REPRINTED FROM MARCH 7, 2024

THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Astronics Corporation (NASDAQ:ATRO)

PETER J. GUNDERMANN is Chairman, President and Chief Executive Officer of Astronics Corporation. Appointed President and Chief Executive Officer in 2003, Mr. Gundermann has been with the Company since 1988. Mr. Gundermann has been a director of Astronics since 2001 and was appointed Chairman of the Board in June 2019. He holds a B.A. in Applied Mathematics and Economics from Brown University and an MBA from Duke University.

SECTOR — AEROSPACE/DEFENSE

TWST: It's been a few years since you've spoken with The Wall Street Transcript. Let's start with a review of the company.

Mr. Gundermann: We are primarily an aerospace systems supplier, which makes up 85% to 90% of our business. And those systems revolve around lighting systems, in-flight entertainment or flight critical electrical power.

The remaining 10% to 15% of our business is within our test segment. Our main thrust there is radio tests — testing radios and communication devices for the armed services or first responders like police forces. We also test transit systems, working with municipalities that operate train and subway systems.

TWST: What types of radios?

Mr. Gundermann: It's for highly complex radios that, for example, the Army uses, which involve all kinds of encoding and decoding systems and frequency hopping. Basically different technologies designed to keep the user disguised and hidden and undecipherable from bad guys.

So the U.S. military, for example, has like 500,000 radios, and roughly 26 different families of radios. What they need is a single piece of hardware that can test all those radios, all 26 families. That's the kind of technology we get involved in and the kind of systems we provide.

TWST: Back in 2018, the split between aerospace and test was more like 80/20. Was this an intentional shift, just one side growing more than the other, or something else?

Mr. Gundermann: The big change from 2018 is that, at that time, we had a semiconductor test business. It was about half of what we did in test, and we sold it about that time.

TWST: In aerospace, overall, what's the split in business between military and commercial markets?

Mr. Gundermann: Being an aerospace company and still recovering from COVID, these are not quite yet normal times. In normal times, our test business is about 10% of our overall volume, another 10% of our overall volume is military aircraft. So, Sikorsky Black Hawk, Lockheed Joint Strike Fighter, F-18s, F-15s, F-16s, Apaches, all the different military aircraft, both fixed wing and rotary wing. Another 10% is private aircraft or business jets in particular.

So you've got 10% business jet, 10% military, 10% test, and then the remaining 70% in normal times again would be commercial transport, which is basically the commercial airplanes that Boeing and Airbus make most prominently and that are operated by airlines around the world. So, heavy exposure to the commercial transport market.

TWST: A lot of people think that COVID is over, we're back to normal. But you're discussing it as something that's more significantly ongoing in terms of its effects. Can you please go into that more?

Mr. Gundermann: In many respects, it is over, and the world's moving on and recovering. But for companies in certain business areas, it was really a traumatic hit. Given 70% exposure to the airline market or commercial transport market, it was a really big hit against us.

If you look back at our revenue over the last few years, before the pandemic hit, we were more than $770 million in 2019. And again with 70% exposure to that market, it just really kind of dried up. And two years later, in 2021, we did about $445 million, which was a huge drop. And since then, we've been clawing our way back.

We did $535 million in 2022, which was 20% growth. And last year in 2023, we just wrapped up at $689 million. That was almost 30% growth.

So, really strong recovery, but the reality is that we as a company were positioned for prosperity up around $770 million, not at $500 million, not at $600 million. We've incurred a lot of losses, and we're just now getting back to the range of where we were pre-pandemic.

That's why I say we're coming out of it. It's a recovery in process. We've released revenue guidance for 2024, which has us finally back in that range of where we were in 2019, and we expect to be solidly profitable and cash positive. You might ask, with the big revenue hit, why didn't we cut cost?

TWST: I was about to.

Mr. Gundermann: It's a logical question. The reality is we could have, this is a high variable cost business. And we can make it profitable at pretty much any revenue level. But in 2019 when the pandemic hit, we were on the verge of winning a wide range of exciting new programs, which would require a lot of engineering effort.

"As we enter 2024, what's exciting is we've got a record backlog or very nearly so. We've got a supply chain that's much more competent than it's been over the last two or three years, and an employee base that is settling down. The combination, I believe, gives us confidence that 2024 is going to be a good year."

We made the calculated decision back at that time that the company in the long run would be better off accepting that work and continuing those programs, even though it would mean a higher cost structure than we would otherwise have.

And we were successful winning those programs. Today I can tell you that we're well on the way. Many of them are completed and others are going to be long term initiatives.

But I think the vision that we had back then, the goals that we had, have largely been achieved. So, I think we're going to come out on the other side really happy about that thinking and that thought process and those decisions back in 2019 and 2020.

However, to be honest, back in 2020, we thought the pandemic would last maybe six months, we didn't think it would last multiple years, so it was longer and deeper than we expected. And it was a stressful time in terms of significant losses for the company and financial stress.

All that's getting better, and I expect 2024 will be kind of a completion of the recovery, which is a good thing for our company.

TWST: Well, when I was looking at your financials over at S&P Global Intelligence, I noticed that suddenly, bang, you were running at a loss for years when you hadn't before. Occasionally you did in a year, but that happens with most companies. This makes sense. You also, it seems to me, had to make the calculation of, do we make things look good in the short time, or do we lose a lot of intellectual capabilities and internal knowledge and the like that would make starting up again a lot harder.

Mr. Gundermann: That's exactly right. And again, it was a conscious decision to maintain capabilities and expertise that we needed to execute on those new programs.

But I should also make clear that we did cut a lot of costs. We shaved a lot of things to the bone. Our employee count went from about 3,300 people before the pandemic down to about 2,300.

We cut back on the obvious things. Our capital spend has been on a bare bones basis for years, and trade shows and travel and incentive plans have been suspended. We're just now reinstating those also. There are signs of recovery everywhere.

We cut costs everywhere we could, but we also at the same time wanted to keep our focus on some of these new opportunities, which are going to pay off in the coming years.

TWST: So, there were deep cuts and a lot of layoffs. That's a significant number. But still, you could have gone deeper but couldn't if you were going to maintain the long-term view.

Mr. Gundermann: The shareholders that we have, by and large, understand that. And they know that. They are confident in our ability to get back to prosperity.

One of the things that's given them a lot of confidence over this time, over these years, is that our bookings were really strong. Our book-to-bill for 2022 and 2021 in particular, was like 1.3. We were stacking up record backlogs during that time and also through most of 2023.

The challenge for us, and as it was for most companies in the world, not just in our country and not just in our industry, had to do with supply chain mess-ups, and an inability to get the components that you need to build your products. That's great to get the orders, but we couldn't ship the products.

And the secondary concern was just the great resignation. I mean, all the churn in the employee base. Like many companies, we were used to a pretty low turnover rate of low single-digits every year. And for a couple of years there, we were closer to 15% or 20%, which really does a number on the efficiency of your workforce at all levels.

The good news about today is that the supply chain is largely straightened out, labor supply or availability has consistency settled down. The churn rate is much lower, and also inflation during that period peaked, and is coming down.

As we enter 2024, what's exciting is we've got a record backlog or very nearly so. We've got a supply chain that's much more competent than it's been over the last two or three years, and an employee base that is settling down. The combination, I believe, gives us confidence that 2024 is going to be a good year.

TWST: And you also had that lawsuit from Teradyne, right?

Mr. Gundermann: We have a couple of lawsuits that have been going on for some time. Teradyne is one of them, that's in our test business, and it started off as a patent infringement suit that they brought against us. Long story short, we got the patent annulled, thrown out, then it morphed into a trademark or a copyright right.

TWST: Copyright right over the application programming interface, or API, to interact with their software, like the Google and Oracle fight over the use of the Java API by the former, right?

Mr. Gundermann: Right, exactly. In December we got a legal decision that we were successful. Basically, there are four points of contention, and we won on all four. So it was a significant expense item in 2023. I'm hoping it dies down and goes away in 2024.

But as is the case in most legal disputes, they have the right to appeal, and they may do so. If they do appeal it, I expect it will kick back up again sometime middle or later of 2024.

TWST: Yeah, it becomes an issue of cost management, too. They think, "Do we peel and try to keep somebody from using our API, or do we stop paying lawyers?" It sounds like a joke, but that's how litigation is viewed in a lot of corporations.

Mr. Gundermann: Yes, and if there's a cost benefit analysis to settling something like that, we're more than happy to consider it. We frankly have not seen a viable path that way. It's a lot cheaper from what we see to pay lawyers to win the case. So that's what we're doing.

TWST: And what is the other lawsuit?

Mr. Gundermann: The other legal dispute is with Lufthansa Technik, a German company, a division of Lufthansa Airlines. That one has been going on for over a decade, actually. It started in 2012, and it has to do with a safety mechanism or a safety feature on one of our product lines that provides electrical power for passengers in airplanes.

If you sit in a commercial airplane and you plug your computer into an outlet or your phone or whatever, that's more than likely our system. We have like 90%-plus market share around the world on that. And we have been involved in a dispute with Lufthansa Technik over that safety feature.

It was a lawsuit initiated by them against us for patent infringement. It's been playing out in four countries, the U.S., France, the U.K., and Germany. We won in the U.S. The patent was annulled, and that's been settled for a couple of years.

We are strongly winning in France. They are appealing to the equivalent of the Supreme Court there, but that's not going to be heard until sometime later in 2024. But we're winning there.

In the U.K. and Germany, we're losing. So, you might ask, how is it that you win in two countries and lose in two countries? It turns out that there are slight differences in patent law and slight differences in some of the patents filed in those various jurisdictions.

Anyway, all this to say that this Lufthansa dispute is also kind of in a dormant phase. It will pick up later in the year, and I'm hoping that it wraps up finally in 2025. We're optimistic that will be the case.

TWST: And I'm assuming the U.K. and France are because of Airbus.

Mr. Gundermann: In this case, most of the infringing product, or the product assumed to be infringing, went on wide-body airplanes. And most of the wide-body airplanes over the last 25 years have been built in the U.S. by Boeing or in France by Airbus. Airbus builds the A380 up in Germany, but the A380 was not a high-volume airplane. So A330, A350, A340 are all built primarily in France.

We want to win in France and did win in the U.S. The U.K. and Germany are important, in part, because Germany is where the narrow-body airplanes are built, A320s in particular. They're also built in other places, but mostly in Germany.

Because it's an electrical outlet that is mounted on seats, the seat companies get dragged into this dispute. Those seat companies are not only in the U.S., but in France, in Germany, but also in the U.K. So that's how the U.K. gets involved.

TWST: Speaking of aircraft, Boeing is traditionally a large company of yours — I saw around 11% of sales in the 2022 annual report. The company has had a rough number of years. And again, new problems with the 737 MAX. How is that affecting you?

Mr. Gundermann: We have been heavily affected over the last few years with some of those problems that you referenced. The 737 has traditionally been our biggest program, and they actually shut it down. I mean, they stopped building for a while as the pandemic started. That was a very painful phase.

And the 787 has also had its manufacturing difficulties as they shut down production in Seattle, and they started it up in Charleston.

The good news is that despite all of the troubles, which are well-documented in the press, demand for those airplanes remains strong. The 737 has a backlog that goes out for years. The 787 is widely considered the most prominent wide-body airplane out there these days.

The FAA has got a little bit of an issue with production rates these days. I think eventually Boeing will get past that, but they want to ramp up production. And the world needs Boeing to be successful.

So they are an important customer of ours. We want them to be successful, and I'm confident that they will eventually get there.

"I should also point out though that we do quite a bit of work for Airbus. If you're going to be an aerospace systems supplier, Airbus is pretty important too. We don't put as much product on Airbus airplanes on the production line, but we certainly do on an aftermarket basis all around the world."

I should also point out though that we do quite a bit of work for Airbus. If you're going to be an aerospace systems supplier, Airbus is pretty important too. We don't put as much product on Airbus airplanes on the production line, but we certainly do on an aftermarket basis all around the world. So both of those companies are important to us.

TWST: That's really interesting. I had never thought about an airplane aftermarket, but it makes sense. And then how about Panasonic? It used to be listed as a significant customer, like 11.1%. Now it's down to under 10% of consolidated sales. What happened there?

Mr. Gundermann: They're still an important customer of ours.

TWST: I should say, I'm not trying to minimize. But it's less than 10% now versus the previous 11.1%. That seemed like an important threshold.

Mr. Gundermann: The story there is that Panasonic makes in-flight entertainment systems, and we sell components that they use in their systems. And not only Panasonic, but a couple other prominent companies, Thales and Safran also.

Those three companies specialize in making in-flight entertainment systems that go in airplanes where there is a screen in front of the passenger. If you're sitting as a passenger and there's a screen in front of you, chances are that system came from one of those three companies, though Panasonic is the largest.

TWST: In the seat in front of you, not the overhead, right?

Mr. Gundermann: Right. If there's a screen on the seat in front of you. Now, most of those systems are found on wide-body airplanes around the world. In fact, almost every seat in every wide-body airplane has a screen in front of you.

Over the last few years, the 787 was basically on hold and stopped production for a while. The A350 was cut way back at Airbus, and wide-body air travel in general was significantly reduced. Therefore, Panasonic's business was significantly reduced, and Thales' and Safrans', and therefore our sales to them was significantly reduced.

The fact that they dropped below 10% mostly has to do with effects of the pandemic. That will likely change going forward.

TWST: When I was going through the 10-K, I couldn't find any mention of R&D, research and development expenses, which is unusual, especially in a company where R&D would seem to be critical to your lines of business.

Mr. Gundermann: Yes, it is. And we spend quite a bit of money in what most people would consider R&D. We don't have an R&D element that we break out in G&A. It's rather buried in cost of goods. And if you go back, for many years we used to break it out separately as E&D, Engineering and Development. We will eventually split it out as an identifiable number, as most companies do, but we haven't done it yet.

TWST: Do you know when you're planning to do that?

Mr. Gundermann: You have to have history so you can go back and do comparator numbers. We're collecting that data, but you have to do it basically for two years before you get to the point where you can break it out.

TWST: Have events in the Ukraine-Russia war and in the Middle East had an impact?

Mr. Gundermann: Not a major one. There actually are important elements of the supply chain in Ukraine for aerospace in general, but not for our business. And the Israeli-Hamas conflict is not something that has affected air travel or the supply chain either very significantly.

The most relevant thing is that we have an engineering operation in Ukraine, in Kyiv, with about 40 people who are important to our operation and have managed, even with the war going on, to continue to do their work and do a good job, so we're grateful for that.

And at the same time, they're doing their best to survive in a war zone. Some of them have actually gone off and fought, and we support that and respect that also.

TWST: There's a lot of dysfunction in Congress, to put it mildly. How might that affect your business during a major election year? I'm thinking in terms of budgets and allocations and the fighting that's been going back and forth, which puts politics ahead of governance a lot of times.

Mr. Gundermann: Yeah, it's frustrating, no doubt. I don't think we're terribly at risk. Most of the programs that we're on are well-supported and well-funded with multi-year plans.

The only exception comes in the area of a potential disruption to contract awards. If the government were to shut down, some of the machinery that is required to actually initiate contracts or evaluate proposals or make awards, that machinery can get clogged up. So there is a potential risk there for us. And there are some significant awards that we're expecting in the first half of this year.

I would prefer not to see a shutdown. But the bigger picture in terms of funding and support for programs, if the government shuts down, Lockheed is still going to build F-35s. So that's where we'd come in, we're a supplier to Lockheed. So we're OK for the most part.

TWST: What are your company's biggest challenges and opportunities in the coming year?

Mr. Gundermann: The biggest challenge will be another year of recovery and growth like we've been talking about. We grew 20% in 2022, we grew 28% last year in 2023, and we've issued guidance that has us growing another 13% or 14% at the midpoint in 2024. And that's important to do because everything else being equal, the top line is heavily influential about what the bottom line looks like.

What we demonstrated in our fourth quarter was basically in the range of where we expect to operate on average in 2024, that we will be solidly profitable. We just need to string together three or four quarters in a row like that to prove it. And that's our biggest opportunity and that's our biggest challenge.

TWST: Anything we haven't touched on that you'd like to mention?

Mr. Gundermann: We didn't talk about FLRAA. There's a whole bunch of program things we could talk about. FLRAA stands for Future Long-Range Assault Aircraft and is a huge opportunity for us. It is the U.S. Army's successor program to the Sikorsky Black Hawk helicopter.

It has been awarded to Bell, a Textron company. The aircraft is called the V-280 Valor. Astronics has been awarded the electrical power and distribution system for that aircraft from Bell.

I expect that when all is said and done, I'll probably be long gone, because major airframe programs like this can easily run 30 to 40 years. We have a big piece of it, and it's a big award and a big opportunity for our company. The next couple of years will be heavy development.

By the way, this is one of the programs that we won during the pandemic that we kept a lot of engineering resources and staff for, one of the ones we were talking about earlier.

When production kicks off, this will have a very noticeable impact on our business. Everybody will know about it. That's one program that's really good.

The other one on the test side that we're waiting for is the Army radio test program. I described it somewhat earlier when I talked about what we did in our test business. But there is a very specific award that we're waiting for, which is a sole-source directed procurement award that we expect to have in hand in the first half of 2024. I expect it will be an IDIQ contract, which stands for indefinite delivery/indefinite quantity.

Over the next three or four years, I expect it to be worth $200 million to $300 million. That's a huge award for us, as our test business is about an $80 million business. That program should contribute $30 million or $40 million a year once it gets going on an $80 million base. So that will make our test business look a lot better.

TWST: Right. That would be a jump of, what, 37%, 38%?

Mr. Gundermann: Yes.

TWST: Thank you. (EBS)

PETER J. GUNDERMANN
Chairman, President & CEO
Astronics Corporation
130 Commerce Way
East Aurora, NY 14052
(716) 805-1599
www.astronics.com
email: invest@astronics.com