ASTRONICS CORPORATION

NEEDHAM GROWTH CONFERENCE TRANSCRIPT

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Presenters and Participant

PRESENTERS

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Chairman, President & CEO

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Vice President & CFO

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Presentation

Chris Grenga
Analyst, Needham & Co. LLC

Good afternoon. Welcome to Day 2 of the 27th Annual Needham Growth Conference. My name is Chris Grenga and I'm a research associate in the Advanced Industrial Technology team at Needham. We are pleased very much to have Astronics Corporation with us here today.

Astronics is a leading supplier of advanced technologies and products to global aerospace, defense and other mission-critical industries, and provides an array of power, connectivity, lighting, structures, interiors solutions. The company is headquartered in East Aurora, New York.

Presenting from the company today is Peter Gundermann, Chairman and CEO; and Nancy Hedges, who was recently named CFO. Thank you for joining us, Peter and Nancy. Peter will present an overview of the business and then we'll open it up for Q&A after that.

Without further ado, Peter, take it away.

Peter J. Gundermann
Chairman, President & Chief Executive Officer, Astronics Corp.

Thank you, Chris. And good afternoon, everybody. Sorry for the delay. Somehow, we ended up with a presentation from this conference last year, dated January of 2024. Our performance these days is much better than it was a year ago, so we thought it was worth waiting a few minutes to make sure we got the right presentation up on the screen. We appreciate you bearing with us on that.

This is a standard company overview. There are some well-known faces in the crowd. For you, this is a review, and you could probably do this presentation for me if you'd step forward, but for others, I'll provide a general overview.

We're a small mid-cap company with a current market cap of close to $600 million. A couple of unique things about our structure. We have pretty heavy insider ownership, about 9% of the company these days, and we have two classes of stock. The difference is that Class B shares have 10 votes per share, while common shares have one vote per share. Class Bs do not trade, but they do have economic value, because you can convert them to common at any time.

A couple of important things to understand about our business. At a very top level, we report in two segments. We are an aerospace supplier. Primarily, about 90% of trailing 12-month revenues are in the Aerospace industry. A much smaller portion of our business, about 10%, typically is in the Test business. So, we act and feel like an aerospace company.

The pie chart on the right here is important to understand. It looks at sources of revenue by certain markets. You can see that two-thirds of our revenue in the last 12 months was from the commercial transport industry, commercial transport or commercial airlines built by Boeing and Airbus, primarily operated by airlines around the world. That concentration is what I want you to think about.

Our company had a real adventure going through the pandemic as the commercial transport industry basically collapsed, so our revenues dropped pretty dramatically. We've been climbing back with the recovery in commercial aerospace, and, while that's been happening, we've won a number of new programs, which, while not necessarily affecting our income statement in a positive way right now, we expect will contribute very heavily to our results in short order.

So, thinking about 66%, two-thirds, concentration in commercial aerospace and the collapse of commercial travel during the pandemic, this is what our top line has done. The bar chart way over on the left looks at what our revenues were in 2019, right before the pandemic hit, $773 million.

You can see that we really dropped dramatically to $445 million over two years in 2021. That was not a lot of fun. It's not something I ever want to do again in my life, but since then, demand has bounced back very strongly. In the last three years, I think our average growth has been something like 21% per year, and we have pretty strong growth, we think, in our future coming up.

We're not going to talk a whole lot about it, but everybody is aware of supply chain problems that happened during the pandemic. Our products are very heavily dependent on electronics, so that global electronics supply chain mess was something that we wrestled with. Also, the Great Resignation, labor changeover, we went from 3,000 to 2,000 employees, climbing back to 3,000 employees where we are about now, was a complicated endeavor during the pandemic. And during that time of course, there was also a little bit of inflation, so input costs were pretty dramatic, both on the material side and the labor side. It's been something that we've been wrestling with on our income statement, but we think we have that largely straightened out as we head into 2025.

So, to understand our company, if you look at our press release, we have a number of different ways of presenting our company. This pie chart looks at four major strategic thrusts. That's how I think you can best understand our business. Approximately half our sales, these days, are in the in-flight entertainment and connectivity space. So, when you ride around in the cabin of a commercial airplane and you watch a movie or you watch a game or you stream content or you plug in your computer, or you go off airplane for connectivity, there is a very good chance that you're using some of our hardware.

That's a major market for us. It's a very interesting market. One of the interesting things about it is that, technically, it evolves very quickly. It has short life cycles, so the things that you can do with your electronic devices today are different than what you could do four or five years ago. People want to be able to do the same things in airplanes that they do in their offices or in their homes, and that creates a retrofit opportunity for us where we can obsolete ourselves and sell back to the same client upgraded hardware in relatively short order compared with typical aerospace life cycles where braking systems on a 787 today are very similar to a braking system on the 787 when it first flew a decade ago.

And then, our Test business is about 10%, our flight critical electrical power is about 10%, and aircraft lighting and safety is about 20%. We're actually one of the world's largest lighting companies for aerospace lighting.

So, we'll go through each of these really quickly to describe the business. And then, I'm going to turn it over to Nancy to go through some financials at the end.

I already talked about in-flight entertainment and connectivity quite a bit. In-seat power systems are a major franchise for us. Data loaders, file servers, wireless access points, little devices called modem managers that steer antennas to connect with satellites, those are all products that we manufacture and are all increasingly expected when people get on airplanes.

Some of you might remember when connectivity was a new thing. It came into existence, but it wasn't very good. Everybody wanted a better and better performance, and you're probably still in that camp. That's that continual evolution that I was talking about just a minute ago. It's an opportunity for us to continually improve performance in the airplane to what people expect and have grown used to on the ground.

We have some really high market share, the power side of it, in particular. We describe our businesses having 90% market share in in-seat power. This is a big deal. Every seat in every widebody airplane for the last decade, at least, has had power and we do like 90% of it or more.

More recently, narrowbody adoption has increased dramatically. There are like 30,000 narrowbody airplanes out there in the world, and no matter what continent you're on, in Asia or in South America or in Europe or in North America, people are increasingly digital and they want to be able to plug in and use their device for entertainment or work efficiently as they travel; and they want to get off the airplane with a charged device. They don't want to get off the airplane with an empty device, major product line for us.

In terms of lighting and safety, we break the lighting market into three different categories. There are the lighting systems that go on in the cockpit. There are the lighting systems that go on in the cabin. There are the lighting systems that go on in the exterior of the airplane. We're active in all three.

Here are some pictures to show some of our products. In the upper left, that's an F-35 Joint Strike Fighter. We do the exterior lighting suite in that. The picture on the right is a business jet cockpit with a Rockwell Collins avionics suite. We do a lot of work with Rockwell Collins, or Collins Aerospace, I should say. They're a major customer of ours. The lower left is a passenger service unit on a 737 MAX. If you sit in a 737 MAX and you hit that reading light above you or the oxygen system, you adjust the air gasper or, heaven forbid, you have an explosive decompression happen while you're flying and an emergency oxygen system comes down and you put it over your nose and breathe normally, that's all ours. And then, in the lower right, that is a Pilatus PC-12. We do exterior lighting and cockpit lighting on a lot of business jets.

A smaller product line, but an important one as we look to our future, is flight critical electrical power. This is moving away from a passenger amenity and to a flight critical system. So, the airplane doesn't fly without this system functioning, and our topologies are pretty unique. They're high reliability and they're becoming increasingly standard on new aircraft. They basically revolve around electronic circuit breakers, which are different from the traditional thermal circuit breakers, the fuses - I'll show you a picture in a second about what that means - and also, high reliability generators and starter machines, spinning machines that instead of being based on traditional windings that have an MTBF in meantime between failure of, say, 600 hours to 1,000 hours, we use permanent magnets or induction-based machines which can run for 30,000 hours. So, we take technology that's available in larger, higher end airplanes and bring it down to small aircraft. That's really what our niche is here.

To demonstrate the point, here's a picture of an older Lear 45 cockpit on the left and a Pilatus PC-24 cockpit, a modern cockpit on the right. The thing I want you to observe is all the circuit breakers on the left side and the right side of the Lear cockpit. Those control every single load on the airplane, so every single load on the airplane runs from the generator to the cockpit and out to the final load. That’s a lot of wiring, it's load rated wire, and in the event of a fault, the pilot or co-pilot is responsible for managing those circuit breakers and resetting them as appropriate based on the problem that's happening in the airplane.

You don't see those circuit breakers on the right side. That's because they don't exist in the cockpit. They're electronic circuit breakers remotely located throughout the airplane. They have a number of advantages to them in terms of reducing wire weight, automating fault recovery, and also being flexible and stable. Those thermal circuit breakers on the left, 10 years into life, are very different from what they were when they came out of the factory, whereas the electronic circuit breakers, which are little computers, basically can be much more stable over time.

We've won a number of programs here. This is, again, only 10% of our business, but we think we're building a very valuable franchise. I want to draw your attention to the FLRAA entry, the second from the bottom, the Bell V-280. The FLRAA airplane is the planned replacement for the Sikorsky Black Hawk for the US Army. FLRAA stands for Future Long-Range Assault Aircraft. Bell has been awarded that program, and they have awarded us the electrical power generation and distribution system on that airplane. This is going to be a very big deal for us.

It's unclear or unknown at this point how many aircraft the US Army might eventually want. The number that's typically batted around in the industry is about 2,000 aircraft. Our shipset content, which is still in flux a little bit, we think, is going to approach or exceed $1 million an airplane. $1 million an airplane for a company our size is very significant. Typically, today, the largest shipset content we would put on an airplane is $400,000 or $500,000, so this promises to be a very significant program over its life.

The Sikorsky Black Hawk, for information, was designed in the early-1970s and has been in production since the late 1970s. It's still in production. If this airplane enjoys anything near that kind of life, it will be, by the time it's over, a significant adder to our business.

Finally, here's a list of some of the airplanes that we're on and our shipset contents. Some well-known names here. I describe our business sometimes as a small business with really long fingers. I mean, Joint Strike Fighter, 787, 737, the Cessna Citation business jet line, and the FLRAA program. Our content on all these airplanes is something that we're proud of.

And finally, our Test business. Our Test business is primarily involved in two business pursuits. One is a transit test, so think of a municipal train system, a subway system like what exists here in New York City or in many other cities around the country and around the world, and also radio test.

We have won a program, which is going into production later this year, from the US Army to provide test equipment and test capability for the 28 sets of radios that they use for communication when they go out and do their missions. So, instead of traveling around with 28 different test setups, they can carry around one test setup, which we would provide. That one tester is going to be designed to handle all 28 families, which is a big savings for them. That's going to be something like a $215 million program that we expect to kick off in the fourth quarter of this year.

Transit test has been a little bit of a slow roll for us. Frankly, it's been negatively affected by the pandemic and work from home. Municipal transit authorities have struggled for funding, because ridership is down and so on and so forth. There's lots of evidence these days, I'm sure everybody reads the papers and knows a lot of this is happening, where work from home is on a little bit of a retreat and people are being brought back into the office. We think that means good things for our transit test business over time.

And with that, I'm going to hand it over to Nancy.

Nancy L. Hedges
Vice President & Chief Financial Officer, Astronics Corp.

Good afternoon, everybody. I want to take you through just a few financial slides here. Starting with our sales, you can see that our sales have been on a steady path of improvement over 2024 with sales increasing sequentially, beginning with the first quarter here. As our productivity continued to improve with a stabilized workforce and more predictable supply chain, we've enjoyed the increasing benefits from that.

We're also benefiting from increased pricing. During the pandemic, as Pete mentioned, we saw escalation, as did many companies in our input costs and most of our contracts are fixed price contracts over a longer-term period of time, so we didn't have the ability to immediately pass those price increases along to our customers. As those contracts have come up for renewal, we've been able to negotiate more updated pricing, which should also benefit us, not only from the top line but from a margin perspective as well.

Moving over to the right side of the slide, bookings were $189 million in the third quarter, $199 million in the fourth quarter, healthy booking level. I do want to point out that both of those quarters were impacted by the Boeing strike. We estimated in our third quarter release about a $7 million to $8 million impact from the Boeing

strike as those orders slowed down earlier in the quarter, we assume, in anticipation of the strike, and that impact on bookings did continue into the fourth quarter as well.

Our backlog, on the bottom part of the slide there, is in excess of $600 million currently, which is a very healthy level of backlog for us. The vast majority of that backlog will deliver within the next 12 months.

If you look at the similar sales levels in our pre-pandemic period, so say around $200 million a quarter, our backlog was about 30% lower than it is currently. We're generally a book-and-ship type business, but we've been seeing elevated orders as customers are ordering earlier with the supply chain issues that had occurred during the pandemic. Customers were ordering earlier to secure products that had extended lead times.

So, we may see, at some point in the future, where our bookings may trail our sales for a period of time, but we have not yet experienced that. In any event, at $600 million, our backlog is at a healthy level and gives us confidence in our 2025 outlook.

Turning to profit and margins. With that increase in sales, we're also seeing steady improvement in our margins, as the headwinds of the past few years have generally resolved. Cost inflation has moderated, and our updated pricing is rolling on.

I also point out we have strong operating leverage of about 40%, so, for every $1 of incremental revenue that we see, about $0.40 of that drops to the operating income line. We've also been intentionally improving the business as well. It was on one of the Test slides earlier, but in the past couple of years, we've closed three of our Test facilities, and we've also done a number of restructurings over the last 12 months to 18 months where we've taken out about $5 million worth of annual costs from that Test business. We'll see the benefit of that really fully beginning in 2025.

I also wanted to point out, in the gray box that you see on the slide here, we presented our operating margin and our gross margin on an adjusted basis. We did have some unusual events that occurred during the third quarter that really aren't indicative of our normal run-rate operations. We've adjusted those out to present really a view of what the underlying business looks like. So, I would point you to the slides in the back of the deck that lay out what those adjustments were and provide a calculation of the adjusted metrics against the GAAP metrics.

Okay. Turning to EBITDA, which is over to the right side of the slide, we achieved 13.3% of sales adjusted EBITDA as a percentage of sales in the third quarter, or $27 million on a consolidated basis. We believe that mid- to high teens adjusted EBITDA is within our line of sight currently. Especially, as we reduce our working capital requirements, we benefit from that improved pricing that I talked about earlier and we continue our efforts to improve productivity and, of course, as our top line continues to grow.

Moving to the balance sheet and cash flows here. We returned to cash flow positive in the third quarter of 2024 and a primary focus for our business going forward is to improve our cash flow generation. Our capital spending, as you can see from the chart on the bottom right, has been controlled over the last few years, as we've been dealing with the challenges that Pete mentioned earlier during the pandemic. But, as we drive stronger cash generation, we do plan to reinvest in the business to be in a position to meet our growth plans.

As you may have seen in terms of the capital structure, we recently completed the convertible bond offering in early December. This allowed us to do a couple of things. First of all, and probably most importantly, it puts us in a position to have greater liquidity and financial flexibility to deal with a potential obligation associated with a patent lawsuit in the UK. We don't have a judgment on that yet. We expect that it will come about in the first quarter here, and we need to be able to deal with that.

We don't know what it's going to be, but the plaintiff's estimate of the damages far exceeded what we and our specialists had estimated. So, we felt it was prudent, while we're hoping for the best here, that we needed to be in a situation where we are prepared for the worst to de-risk that situation.

The convertible also allowed us to pay down a $55 million higher interest rate term loan, and the remainder went to pay down our ABL facility. So, we have an asset-based loan facility that's secured by our accounts receivable, our inventory and our fixed assets. So, right now, the balance on our ABL is quite low and we would draw on the ABL as necessary to fund any potential obligation.

Covering a few of the high points of our convertible bond offering, we closed a value of $165 million at a coupon of 5.5%. It's a five-year, three-month maturity that is provisionally callable by us beginning in March of 2028. We retain the flexibility to settle the bonds in cash or stock or a combination of both. Our intention at this point is to reduce the dilution impact by paying off the principal value in cash and potentially covering only the premium in stock.

In the meantime, as our trailing EBITDA improves over the next 12 months to 18 months, we expect to be in a position to restructure our revolving credit facility from that ABL to a traditional cash flow-based revolver. That would give us more flexibility to use that excess liquidity to potentially buy back shares that we believe are trading at a discount, possibly take out the bonds or do other types of activities, capital spending, M&A, et cetera. But we could also choose to settle the entire bond in cash if our liquidity was in that situation.

Okay. And with that, turning to Q&A.

Peter J. Gundermann
Chairman, President & Chief Executive Officer, Astronics Corp.

I think we have 6 minutes.

Question and Answer Section

Indiscernible Question

Peter J. Gundermann

The question has to do with Gilat and whether they're a competitor or a customer or a partner. They are more in a situation where they would provide an antenna to an aircraft and we would provide, say, a modem manager, which worked with their antenna to provide connectivity to the airplane. At one time, we were more of a competitor. We've backed away from that antenna market pretty significantly.

Indiscernible Question

Peter J. Gundermann

That's a really long debate. It's emotionally charged. There's Ku, there's Ka, there's ATG; now, there's going to be LEO. There are a number of different architectures in that satellite space, and the contestants are very passionate about it. We're not directly involved, so I don't want to start any fights.

Indiscernible Question

Peter J. Gundermann

I would say there are two issues. The question, again, is our recovery compared with other aerospace stocks. If you look at most aerospace stocks, you will generally not find the same kind of high exposure to commercial aerospace that we had. Even Boeing is somewhere around 40% commercial aerospace. They have a big defense business. They have a big space business. We were 70% when the pandemic hit. That's relatively high.

That means our bottom was deeper and our climb back was slower, number one.

Number two, I think there is some overhang from this pending lawsuit judgment that we're facing. We think we have that covered in a worst-case scenario. One thing I would add to Nancy's comments is that whatever this judgment is that comes down, we expect an appeal later this year. That means that if the judgment kind of favors us, we expect the other side to appeal. If the judgment faces the other side, we will appeal. And the higher court, as we understand it in the UK, is a relatively sophisticated court with respect to intellectual property law compared with the court that we're in right now. So, I think those two things are probably weighing on our stock.

Indiscernible Question

Peter J. Gundermann

This is another presentation in and of itself, but yeah, it's something that's been going on since 2010. It's been a really long battle. It's specific to a particular patent and it's been fought out in four countries, the US, France, Germany and the UK. In the US, we got the patent annulled. It was basically found not to be novel, dismissed, case over. In France, we have the same initial conclusion from the court there. The other side is trying to appeal that and reopen the nullity case there, but we're hopeful that we get it dismissed there. In Germany, the patent was partially upheld and partially dismissed. Proceedings there are on hold waiting for the UK to resolve. In the UK, the patent was found to be fully enforceable.

So, same patent, three different results, four countries. And so, the patent was found to be valid, we were found to be infringing, and then, there's the damages case. So, we have a wide disagreement between what we think is reasonable and what the other side thinks is reasonable, and we're going to have to kind of fight through that. Again, the bond offering that we did, we think, protects us.

Indiscernible Question

Peter J. Gundermann

In 2024, we're basically running about $5 million a quarter.

Indiscernible Question

Peter J. Gundermann

We're looking forward to that day.

Indiscernible Question

Peter J. Gundermann

Oh, yes. For webcast purposes. The question was, what is our legal expense? For 2024, it was worth $5 million a quarter. There's reason to think that it will be quite a bit lighter in 2025, because the appeal that I'm just done talking about should be much less expensive than the initial prosecution. France is quiet for now. Germany is

quiet probably till the UK is over. And then, we have another little thing that we think also is kind of wrapped up at this point. So, there's reason to think we could be quite a bit lower in 2025.

Indiscernible Question

Peter J. Gundermann

Name one, which one are you thinking about?

Question

I don't know, Gulfstream, Bombardier, like both business jets?

Peter J. Gundermann

We're actually on them, but that was just a representative list.

Indiscernible Question

Peter J. Gundermann

That's more of a relationship sale, I would say. That's not a technically sophisticated product. But relationships are very important. And what happens is, in this industry like a lot of industries, if you do a good job for an airplane manufacturer on one airplane, they tend to drag you along on the second airplane. That FLRAA program I was talking about. It's a great example.

We have an electrical system that Bell chose for something called the Bell 525. It's been a problematic helicopter for them, but it's one that they developed probably eight years ago, nine years ago, and they fell in love with our capability in our system. Then, they developed something called the Bell 505, which is a relatively small helicopter, and again, the relationship worked really well. Then, they went into something called FARA, which no longer exists, and FLRAA, which is the one I was talking about, and we were basically put on those airplanes. I hope they're not listening, but I don't think they competitively bid us. I mean, it's just the situation where they liked the program, and they trusted our performance. And so, there's a lot of ongoing relationships like that that we do well with. There are some that are less mature and you've hit two of them, for sure, but we have some exciting things going, which we'll talk about this time next year when we get the 2026 version.

Anyway, thank you for your time.