

**Operator:** Greetings, and welcome to the Astronics Fourth Quarter 2019 Financial Results Conference Call. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Deborah Pawlowski, Investor Relations. Thank you. You may begin.

**Deborah K. Pawlowski:** Thanks, Christine, and good morning, everyone. We certainly appreciate your time today and your interest in Astronics. Joining me on the call are Pete Gundermann, our Chairman, President and CEO; and Dave Burney, our Chief Financial Officer. You should have a copy of the 2019 fourth quarter and full year financial results, which were released earlier this morning. And if you've not, you can find them on our website at [astronics.com](http://astronics.com).

Let me mention first, as you're likely aware, that we may make some forward-looking statements during this formal discussion as well as during the Q&A session. 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. These documents can be found 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 would be useful in evaluating our performance. You should not consider the presentation of this additional information in isolation or as a substitute for results per in accordance with GAAP. We've provided reconciliations of non-GAAP measures to comparable GAAP measures in the tables that accompany today's release.

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

**Peter J. Gundermann:** Thanks, Debbie, and good morning, everybody. Our agenda today is as follows: I'm going to start with a discussion of some of the major issues facing the company, not only in the fourth quarter, but looking a little bit backward and a little bit forward. There are a number of them: three on the aerospace side and two on the Test side. Then I'm going to turn it over to Dave, and he's going to walk us through the numbers, both on the income statement and the balance sheet. Finally, we'll talk a little bit about the future to the extent that we can see it; and do the normal question-and-answer at the end.

So major events, starting with the Aerospace segment and probably the elephant in the room. The 737 is a challenge for us. When we released third quarter results in the first week of November, at that time, we issued preliminary revenue guidance for 2020. There were some assumptions stated as part of our revenue guidance. Specifically, we assumed that the 737 MAX would see a return to service at or near year-end. And, at that time, we would expect a pretty quick production ramp from 42 airplanes a month to 47 a month, eventually going to 57, probably sometime out in 2021.

Those expectations proved way off base. Instead, 42 aircrafts a month have gone to zero and 800 airplanes plus remain grounded. The 42 airplanes a month going to zero affects us because we put about - just shy of \$100,000 of product on each airplane as it's built. That's about \$4 million a month in revenue. That's a good business for us. It's one of our largest production programs actually at 42 or 52 units a month.

The 800 airplanes grounded essentially cuts the capacity for the airlines around the world. And, given the lack of capacity that they have, they are reluctant to take airplanes out of service for the passenger amenity aftermarket products that we offer. So as many of you know, most of our products are not flight critical that we do in the aftermarket, it is an amenity. And, with a shortage of capacity, we have seen starting late last year, a tendency towards deferral, where programs that were in process, have been pushing out. This is evidenced in our Q4 bookings. Our aerospace bookings were \$140 million, that's the last page of our press release that is well off the pace of recent history. You've got to go back a few years for us to be at that level.

So we have been asking questions and continue to ask questions of ourselves and of our customers. Specifically, when will production restart? At this point, we are on a production pause, and we have discussions going on with Boeing. There's not a clear resolution to those discussions at this point, so we don't really know. And also, when will the return to service occur? That's not so much a Boeing question, that's an FAA question. Once return to service starts, of course, we'll have to figure out how those 800 airplanes get implemented by the airlines. And how will the airlines react and when will they return to normal.

In the meantime, given the lack of clarity, we have managed down our cost structure as much as we dare in our operations that are specific to the 737. We're down approximately 50 people, mostly on the direct side in those operations.

The second major issue in Aerospace is one that we're in a little bit more control of, and that is the three problem kids, or problem companies, that we've talked about quite a bit over the last year and a half or so, and we actually feel like we're making lots of progress in this area. The fourth quarter operating loss of the three combined was \$5.1 million. That's a lot, but it's down from the average of the first three quarters, which was \$9 million.

So, a brief summary of the three. We've talked in the past about Armstrong. Armstrong in the fourth quarter was within shouting distance of breakeven, a \$200,000 loss, down from an average of \$800,000 over the first 3 quarters. We've talked in the past about how we feel Armstrong is basically out of the woods and okay. It's not probably sustainably profitable at this point, but we have integrated it into our CSC operation in Chicago. We've taken three Chicago locations down to two, and we expect it to be basically at or near breakeven throughout 2020. We think, basically, Armstrong is out of the woods.

CCC, our second challenge, similarly had a relatively good fourth quarter. The big highlight here is that CCC, in the fourth quarter, concluded the development process for its Avenir product, which is a state-of-the-art cabin management system for VVIP airplanes that we've been struggling with for about a year and a half, or a little bit longer. CCC, in the fourth quarter ended up with a \$700,000 loss, which again is a lot, but it's way down compared to its average over the first 3 quarters of a \$3.3 million loss. Going forward, we expect that drop in development expense basically, combined with the revenue increase, to bring CCC at or near breakeven also for all of 2020.

That brings us to AeroSat. I announced in our last call that we were doing a review of the AeroSat business, and we were planning to do a restructure. We have implemented that restructuring. It is a substantial restructuring, basically bringing the focus of the business, down from about 4 business initiatives to 1.

To give you an indication of the scope, the headcount in the business has gone from about 106 at the beginning of the year to about 44 today. And the breakeven is down from about a \$40 million level to \$10 million today. This was not an inexpensive exercise. The restructuring and impairment charges were quite a bit more than we thought they would be when we started the process, ending up at about \$29 million for the quarter. AeroSat had about a \$4 million operating loss in Q4. We expect that to drop to a level that's approximately half of that going forward and getting down towards breakeven at the end of the year.

In sum, when you look at the 3 problem kids cumulatively, the operating loss, excluding impairments and restructuring charges for 2019 was about \$32.7 million. We are quite confident today that, that's going to be, as we get to the end of 2020, depending on how things evolve with AeroSat, at or near breakeven. There could be a minor loss there cumulatively, but in general, the numbers won't be anywhere near what they've been in the past.

The third issue on our Aerospace segment was the reserve we took for a legal process that we've had ongoing in Germany. We talked about this in advance in the fourth and third quarter call also. The charge is more than we expected, and we are appealing it. We think the court's decision is deficient, and we disagree. And the appeal process, we expect, will last well into 2021.

The longer story is that this is a process that's been playing out since 2010. The original filings in 2010 were both in the U.S. and Germany. Now they have been initiated in France and the U.K. also. The technology in question, frankly, is not critical. It is not important. And in fact, we designed it out about 6 or 7 years ago, in 2013, 2014, when we first figured out that we were going to have an issue here.

In the U.S., the case basically ended with the patent being invalidated.

In Germany, the patent was downsized or reduced but still stood, and the penalty that came down in December was significantly higher than we anticipated. We took a reserve for \$17.9 million additional, bringing the total for Germany to \$20.6 million. That number is a bit of an estimate. There's a lot of moving parts to the order and some things that we don't know for sure at this point. It could bounce around a little bit as we go forward. But, until the appeal is heard and resolved, and again, we expect that in 2021, we don't think there's going to be major news in Germany.

France and U.K. are just getting started. The U.K. first, France will be second. And again, we think that will probably mostly be 2021 news, we don't expect too many issues to happen here in 2020 on either of these cases.

Moving away from our Aerospace segment, talking a bit about forces affecting our Test business. Our Test business in 2019 saw a significant year of transition. In February, we sold our semiconductor test product line. Followers of the Company remember that, I'm sure. It was a price of \$100 million. The net gain on the sale was about \$79 million. That shows up in our 2019 income statements as a gain on sale.

The revenue from our semiconductor test product line in 2018 was substantial. It was \$84 million total in 2018 and, as a result of the sale, just \$9.7 million in 2019, so a big drop off. Year-over-year comparisons for GAAP revenue recognition purposes are quite a bit misleading. This is a big part of the reason why we've gone to an adjusted presentation over the 4 quarters of 2019.

For Test in the second half of 2019, we added a couple of smaller acquisitions to reshape and refocus the business. We added Freedom Technologies in July and Diagnosys in October. Freedom is a radio test company. It complements our military focus with a product line geared more at municipal users like police forces or first responders or border patrol. Diagnosys is a complementary fit in the transit area for train test. That's an area we've recently entered, and we have some pretty strong hopes for this product line for 2020 and onward.

Our test business on an adjusted basis, backing off the semiconductor sales, saw very strong growth in 2019 of 62%, approximately half organic and the other half through acquisition. Margins are not where we expect them in part due to purchase accounting, but we'll talk about the future in a few minutes. Kind of a sneak preview on the test side is that we expect 2020 to be another year of pretty strong growth organically in the range of about 20%, although, we're not issuing guidance today. We rescinded that earlier this month, as you know, in the press release we issued on February 3. But the Test business, obviously, isn't affected by some of the unknowns in the aerospace world. We're thinking that our Test business should see a 20% growth year in 2020.

With that, I'll pass it over to Dave to talk through the numbers and take it back a little bit later.

**David C. Burney:** Thanks, Pete. As Pete touched on there was a lot of noise in the fourth quarter to cut through. So in addition to looking at GAAP results, as he mentioned, it makes sense to talk to adjusted results, removing sales and direct costs from our semiconductor test business, which we owned for the full year of 2018, but sold in February of 2019. Also, we removed the impact of the restructuring and impairment charges for our antenna business and the legal reserve that Pete just spoke to. We believe these non-GAAP measures will help users of the financial statements better understand the core performance of the ongoing business. Included in our press release from this morning are a few tables on Page 11 and 12, reconciling the GAAP numbers to the non-GAAP information. Also, if you refer to the footnotes, at the bottom of the income statement on Page 8 of the release, you can see geographically, the income statement lines impacted by these items.

Getting to the fourth quarter operating results. Fourth quarter consolidated sales were down \$4.5 million to \$198.4 million. This reflects a \$10.3 million decline due to the divested semiconductor test business, partially offset by added sales from the Diagnosys and Freedom Communications acquisitions that were also in our Test segment. Those added \$9.9 million of sales.

Aerospace segment sales decreased by 1.8% to \$172.1 million. This is a point where I'd like you to follow with me on Page 11 of the press release where we have the reconciliation of GAAP to non-GAAP information. We had GAAP loss from operations of \$36.9 million in the fourth quarter of 2019, which reflects \$46.7 million of restructuring and impairment charges and an increased reserve for the ongoing lawsuit. More specifically, in our antenna business, we took charges totaling \$28.8 million relating to the restructuring and refocusing of that business. And additionally, we increased the legal reserve by \$17.9 million, both of those are in the Aerospace segment. Additionally, to aid in comparing this year with last year, we removed the direct profit generated by the semiconductor test business in each period. Making these adjustments, we end up with an adjusted operating income of \$8.1 million, or 4.1%, on adjusted sales of \$196.5 million compared with adjusted operating margin of 8.1% in the prior year.

The 2019 fourth quarter operating margin was affected by higher legal and warranty costs, both primarily in the Aerospace segment. Additionally, affecting operating margins was \$6 million of sales of the acquired Test businesses that yielded very little margin due to the stepped-up basis to the related inventory required by accounting for acquisitions. We would typically expect contribution margins on those sales to be in the 30% to 40% range.

Going to the Aerospace segment for the quarter: Aerospace segment sales compared with the prior year's fourth quarter decreased by \$3.1 million, or 1.8%, to \$172.1 million. The drop was mainly in the Avionics product line, which declined \$4.1 million, or 13.1%, relating to soft in-flight entertainment and communication hardware sales in the quarter.

The Aerospace segment GAAP loss from operations was \$32.3 million. Adjusting for the restructuring of the antenna business and the legal reserve, the adjusted operating income was \$14.5 million, or 8.4%, of sales compared with 12.7% last year. The 2019 fourth quarter was negatively impacted by the previously mentioned increased legal and warranty expenses. The 3 struggling businesses had fourth quarter losses of \$5.1 million excluding the impairment charges, and we have a path forward to get these businesses, as Pete mentioned, to run near breakeven by the end of 2020. And, if they had breakeven in the fourth quarter this year, Aerospace margins would have been closer to 11% to 12%.

Going to the Test Segment sales in the quarter. Sales were \$26.3 million compared with \$27.7 million in the 2018 fourth quarter. Adjusting out sales of the semiconductor business from both periods, Test Systems segment sales rose from \$15.5 million in the 2018 fourth quarter to \$24.4 million this year. The increase was driven by the Acquired Businesses, which contributed \$9.9 million in sales in the quarter. Test segment had adjusted operating loss of \$1.5 million this year compared with an adjusted operating loss of \$2.3 million in the prior year. Operating margin was impacted by approximately \$6 million of sales that had little or no margin, as I previously discussed.

For the full year, consolidated sales were \$772.7 million, a decrease of \$30.6 million from 2018. Again, for comparability, we need to exclude sales from the divested semiconductor Test business from each period. This gives us adjusted sales of \$763 million, which was an increase of \$44 million, or 6.1%, for the ongoing business. Aerospace sales increased by \$17 million and Test sales increased by \$27 million.

GAAP consolidated income from operations was \$1.7 million in 2019 compared with \$63.7 million in 2018. Applying the same adjustments previously discussed to remove the impairment and restructuring charges of \$28.8 million, a legal reserve of \$19.6 million and the direct margins from the semiconductor business of \$6.8 million, adjusted full year operating income was \$43.4 million or 5.7% compared with adjusted income from operations of \$40.6 million or 5.6% in 2018.

Full year Aerospace segment sales increased by \$17 million to \$692.6 million, or 2.5%, compared with the prior year. Electrical Power & Motion sales increased \$35.1 million, Lighting & Safety increased

\$11.1 million and Avionics sales decreased by \$25.1 million. Aerospace GAAP operating profit for the year was \$16.7 million. Adjusted operating income was \$65.1 million, or 9.4%, of sales after adjusting for the impairment and restructuring charges and the legal accrual, compared with 10.5% in the prior year. Aerospace operating profit was negatively impacted in 2019 by increased tariff costs, which increased \$5.9 million compared with the prior year, as well as increased legal fees and warranty costs.

Test segment 2019 sales were \$80.1 million compared with \$127.6 million in 2018. The decline was entirely due to the divestment of the semiconductor test business in February 2019. Removing sales of the divested business from each period, adjusted Test segment sales were \$70.4 million in 2019, up 62.3% from adjusted 2018 sales of \$43.4 million. Organic sales increased \$14.1 million and acquisitions added \$12.9 million. GAAP operating profit for the segment was \$4.5 million compared with \$10.7 million in 2018. Adjusting out the direct profit margin from the divested business, adjusted operating loss was \$10.3 million in 2019 and \$13.4 million in 2018. Most of the loss in 2019 was a result of the \$2 million of restructuring charges that we recorded in the second quarter.

Over to the balance sheet. Our balance sheet continues to be in good shape. Net debt was \$156 million and our trailing fourth quarter leverage ratio, as defined by our borrowing agreement, was 0.9x adjusted EBITDA. This reflects the \$80 million gain that we recognized on the sale of the semiconductor business in the first quarter. Excluding that gain, the leverage ratio would have still been very low at 1.7x EBITDA. Our maximum leverage is 3.75x for our revolver borrowing capacity.

Regarding capital deployment, on February 3, we issued a press release announcing the pausing of a share buyback. Given the uncertainty surrounding the timing of the 737 MAX return to service and production and the impact that the Coronavirus might have on our markets, we feel the most prudent course of action is to take a conservative view on capital deployment. Focusing on conserving cash, we're paying down debt until the picture becomes clearer for us. In the fourth quarter, we did buy back 28,000 shares at a cost of \$800,000. And prior to the pausing of our share back this year in 2020, we purchased another 282,000 shares at a cost of \$7.7 million.

Pete?

**Peter J. Gundermann:** Okay. So looking forward for the rest of 2020. Again, on February 3, we issued a release that we pulled our revenue guidance for the year until the situation got clearer. Unfortunately, today, the situation is still not clear. We need a little bit of a firmer estimate as to a return to production for the 737 MAX, and we need some estimate, or some quality predictions, on return to service for the airlines. I'm hoping that when we talk again, reporting first quarter results in early May that we will have that clarity. If we get it beforehand, we'll issue guidance sooner rather than later. But I think for now, a reasonable expectation is that May press release.

However, we are in late February and within shouting distance of the end of the first quarter. We're expecting first quarter revenue to be light, \$155 million to \$165 million is what we're predicting. 90% of it will be Aerospace. We are expecting that we will strengthen significantly as the year progresses. Again, that depends, obviously, on the return to production and some reasonable return to service. But even apart from 737 MAX activity, we have kind of a schedule that's biased towards the end of the year with the rest of our book of work. So one way or another, we expect the second half to be stronger than the first half. The question is how much, and we will publish more results as soon as we can, but we've been surprised enough, I guess, by issuing expectations and having to pull them back that we are reluctant to do it again at this point.

I think that concludes our prepared remarks. Christine, we can open it up for questions now.

**Operator:** [Operator Instructions] Our first question comes from the line of Jon Tanwanteng with CJS Securities.

**Jonathan E. Tanwanteng:** Pete, maybe to start with, you were down 50 people, I think you referred to in operations related to the 737. I didn't catch if there was a charge related to that. And if those cost savings were evident in Q4, I expect not because they're still producing. How should we think of that expense coming down in Q1 and the operating margin in Aerospace heading forward?

**Peter J. Gundermann:** There wasn't much of a restructuring charge associated with those reductions, and they were late Q4, so you wouldn't see it much in Q4. But I think it's probably fair to say that it's a good book of business for us on the 737. So when the volume goes way down, we have a really hard time cutting costs proportionately just because we have too much infrastructure in those operations that we have to maintain and other business we have to execute on. So it's going to compress margins until we get back into some regular production cycle on 737. Dave, you want to add anything to that?

**David C. Burney:** No, I think that's accurate.

**Jonathan E. Tanwanteng:** Okay. And assuming we get to production, if you're starting by midyear, I don't know what Boeing actually end up doing or the FAA, but 40 planes maybe kind of aggressive in the beginning, but assume we get to 40, somewhere between 40 and 57 by 2021, when does the aftermarket actually come back for your business, particularly given all the planes that are being run overcapacity right now?

**Peter J. Gundermann:** It's a very good question, Jon. To be honest, we are asking the same question of ourselves. The 737 affects us those 2 ways. If Boeing announces they're going to restart production at whatever quantity, it's easy for us to kind of plug that into our models and into our factories, assuming that it doesn't stay shut down too long because then you lose some of that capacity permanently or it's much harder to bounce back.

But the aftermarket side that you're asking about is a very important question for us. And frankly, we're at a little bit of an unknown situation. We've never been in a situation where the industry has gone through this kind of hiccup. With this many planes on the sidelines, there are wildly varying predictions as to how long it's going to take to get those airplanes back in the service, and we don't pretend to be experts in that. We don't know. I mean I've seen predictions for 1.5 years, I've seen much faster predictions, like a quarter. But the question that you're asking is even beyond that, which is when do the airlines start kind of resuming normal behavior, as we would understand it. And I would assume that, that's linked to a return to service, but I don't know how closely.

So for example, if it takes 1.5 years to get airplanes into the air, it could be that the airlines resumed their plans and their fleet upgrades immediately, knowing for sure when they're going to get airplanes and they can start in advance with that work. It could also be, on the other hand, that some of them are more conservative and want to wait until they have the airplanes in their hands and in their fleets. We just don't know the answer to that yet. It's a fair question. It's one that I think we need to keep asking, but it's one that I can't honestly sit here and tell you we know the answer.

**Jonathan E. Tanwanteng:** Okay. That's fair. Maybe a bit more color on the, I guess, 800 planes that are sitting on lots right now. How many of those have your aftermarket products installed on them? And maybe how many are in the queue to get them installed? Because those will be the quickest to come back into service, I would assume.

**Peter J. Gundermann:** Very few of them have our aftermarket product on it, very few. Half of them are new builds, so they just got off the production line, so they would have no aftermarket, by definition. The other half are relatively new airplanes, been out there for less than a year or so, 1.5 years maybe. 1.5 years in service I mean.

**Jonathan E. Tanwanteng:** With them sitting on a lot be an opportunity for them to be upgraded to in-seat power and then connectivity and all while sitting there?

**Peter J. Gundermann:** Well, I can tell you, nobody's doing that. Nobody's touching those airplanes.

**Jonathan E. Tanwanteng:** Okay. Dave, one last one. Just how much legal and warranty expense was there outside of the reserve that you took? And does that roll over into 2020?

**David C. Burney:** Well, I don't expect the warranty expense overall will roll into 2020. Combined, it was about \$4 million in the quarter.

**Jonathan E. Tanwanteng:** And was the legal side bigger than the warranty side or were they about the same?

**David C. Burney:** No, the warranty was about 2/3 of it.

**Jonathan E. Tanwanteng:** Okay. Got it. Are there any other charges that we should be aware of that may impact you in Q2 or anymore going forward?

**David C. Burney:** No.

**Operator:** Our next question comes from the line of Ken Herbert with Canaccord Genuity.

**Kenneth Herbert:** I just wanted to ask on the MAX. A lot of suppliers that sell to Boeing directly, like you do, for the PSUs have indicated that they're getting signals that they should start production again in April or around that time frame, obviously, at sort of lower rate. Is there anything else you can comment on or anything else that you can share regarding sort of where your discussions stand and your expectations as to when you might start to ship MAX product again to Boeing directly?

**Peter J. Gundermann:** Sure. We do have ongoing discussions, but they're not firm at this point. So we are asking for certain accommodations to keep the production line going, frankly. We've not gotten a positive response to that. But in general, we read and hear similar things to what you're describing, Ken, kind of a slower rate stood up at the March/April time frame in that going for quite some period of time, so late in the year. But we don't have firm guidance on that at this point. If we did, that would be enough, I think, for us, to put some kind of guidance out there, but we just don't have it yet.

**Kenneth Herbert:** Okay, that's reasonable. And with the cost actions you've taken, when you do start to ramp MAX production, how long will it take? Or what volume do you need to get back to before on the MAX, you're may be at sort of segment margins? Or how do we think about the margin progression on that?

**Peter J. Gundermann:** It's a good question. I think if we can get back in the production at a steady state at even half of what we did last time, or up until the shutdown, we were at 42 a month, so if we could get that half back, I think we'd be in pretty good shape, especially given the cost-cutting and the progress we've made with the other 3 businesses. I mean that's a big margin pickup for us. And for the most part, that pickup has nothing to do with 737, a little bit of CCC because CCC's market for VVIP airplanes is dependent on the MAX a little bit. But for the most part, that margin pickup should happen, kind of regardless of what's happening with the 737, which affects us more in other parts of the business. So I will feel a lot better when we get back into production. But then again, of course, return to service is also important for the reasons I've already discussed.

**Kenneth Herbert:** Okay. That's helpful. And just finally, you obviously did 2 small acquisitions on the test side in the second half of '19. As we think about capital allocation, how should we think about M&A activity this year? And is it still something you're looking at? Or is that maybe getting sidelined a little bit here just until you get better certainty on the business?

**Peter J. Gundermann:** Yes. I think it's probably safe to say it's a little bit sidelined. I mean we have our eyes open, you always have to because it's not up to us when a good acquisition candidate becomes available. But our first priority is to execute on the things that are in front of us and prepare ourselves for the future as best we can read it. And to that extent, that takes some attention away from the possibility of acquisition. I think, also, it's probably safe to say that most sellers in the market right now are probably thinking twice about that and pulling back a little bit. So I think the whole activity level is slowing down a little bit.

**Kenneth Herbert:** Okay. Just one final question. There's obviously a lot of concern with the virus on supply chains, and I know you've been working to maybe move some of the work out of China on your supply chain. Can you just give any high-level comments on to what extent you're maybe seeing, the impact of this yet on your business, either supply chain or customer demand? Or how we should think about that? Obviously, a lot of uncertainty there, but any more color around that would be great.

**Peter J. Gundermann:** Yes. Well, there is a lot of uncertainty, as you said, and it wasn't in our prepared remarks because we don't have anything firm to say about it, but there are 3 potential impacts for us. One is, obviously, it is hurting airlines right now, and anything that hurts airlines risks hurting us. But we've not seen or had that virus fear used as an explanation for a lack of demand in the market. That's not what we're hearing at this point. So we've got our eyes on it. We obviously have close relationships with airlines. But at this point, that's not a major driver.

The second potential impact for us is sources of supply. We are pretty vertically integrated in most of our businesses, but we do some sourcing out of China. For better or for worse, we've been actively trying to move many of those supply chains, in part, because of tariff expense, and we've made a lot of good progress. And so far, we're not aware of major supply wrinkles. But people in China are slowly getting back to where factories are slowly getting back to answering phone calls. So we're not exactly sure if we're going to have much of an issue or not. Most of what we do there is pretty low level assembly, mechanical or electrical, electronic circuit boards or some metal work maybe, but it's not terribly limiting in terms of sources of supply. So we could do most of what we do in China somewhere else. So at this point, that's not a major issue for us.

The third area, is we actually have quite a bit of sales activity going on in China. And like anywhere else in the world, if you're going to do an aftermarket sale to an airline, they have a process they typically go through and that process typically involves flight trials and fit checks, and some of these things can take 2 or 3 months to go and to run the course, and you have to run the course before you get kind of a big production order, and we are seeing those efforts push out. So again, not major things that we necessarily are wringing our hands over, but 3 areas where we're watching it, kind of airline traffic, our development programs and sources of supply, but nothing major to say today.

**Operator:** Our next question comes from the line of George Godfrey with CL King.

**George Godfrey:** The first one is, I wanted to follow-up, Pete, on your comments around acquisitions and thinking about the last 5 years and the challenges you faced in the semiconductor business and the 3 businesses we have. Do you think the complexity of the business is such that doing more acquisitions just brings in more volatility or difficulty, and therefore, perhaps the business or the capital should be allocated more towards share buyback? And anticipating you saying no, we can do more acquisitions, but I'm thinking about AeroSat, for example, where the issues were not with Astronics but with the partners, so even if you've got your arms around the company you buy, the partners you deal with may not, and therefore, you have these problems that can keep lingering on. That's the first question.

**Peter J. Gundermann:** Well, I will grant your charge there. And certainly, acquisitions bring complexities, no doubt about it. So that's something you have to weigh in from a risk analysis, and we've obviously missed a few here recently. So I think we've learned some lessons and we can carry that forward. And like I said, you have to keep your eyes open because you never really know. But at this point, we're not feeling a tremendous amount of pressure to do an acquisition for sure.

And your other question about buybacks, with the share price where it is currently, I think that's a compelling use of capital compared with anything else we might do with it right now.

We're not buying shares right now. As Dave said, I think we have a responsibility to be a little bit conservative as managers of the company's assets. Given the questions in the market and the continual, I guess, slide in one of our major programs, the 737 MAX, we want to get that under control. But we're aware of the trade-off of external investment versus internal investment, and I think we will continue to balance our priorities as opportunities permit.



**George Godfrey:** Okay. And then my second question is if I look at the 3-month period just ended versus last year, and I'm looking specifically at the Aerospace segment, \$172 million this year versus \$175 million. And, if I look at the margin and add back the \$5.1 million you talked about to the adjusted Aerospace operations, we're still below what the margin was a year ago. And I'm guessing those 3 problem businesses were contributing to the loss there. So my question is, is the product mix today fundamentally less profitable than it was a year ago? Or is the customer demand for the certain revenue mix changing, such that the revenue might not look different, but the profitability of the revenue mix results in it being less profitable on revenue stream as we move forward? And if that didn't come through clearly, I'll restate it.

**David C. Burney:** Yes, I think George, we also have the increase in the legal and warranty costs that were primarily in the Aerospace segment. And we had an increase of tariffs compared to the year before, for the year anyways.

**George Godfrey:** Okay. So the estimate, just very simple, so \$100 of Aerospace revenue today and going forward, even if revenue mix shift with customer demand or specific product changes, the net result is that \$100 should be every bit as profitable as it was today or 5 years ago?

**David C. Burney:** Yes. I mean, we typically talk about the leverage we have on our incremental sales being 40% plus, so I think that's still applicable to the model today.

**Operator:** Our next question comes from the line of Dick Ryan with Dougherty & Company.

**Dick Ryan:** Say, Pete, at the Q1 guided level, are you guys anticipating profitability?

**Peter J. Gundermann:** We are, Dick. It will be close, but we should be profitable at that level.

**David C. Burney:** It's a low single-digit operating income level at that point. But to be clear, if we expected we were going to continue to operate at that \$155 million to \$165 million quarterly revenue level, we would make some changes, more changes than what we've seen over the last 6 months. We don't expect, while we're not providing some detailed guidance, the business is not currently staffed to run at \$163 million rate. We're staffed to run up to a \$200 million plus quarterly rate, and if we didn't expect that, at some point, we would be making some significant adjustments.

**Dick Ryan:** Sure. Okay. On the legal side, is there any historical precedent that would suggest the U.K. or France goes more towards a U.S. ruling or towards a German growing?

**Peter J. Gundermann:** That's a very good question. The rules, it turns out, vary pretty dramatically from country to country. There is a set process that you go through, and you kind of started at the beginning over and over in each country. Different lawyers, same material. From a cost standpoint, one of the good things I guess, is that we've kind of been over this a couple of times now, so we wouldn't expect to have the same level of cost, repeating the argument in the new countries. But they are different, the period of performance is different, the damages calculation techniques are different. And some other rules, well the way the product gets to the country, the applicability towards the patent infringement rules there varies too. And I'm talking a little bit in code because I've got to be a little bit careful, but it is basically starting all over. And you can't help but notice that the U.S. company wins in the U.S., and the German company wins in Germany, and maybe that's just not the way it always works, but I wonder how many times the U.S. company wins in Germany and the German company wins in the U.S., it'd be interesting to run an experiment. I don't know. But we're moving to a relatively neutral turf in these other 2 countries. So to the extent that there's a home advantage, and I don't know if there is, but to the extent that there's a home advantage, you'd expect it to be a little bit more even in those other 2 locations.

**Dick Ryan:** Okay. Say, now that AeroSat's more focused on the business connectivity front, can you kind of handicap where do you think the competitive landscape is today, Pete? I mean you've got satellite options, obviously, with your offering, and you've got some air to ground competition as well. How is the progress with the new partners on the business jet offering looking? And what's your sense of that market rolling out?

**Peter J. Gundermann:** Well, our main partner there is Collins Aerospace, and they are a very credentialed company. They are very successful, obviously, in a lot of ventures, and they have a lot of fingers in a lot of places. And so far, I'd say we think things are going pretty well. We have made some changes to our product, partly driven by improvements on our side, partly driven by requests on their side, and we think the combination makes a compelling product. It's a little early to put detailed plans out there as to how we're going to succeed, but we're optimistic. And you're right, there are competitive offerings today, for a plane that flies primarily domestically over North America and air to ground installation is relatively cheap and effective, it may work better in many circumstances. But for bigger airplanes that go across the water, those options don't work. So that's where our market really is. And I guess we feel we're a little bit cautious, obviously based on our experience, but we're giving everything we got to this one program, and we're very focused on that. As the year progresses, we should be able to start talking about installation rates and STCs. At this point, it's mostly a certification exercise.

**Operator:** Our next question is a follow-up question from George Godfrey with CL King.

**George Godfrey:** I'm just kicking this thing around in my head, and I'm thinking back to my question on complexity. And I want to use the lawsuit you mentioned about winning in the U.S. and winning in Germany that even if you're in the right and fully recognize that, the NPV of victory is just not as great as the time it uses up with management's bandwidth to focus on other issues, and so I'm using that as a data point or an issue in the California plant or Washington where you say, "You know what, I just can't deal with that right now. I've got to focus on other things." Does that thought process come in where you just have to bite the bullet and just say, "Yes, we're right, but we need to move on."

**Peter J. Gundermann:** Well, in this case, just for a little more background, the history stems from activities that happened way back, like in 2000, 2001, 2002, 2003. The activities are central to our in-seat power product line, which we've owned for, I don't know, 17, 18 years, about that time. And there has not been and is not a reasonable option to walk away based on disagreement of the parties, just not an option, frankly.

So this is something that we have to go through. We don't prefer not to spend time or money doing this, but you don't always have your choice. We'd prefer not to deal with 737 groundings either, but we don't have a choice. This is one of those things that's kind of central to one of our core technologies. We think it's frivolous to a large extent, but we got to compete it, so not much of an option.

**Operator:** We have reached the end of the question-and-answer session. I would now like to turn the floor back over to management for closing comments.

**Peter J. Gundermann:** No closing comments. Thank you for your attention. We'll look forward to talking with you at the end of the first quarter. Have a good day.

**Operator:** Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation, and have a wonderful day.