

Operator: Good afternoon, everyone, and welcome to the Astronics Corporation Third Quarter 2023 Financial Results Conference Call. [Operator Instructions] Please also note, today's event is being recorded. At this time, I'd like to turn the floor over to Deborah Pawlowski, Investor Relations for Astronics. Please go ahead.

Deborah Pawlowski: Thank you, and good afternoon, everyone. We certainly appreciate your time today and your interest in Astronics. Joining me on the call are, Peter Gundermann, our Chairman, President and CEO, and Dave Burney, our Chief Financial Officer. You should have a copy of our third quarter 2023 financial results, which just crossed the wires after the market closed today. If you do not have the release, you can find it on our website at astronics.com.

As you are aware, we may make some forward-looking statements during the formal discussion and the Q&A session of this conference call. These statements apply to future events that are subject to risks and uncertainties as well as other factors that could cause actual results to differ materially from what is stated here today. These risks and uncertainties and other factors are provided in the earnings release as well as with other documents filed with the Securities and Exchange Commission. You can find those documents on our website or at sec.gov.

During today's call, we will also discuss some non-GAAP financial measures. We believe these will be useful in evaluating our performance. You should not consider the presentation of this additional information in isolation or as a substitute for results prepared in accordance with GAAP. We have provided reconciliations of non-GAAP measures with comparable measures in the tables that accompany today's release.

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

Peter Gundermann: Thank you, Debbie, and good afternoon, everybody. Thanks for tuning into our call. Our feeling is that the third quarter was a reasonably good quarter for our company. Though there are many things to discuss, as usual, Dave and I will divide things up between us with respect to prepared comments, and then we'll take questions. Dave will focus on the nuts and bolts of the quarter, but I want to focus my time on what I consider to be the most important thing that is happening in our company these days and the most important thing for investors watching our company to understand. And that is the growth trajectory we have been on and that will continue to feature prominently in the coming quarters. It is important to understand that trajectory, both where we have been and where we are going in order to properly understand our company.

I need to start with a bit of a history lesson that will be old news to those who know our company well, but setting the stage is important to understanding where we are and what is before us. I'll start by going way back to 2019, the good old days, pre-pandemic when we had sales for the year of \$773 million. We were at that time and still today, heavily exposed to the commercial transport airplane market, both OEM and retrofit applications. They made up about 70% of our sales back in 2019. COVID arrived in early 2020 and hit the commercial transport industry hard and companies that were focused on it like Astronics.

We bottomed out in 2021 with revenue of \$455 million, so we went from \$773 million down to \$455 million. It was a fairly painful decline for our company. The only glimmer of hope back then was the bookings level, which started to pick up as the year progressed, especially in the narrow-body market. Our book-to-bill in 2021 turned out to be 1.3x. In most cases or most times, a pretty successful performance. However, the supply chain styles that were prominent at that time became apparent. And while we were booking business, we couldn't generate the revenue that we wanted to. So again, 2021 revenue of \$455 million.

In 2022, things began to improve significantly. Sales rose to \$535 million, up 20% as the supply chain began to correct itself. Bookings, however, stayed strong throughout the year with a book-to-bill of 1.29x. So, while the supply chain began to improve, it did not improve enough for us to make progress with respect to what the market was asking for us, but still 20% growth in normal times, we'd be pretty proud

of that, which brings us 2023 where we are seeing continued recovery in the airline industry and also for our supply chain. Given our Q3 results, our third quarter results and updated guidance issued today in our press release for our fourth quarter, we expect to end the year in a range of \$680 million to \$690 million. At the midpoint, that would be up 28% over 2022. So, 20% growth last year, 28% this year. Again, normally, those will be things to be proud of.

I want to talk a little bit about that fourth quarter forecast, which you saw in the press release, which is \$185 million to \$195 million. Those are big numbers compared to where we've been over the last 3 years since the pandemic hit. But first of all, we have the backlog to do it. In fact, we have the backlog to do more than that if the stars were to align and capacity were to come in play in time, we could beat the high end of that range. But being prudently conservative, we think \$185 million and \$195 million is a proper range to go out with.

Further, we are on pace through five weeks to get there. You can take our 5-week performance, which obviously is not released publicly at this point, but you ratio it to what we did in the second quarter and the third quarter and what our target is, and we're on pace, which is encouraging. Most importantly, that range, \$185 million to \$195 million marks a return to what we typically did back in 2019, finally, at long last. And that's important because during the years of the pandemic, we kept our foot on the gas with respect to new programs, confident that the historical volume would return eventually to help us cover the expense of those development programs. And we finally think we're on the verge of doing that. In the fourth quarter, assuming we hit that range will be a very interesting test of our income statement and our margin profile as it sits today.

While I'm talking about 2023, I want to briefly touch on revenue in the third quarter. Sales of \$163 million were a little lighter than we hoped for. But frankly, for us, at this point, not a major point of concern. Our volume in the third quarter was very much a function of scheduling and supplier capacity and our own capacity more than anything else. We ended the second quarter on a very strong note and came into the third quarter with some pretty empty factories right in the face of a July 4th shutdown and basically, July turned out to be a pretty weak month, and we could not get the volume in August and September. August is also usually a challenging month with vacations and everything.

But we built momentum as the quarter progressed. And given the lumpiness of our business sometimes, \$163 million in the third quarter, followed by \$190 million at the midpoint in the fourth quarter; while maybe not the way you'd want to draw it up doesn't bother us too much. Dave will go over the third quarter specifics in a minute.

But before he does that, I wanted to talk a little bit about 2024, where, obviously, within 1.5 months or so of 2024 being here, we normally would come out with revenue guidance in another month or so and we may do that again. We're in the process of putting those numbers together. We're not done yet, so we're not ready to issue official guidance at this point. But I guess the message I wanted to send was that the revenue level that we're expecting for the fourth quarter, all indications are that is a fair indicator of where we're going to be throughout the year in 2024. In other words, the fourth quarter at \$185 million to \$195 million is not -- we do not view it as a fluke. It's not something that's going to be a one and done kind of situation.

So, we expect when we do initial guidance that we're going to -- for 2024 that we're going to end up in a range in the high \$700 million, \$750 million or above, up in that neighborhood, which will be a big improvement again over 2023. So, we are looking forward to that. And again, we would expect to issue that guidance sometime towards the end of this year.

Dave, I'll turn it over to you now.

David Burney: Thanks, Pete. So consolidated sales were up \$31.5 million or 24% from last year's third quarter. The increase was across the board in all of our markets, but primarily driven by the commercial transport businesses. Global airlines have increased their retrofit programs and OEM build rates have increased. Other than that, the sales increase was consistent throughout the entire aerospace business, but clearly dominated by the growth in the commercial transport business.

I'll jump to some significant items that had impact on our margins this quarter. The largest item was the unexpected sudden bankruptcy a few days ago of a non-core customer. We did contract design and manufacturing work for that goes back to 2021 and 2022. We've been in weekly contact with the customer regarding their sales pipeline and prospective customers' order pipeline for their product, and we're surprised by the filing. We had very minimal sales activity with this customer this year and have not been including any sales relating to them in our forecasts. The impact of this bankruptcy will have no impact on our operations beyond the reserves that we recorded this quarter related to inventory, all of which was purchased prior to 2023 and receivables, most of which were prior to 2023.

Looking at gross profit for the quarter. Gross profit was \$20.6 million or 12.7% on sales. Lower than expected on \$163 million in sales, primarily as a result of the reserve for inventory related specifically to that customer bankruptcy, which added \$3.6 million or 200 basis points to cost of sales. Absent this inventory reserve, gross profit would have been \$24.2 million or 15%, up from 10.9% last year, but down sequentially from the second quarter due to the lower sales volume.

SG&A of \$35 million or 21.5% of sales was higher than expected due to the accounts receivable reserve for the customer's bankruptcy, which was \$7.5 million. That equates to 460 basis points on sales. Legal costs continue to run high and were \$4.6 million in the quarter. Absent the accounts receivable reserve, SG&A would have been \$27.6 million or about 17% of sales. The loss from operations was \$14.5 million. Absent the impact of the customer bankruptcy loss from operations would have been \$3.4 million, a significant improvement compared with a loss from operations last year's third quarter of \$14.3 million.

Looking sequentially to bridging our second quarter operating income of \$2.4 million to our third quarter operating loss of \$14.5 million. We lose roughly \$4.5 million to \$5 million of contribution margin on the \$11.5 million sales drop. The balance relates to the \$11.1 million of reserves taken related to the customer bankruptcy. Interest rates remain a headwind. Our cash interest for the quarter was about \$5.6 million, which equates to a rate of 12% on our debt, outstanding debt balance during the quarter. At the end of the quarter, we had outstanding debt of \$174 million.

Jumping over to the balance sheet, cash, and cash flows. Cash used in operations in the quarter was \$1.1 million, which is all an increase in net operating assets of \$8.3 million that was largely offset by the net loss adjusted for non-cash expenses. On a positive note, our inventory level has stabilized and we're expecting from this point forward, we will begin to improve our inventory turnover, lowering inventory levels and generating cash flow as we move into next year. As liquidity remains tight and our working capital remains high, we were active using our at-the-market program to sell 835,000 shares at an average price of \$16.70 that generated \$13.6 million that was used to fund the working capital needed until we realize the cash flow from the growing sales. This equates to a dilution of about 2.5%.

Looking into the future, in terms of deploying free cash flow, the first place we'll start to target is to de-lever our balance sheet. With our large fourth quarter sales forecast, we expect cash flow to improve significantly but not until the first quarter of 2024. We are compliant with our debt covenants and are forecasting continued compliance.

With that, back to you, Pete.

Peter Gundermann: I think that ends our prepared comments. If you want to open it up for questions, now is the time.

Question and Answer

Operator: [Operator Instructions] Our first question today comes from Pete Osterland from Truist Securities.

Pete Osterland: I'm on for Mike Ciarmoli today. So first, I just wanted to ask on the expectations for margins. If I look at your level of sales and EBITDA throughout the year, it would seem like in the fourth quarter, you should be able to put up at least low double-digit EBITDA margins based on that sales level and continuing that momentum into 2024. Is that reasonable? Or is there anything else you're currently seeing with costs or mix that would change how to think about the incrementals here?

David Burney: Yes. This is Dave. Well, typically, we don't provide guidance on margins, but I'll steer you that the way we think of it is somewhere around 40% to 45% of our incremental sales drops to operating income. So, it's reasonable, I think that we can get back up to close to that double-digit of EBITDA number at that sales level for sure. But for your modeling purposes, I typically -- in my back of the napkin is generally to look at like a 40% is a quick number that will drop to the operating income line on the sales.

Pete Osterland: And then I just had a follow-up on the commercial aero build rates. Are you currently aligned with the stated OEM build rates that is publicly announced and have been talking about recently? Or are there any areas where you're currently lagging?

Pete Gundermann: Well, sometimes we're aligned. I would say we're typically at this point on the narrow-body MAX line, which is probably what you're asking about, we're running around mid to high-30s. And so, we're reasonably close to stated production rates at this point.

Pete Osterland: Okay. So given that rates are picking up and expected to make meaningful progress soon, are there any areas you'd call out where you saw meaningful challenges during the quarter within your manufacturing processes, whether it's labor productivity or anything with key suppliers. Just anything you call out there that you're kind of still seeing in the current quarter, in the fourth quarter?

Pete Gundermann: No. I think it's safe to say that we continue to face supply chain flare-ups here and there across all of our operations, but there's nothing that really stopped us in our tracks with any of our major products in the third quarter. I think the bigger issue really was that we had a very large second quarter with huge shipments right at the end, if you go back and listen to that conversation that we had around that call, one of our concerns was that we're in this cycle where everything is back-weighted or back-ended and you end up with this huge push and then you end up with empty factories as you start out the next period.

And that was definitely the case as we moved from the second quarter into the third quarter. And that combined with some shutdowns, a lot of our operations shut down for the week of July 4th really made for a pretty weak start to the third quarter and we just never really caught up. But I think that was the more major issue. I would say, generally kind of across the board, our supply chain continues to improve. And once we got kind of through July and into August and September, we accelerated, and the operations are working more routinely at higher volumes. And certainly, now as we're into the fourth quarter with the volume that we were expecting, things are accelerating. But I can't pin the weakness of the third quarter on any specific supply chain problems.

Operator: [Operator Instructions] Our next question comes from Jon Tanwanteng from CJS Securities.

Jon Tanwanteng: I was just wondering today; how much excess is stranded inventory you're hanging on to and kind of what is the path or timing to work that down to more normalized levels?

David Burney: I don't think we have a number for kind of the excess or stranded; it's definitely there and it's significant. And when we call it stranded, it just means that it's waiting for the rest of the parts to catch up with it so that the orders can be completed and shipped. So, it's the contributor to our high inventory levels for sure. I don't have a number for you on that.

Pete Gundermann: I would add some color, Jon, that there's stranded inventory and then there's slower moving inventory. And one of the things that happened as we went into the pandemic is the wide-body world really slowed down. And we got caught with some inventory that's specific to widebodies that we expect will start to burn down as we move through 2024 in the wide-body production rates and markets continue to pick up. So, I think we're going to see a reduction in inventory, both in the stranded variety and kind of the wide-body variety. How to quantify those is difficult with our systems. But we would like to think that we could burn down our inventory by the end of the year, at least \$20 million or \$30 million. I think that's what we're thinking.

David Burney: No, it will be less than that.

Jon Tanwanteng: I was wondering just next year, you gave kind of a range for what you expected on revenue, just measured against Q4. But I was wondering what you thought about order rates going forward and what the demand you think is going to look like from your customers, and that's excluding whatever large military orders you're waiting for?

Pete Gundermann: Well, that's certainly a watch item. I would think that we're going to at least stabilize around that higher \$750 million or \$800 million level, but we're going to have to watch bookings over the next couple of quarters pretty closely to confirm that. One of the things that has not happened as we hoped for was on our test business, we're still waiting for some very significant programs, been waiting for one of them for over a year now, the U.S. Army radio test program. And that is an example where it will have a significant impact on our bookings when it happens and a significant impact on our 2024 plan.

So, we obviously publish bookings because we think it's a leading indicator of where we're going to be as a business, and we've got a record backlog. So, we feel we're pretty safe with the preliminary initial look in the 2024 that I talked about earlier. But where bookings come out beyond that is something we're going to have to watch.

Jon Tanwanteng: And then is there any update just on the litigation that expenses you're incurring? When do you expect that to either let up or some kind of resolution to occur?

Pete Gundermann: We have two major actions involved, one of which has been going on for over a decade, and that one, we would expect to continue to move pretty hot and heavy through 2024. Hopefully, with some kind of resolution as we get into 2025. That's our thinking there. The other one is relatively recent, and there is a chance, we believe, that could be wrapped up pretty quickly and have minimal expense into 2024. We'll know more about that as we get into year-end here.

Operator: Ladies and gentlemen, at this time, in showing no additional questions, we'll conclude today's question-and-answer session as well as today's presentation. We thank everyone for joining. You may now disconnect your lines.

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