are questions, we'd like to open up to those.

## Question & Answer

**Operator:** Okay. We will now begin the question-and-answer session. [Instructions] Our first question will come from Jon Tanwanteng with CJS Securities. You may now go ahead.

**Jon Tanwanteng:** Hi. Good afternoon, guys. Thanks for taking my questions. Peter or Dave, at the high end of the range, \$175 million in revenue, which is similar to what you did in Q2; that doesn't give you the benefit of volume leverage to drive margins. So, I'm wondering: what kind of improvements are available just in the less spot buys, the price increases that you're talking about? And is volume actually going down as prices are increasing?

**Dave Burney:** Yeah. There are a couple of things that will start rolling in. The spot buys are expected to come down. They were somewhere between \$1 million and \$2 million for the quarter. Historically, they've been running about \$3 million. Ultimately, they'll continue to fade away. There will be new contracts, new purchase orders that will have higher margins on them as we've priced in the inflation over the last year, as we've entered into new agreements on that. And so, there is some leverage. I think that we will see some continued improvement.

The legal costs will come and go depending on what's going on in the various court situations. So, I think that's likely to drop a little bit over the next couple of quarters, depending on what's going on there. And at the top end, I think we're being conservative here. We have some programs that are in the pipeline that we're hoping will increase – that get us up to that top end. And I think we're hesitant with the supply chain the way it is right now to extend out over our skis on that. So, I think that's my take on it.

**Jon Tanwanteng:** Fair enough. And then, just on the bookings, how should we think of the pipeline of design activity and ongoing book and ship activity that you're seeing today? Is that \$200-plus-million order run rate sustainable as you look at the ongoing air recovery? Or are there going to be fits and starts, and a little bit of lumpiness as you go forward?

**Pete Gundermann:** So, it's a very good question and it's something that we all need to keep our eye on. If you look at that table on the last page of our press release, not only just the four quarters; but the trend that has existed, really since the pandemic took hold, as evident by the bar chart on the bottom of the page. I mean it jumps around a little bit, but you can't miss the general direction of it. And we have won a number of pretty significant programs, and I just talked through a handful of them. And none of those are really seriously reflected in our backlog, at this point. There are others like that out there.

So, our ambition is to exceed where we were pre-pandemic, but in order to get there, we have to get to the pre-pandemic level. And this quarter, I think, from a bookings standpoint, felt really good, because we did \$773 million in 2019. And obviously, \$200 million, if we could annualize that, puts us above that rate. If we do that, then shipments will follow. So, we talk about bookings, I think, more than most companies do. For us, we think bookings are a good leading indicator for where the business is going, and that's why we draw so much attention to it, both internally and when we're talking to the market.

**Jon Tanwanteng:** Got it. And then last one for me, just where do you think cash flow can be in the coming quarters? It seems like it's been tighter than expected over the last two – is there any indication that it will get better than that from what you're seeing today?

**Dave Burney:** Yeah. That's what the plan is. It's been tight for the past two quarters. We saw a pretty big buildup in our working capital in the second quarter between inventory and receivables. So, those receivables are converted to cash pretty quick. The one that we're having the hardest time getting our hands around is the inventory at this point, but we are internally forecasting to be cash flow positive for the balance of the year.

**Jon Tanwanteng:** Okay. Great. I'll jump back in queue. Thank you.

**Operator:** Our next question will come from Sam Struhsaker with Truist Securities. You may now go ahead.

**Samuel Struhsaker:** Hey. Good evening, guys. I'm on for Mike Ciarmoli tonight. Appreciate you taking the questions. To begin, I was curious, as you guys are returning on the Aerospace segment to pre-pandemic levels in prior peak, how should we think about margins going forward? Is that kind of the same as you were getting in the past at this level, stronger, weaker?

**Dave Burney:** They're going to start out being probably – I mean, it depends what period you're looking at...

**Samuel Struhsaker:** I'm thinking on like a go forward basis, kind of once you get back to those revenue levels, like what can we expect in terms of margins from pre-pandemic?

**Dave Burney:** Yeah. I don't see any reason why we can't get back up to our pre-pandemic margins. We need the new programs that we are winning and pricing at higher margins to kick in here, which will happen through next year and in the second half of this year. But yeah, the mix isn't a whole lot different

and there's no significant fundamental change there. We're lagging in terms flowing the increased costs from the past year on wages and materials through into our new contracts, but that will catch up as we move through next year.

**Samuel Struhsaker:** Great. Then going along the line of the inventory and supply chain, where exactly are you, guys seeing the bigger issues on the supply chain in terms of getting parts in: is it extended lead times and is there any particular area that's worse than others that might be impacting guidance for the year?

**Pete Gundermann:** Well, a lot of what we do is electronics related. So, I think our answer to that question would definitely include the general electronics difficulties that the world's seen over the last couple of years. We have, in some cases, some extended supply chains that move into Asia and all parts of Asia. So, we've dealt with a little bit of that also. It is not uncommon for some of our more complex products to have a couple hundred components in them. All you need is one to be late, and the other 199 sit there on the shelf until you have everything you need. It's getting better in that the general level of responsiveness and lead time has come down. The surprises we see today are decidedly positive compared to where they were certainly a year ago or a year and a half, two years ago where they were decidedly negative. All surprises seemed to be negative.

So, I think we're making progress on that, but it still is clumsy, and it still is a situation where our customers want to be able to place orders and get parts in 20 weeks in many cases. But the components that go into those parts for us have 40 or 50 week lead times. So, trying to balance the lead times that we face from our suppliers with the lead times that our customers are demanding puts some risk in the system, and that's part of what we're dealing with also. Again, we think it's all getting better. And I think, in terms of inventory management, most parts of our business are doing a better job, but we got to get more consistent across the entire company. So, that is a major focus, all hands-on deck, and we got to do a better job there.

**Samuel Struhsaker:** Great. And if I could just sneak in one more, what's the update on the FLRAA program, anything there?

**Pete Gundermann:** There is activity. I'm not at liberty to discuss it in this context right now. But we are engaged. And I'm looking to make some public news about that shortly.

**Samuel Struhsaker:** Understood entirely. All right, thanks, guys. That's it for me.

**Operator:** Our next question will be a follow-up from Jon Tanwanteng, CJS Securities. You may now go ahead.

**Jon Tanwanteng:** I was wondering if you could go into a little bit more detail on the legal expenses in the quarter, what were they for, kind of what's the run rate that you expect going forward and if there's going to be an end to it any time soon?

**Pete Gundermann:** Well, we have a couple of long-running situations that we've been dealing with. The longest one has to do with our in-seat power product and electrical outlets, specifically against the German competitor. That's been playing out in four countries over the last decade really, I mean the US, France, UK, and Germany. The US is done, and we won that case basically a long time ago. France, we think, is almost done. It could be done depending on whether an appeals court wants to hear the other side's appeal. But either way, we think that one is pretty much done, and it's very much going in our direction. The UK and Germany are a little bit more complicated. The UK we lost, so there will be a penalty phase. We've accrued for what we think that's going to be – that's probably going to play out in 2024-2025. Germany has been going on forever, and that's also one that's probably going to play out in really late 2024 or 2025.

So, it has been active for the last few months and that's why the bills are so high. We also have one going on in our Test segment. It started off as a patent dispute; we got the patent dismissed, it was brought against us. And then it's evolved into a copyright dispute. So, from our way of thinking, the stakes are significantly reduced, but we had no choice but to pursue legal remedies to get there, and we're not done yet. That will be something that – actually, it could shut down depending on court decisions by the end of this year. If not, it will probably wrap up by the end of next year, I would say.

**Jon Tanwanteng:** Got it. Thank you very much.

**Operator:** Our next question will be a follow up from Sam Struhsaker with Truist Securities. You may now go ahead.

**Samuel Struhsaker:** Hey, guys. Thanks for taking the follow up. Just, I have two quick clarifying questions. In your prepared remarks, you mentioned the system for the eVTOLs. Was that \$10 million total or per potential customer?

**Pete Gundermann:** Oh, no, it is \$20 million total for the ten customers. Yeah.

**Samuel Struhsaker:** Got it. Okay. And then within the USB-C product that you guys have across narrow-bodies. Do you have any rough dollar content per aircraft on that?

**Pete Gundermann:** It's pretty highly variable, but I think the general rule of thumb ... I mean it depends on the configuration, and some aircraft want to go just for certain classes of seats. But I would say it's pretty widely variable. A real inexpensive installation might be \$70,000 a ship in expenses, where a more normally priced one could be up around \$130,000 or \$140,000. Highly variable depending on how the airline wants to configure their cabin.

**Samuel Struhsaker:** Okay. Great, got it. Thank you.

**Operator:** This concludes our question-and-answer session. I would like to turn the conference back over to Peter Gundermann for any closing remarks.

**Pete Gundermann:** No closing remarks. Thank you for your attention. Again, we think the second quarter was a very significant step forward. We think we're set up for a good second half and close to the year, and we look forward to talking to you next time. Have a good day.

**Operator:** The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

*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](http://astronics.com)), as well as to information available on the SEC's website ([sec.gov](http://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.*