Air Industries Group
Third Quarter 2023 Earnings Call
December 7, 2023

Presenters
Lou Melluzzo, President and CEO
Scott Glassman, CFO

Q&A Participants
Howard Halpern -- Taglich Brothers

Operator
Hello, and welcome to the Air Industries Group Third Quarter 2023 Earnings Call.

At this time, all participants are in a listen-only mode. If anyone should require operator assistance, please press “*”, “0” on your telephone keypad.

As a reminder, this conference is being recorded.

This call and the accompanying webcast may contain forward-looking statements as defined in Section 27A of the Securities Act of 1933 as amended, including statements regarding, among other things, the company's expectations regarding realization of its business strategy and growth strategy.

Expressions which include forward-looking statements speak only as of the date of this call These forward-looking statements are based largely on our company's expectations and are subject to a number of risks and uncertainties, some of which are beyond our control and cannot be predicted or quantified. Future developments and actual results could differ materially from those set forth and contemplated by or underlying the forward-looking statements. In light of these risks and uncertainties, there can be no assurance that the forward-looking information will prove to be accurate.

This call does not constitute an offer to purchase any securities nor a solicitation of a proxy, consent, authorization or agent designation with respect to a meeting of the company's shareholders.

At this time, I'd like to turn the call over to Lou Melluzzo, President and CEO. Please go ahead, sir.

Lou Melluzzo
Thank you, John. Good afternoon, and thank you for joining us, today.

As I stated in today's news release, and as I want to emphasize on this call, the third quarter was a period of exciting new opportunities for Air Industries, as we further executed on our growth plan.

I say that, even though our third quarter was impacted by shortages of critical raw materials for a certain product. Thankfully, these material shortages have begun to ease, and we expect business to rebound in the fourth quarter of 2023 and into 2024 to both, higher levels of sales and EBITDA.

Our sales for the third quarter were $12.3 million. Gross profit was $1.2 million, or 10% of sales, and we incurred a net loss of $1.3 million.

We experienced increasing traction of our growth strategy for Sterling Engineering in Connecticut. Sterling had a noteworthy quarter, achieving sales that broke through the $2 million level for the first time in many years.

Sterling's increasing sales, favorable product mix and higher volume and better cost absorption continue to contribute to its strong and improving profitability.

As I discussed on the past calls, our strategy for Sterling is to expand its sales, especially through long-term agreements, modernize its plant and invest in critical new equipment, providing unique capabilities and differentiating it in the marketplace.

Towards that end, in partnership with a major customer, we secured flash welding equipment to support the welding of the arresting gear for the U.S. Navy's E-2D aircraft program. Air Industries is now the sole provider of this process used to manufacture mission-critical product and expanding our portfolio of special processes.

We also now have a fully functional and producing paint shop, have added a new large format bridge mill to support our expanding helicopter business and acquired a new CMM, a coordinate measuring machine, to bolster our capabilities in final inspection.

Also at Sterling this year, we have installed a new roof, and the installation of solar panels is underway.

Company-wide, the current tenor of business is exciting and has only increased our enthusiasm for the future.

Air Industries’ increased business development activity has resulted in a notable increase in our quoting activity and bookings. On a trailing 3-month basis, bookings of new business have doubled to over $6 million a month, compared to December 31 of 2022.

The wars raging in the Middle East and Ukraine and continued rising tension in Asia Pacific have increased the focus on military capabilities; perhaps this is a contributor, but I believe our increased activity and focus have been the primary cause.

Recently, we have been awarded a strategic contract to support the U.S. Navy's E-2D aircraft program. The company received an $8.9 million purchase order to fund the acquisition of long lead time product to support future production of this aircraft, which is critical to the U.S. Navy's carriers operations.

Our current consolidated 18-month backlog is continuing to grow and now stands at more than $73.7 million, an increase of $6.6 million, or 9.8%, year-to-date. Additionally, we reduced our overdue shipments by a whopping 58% in the same time frame.

At the Paris Air Show in July, I, together with our business development people, met with a major European-based multinational aerospace manufacturer with a large concentration in landing gear. Subsequent to this meeting, we have had several meetings and site visits with this company and are bidding on several large, exciting projects, which we believe are close to fruition.

Accomplishing this in just a few short months after our initial production is remarkable.

Lastly, our initiative to expand in the nuclear submarine business continues to produce results. We have proven ourselves with sub-tier suppliers, and have taken the next step in the vetting process with prime nuclear submarine manufacturers.

With that portion of the report complete, I am pleased to introduce Scott Glassman, our newly named CFO. Scott is a 15-year veteran of Air Industries and has been our Chief Accounting Officer for many years. Mike Recca is still here with us, has taken on new responsibilities, focusing on special projects related to our growth plans, especially in the aerospace sector.

As I said in our announcement, a good CFO is the CEO's right hand, and I personally can't be thankful enough for the dedication of both, Scott and Mike, for the whole of Air Industries. I am pleased that they are both still people I can count on in their new roles.

Now let me turn the call over to Scott for his report, which will follow up with a Q&A and some concluding remarks. Scott.

Scott Glassman
Thanks, Lou, and good afternoon. I appreciate your kind introduction. I'm honored to take on this new role at Air Industries. Let me provide some additional detail on the results of the third quarter.

As Lou said, our third quarter net sales were $12.3 million, which was 6.9% lower than the second quarter of 2023 and 7.4% lower than the third quarter of 2022. Year-to-date sales of $38 million were down 3.3% from $39.3 million, compared to the same period a year ago. For all three periods, lower sales at CMS were partially offset by improving sales at our Sterling subsidiary.

Lou mentioned that there has been a shortage of raw material, particularly for one product that had a measurable negative effect on sales. Let me give you some more details.

During the first nine months of 2023, we had orders for over 300 parts, which were worth nearly $4 million that, due to the lack of raw material, we could not produce or ship. This has reduced EBITDA by perhaps $750,000 during the nine months. As Lou indicated, these shortages have started to ease.

Gross profit for the third quarter of 2023 was $1.2 million, which is 43.4% lower than the second quarter of 2023 and 45.2% lower than the third quarter of 2022. Gross profit for the first nine months of 2023 totaled $5.3 million, a decrease of 21.8% from the comparable period in 2022. The decline in gross profit was mainly due to lower sales, exacerbated by under absorption of manufacturing overhead at CMS. In contrast, third quarter gross profit at Sterling improved significantly, year-over-year, and increased more than sixfold year-to-date due to higher sales, product mix and increased absorption of overhead.

Our gross profit margin was 10% of sales for the third quarter of 2023, as compared to 16.4% of sales for the second quarter of 2023, and a reported 16.9% for the third quarter of 2022. Gross profit margin was 13.9% of sales for the nine months ended September 30, 2023, whereas, reported gross margin of 17.1% for the same period of 2022.

I'd like to remind you that the gross margin for 2022 was adjusted at year-end to 14.3%, due to the adoption of a more conservative method of calculating and reserving for slow-moving inventory and anticipated losses on one particular contract in 2023.

Operating expenses for the third quarter of 2023 were $2 million, a decline of 3.5% from the second quarter of 2023 and 2.4% lower than the third quarter of 2022. Year-to-date operating expenses have only increased by less than 1%. We believe that being able to control operating costs in this inflationary environment is significant achievements.

We incurred an operating loss of $796,000 in the third quarter of 2023 versus operating income of $72,000 in the second quarter of 2023, and operating income of $169,000 in the third quarter of 2022. Year-to-date, the operating loss was $882,000, compared with operating income of $626,000 reported for the 2022 period.

Interest and financing costs for the third quarter increased 7.5% from the second quarter of 2023, 59.8% from the third quarter of 2022 and 57.7%, year-to-date, with the year-over-year increase primarily due to the increase in the prime rate, which has doubled since June of 2022.

Net loss for the third quarter was $1.3 million, compared with a net loss of $395,000 in the second quarter of 2023, and a net loss of $142,000 in the third quarter of 2022. Net loss for the nine months ended September 30, 2023 was $2.3 million, compared with a net loss of $177,000 in the 2022 period.

Our balance sheet remains robust, more than adequate for immediate needs. Accounts payable and accounts receivable are very current, and we have been successful in reducing our inventory.

Lou, that concludes my report, and I'll turn it back to you.

Lou Melluzzo
Thank you, Scott. In summary, the third quarter was a period of exciting new opportunities for Air Industries as execution of our growth plan is producing tangible results. The new wins this year are the result of the company's continued investment in its business and its people. Because of that investment, we have great momentum in business development and expect to continue to drive our bookings and sales level higher from here.

With that, John, I would like to turn this over for questions-and-answers segment.

Operator
Thank you, sir. We will now be conducting the question-and-answer session. If you would like to ask a question, please press "*", "1" on your telephone keypad. A confirmation tone will indicate that your line is in the queue. You may press "*", "2" to remove a question from the queue. For any participants using speaker equipment, it may be necessary to pick up your handset, before pressing the star keys. One moment, please while we poll for questions.

First question comes from the line of Howard Halpern with Taglich Brothers. Please proceed with your question.

Howard Halpern
Good afternoon, guys.

Lou Melluzzo
Good afternoon.

Scott Glassman
Good Afternoon.

Howard Halpern
In terms of the plan to get you to a sustained period of operating income, it appears that's going to be contingent on improving gross margins more because you have a good cost operating cost structure. So, how should we look at it in terms of generating, I guess, increased sales to help the utilization and in terms of just being able to produce a different type of sales mix? How should we look at that, going forward?

Lou Melluzzo
Well, Howard, this year, it's been all about business development. With the onset of COVID, military spending was not necessarily reduced, but orders weren't placed as timely as they should. And we kind of suffered from that this year, some last year and some this year because materials in this environment or in this field are roughly a year out, if you're lucky.

So, we're seeing now the single product that caused us a little bit of angst and grief this year, special alloy Inconel 718, that the OEMs qualify the mills, and they saw the need now to bring more people and more mills into the mix.

So, that single product could have made a tremendous difference in how our year ran, both from a profitability and sales standpoint.

I believe that the platforms that we're in are robust and we'll be able not only to sustain but help increase our sales and bottom line in the future.

Our folks in business development have been very successful of bringing in some additional opportunities. We're getting traction with nuclear submarines. We now do business with three sub-tiers, and we've had Electric Boat in our facilities. We're going through the vetting process to do work directly for them.

So the mix that we have currently running are--is more than sustainable. We've just got to overcome the material shortages that are just not--we're just not seeing the problem, but it's an industry-wide effect. And thank God, we're seeing the tail end of that, and we're seeing things ease up for '24.

Howard Halpern
Okay. And so, given that you're ramping up the bookings, like you said in the press release, that $6 million a month approximately, do you have going out now a year or two, are you--do you have better visibility into those gross margins you're able to attain on those bookings, or at least some minimums out there?

Scott Glassman
We're looking into that. We, of course, are doing our homework on the pricing, but many of these bookings that we are getting are for repeat business that we've made before, repeat

parts. So, we believe the margin on those parts will be better than products that we haven't made before, obviously.

Additionally, as Lou said, we believe, based on the easing of this material shortage for one specific product, which is a high margin or higher margin products, we will be able to increase our margins based on that. Of course, with the work now going through our shop, our throughput will increase as well, and we'll be able to absorb more manufacturing overhead with the additional hours going through the shop.

Lou Melluzzo
Howard, the platforms are priced right. It's the under absorption that's catching up. This year, we incurred about a 30,000 delta in hours--fewer hours running through the shop, due to material availability. And that's a big number. So we see that easing up which, once you cover the absorption, you're in a different game.

Howard Halpern
And with being able to produce more, get it out the door, generate higher sales, you're not really going to have to increase operating expenses even in the aggregate.

Lou Melluzzo
That's correct. I am 120% confident that the execution level at Air Industries Group is on peak, right now. We're--that is not the problem. Execution right now is not the problem. The people are primed. The equipment is set up. We brought in--we spent quite a bit of money on CapEx in the last few years to be able to support what we need to do.

Howard Halpern
Okay. And just on the sales line, just based on what you said in the press release, we should be able to do better than--we should have a sequential increase from that $12.3 million, but we might not reach the peak that we had in the second quarter of over $13 million. Am I in a roughly right guesstimate in that area?

Lou Melluzzo
I think you're in the ballpark.

Howard Halpern
Okay. Okay. Well, I know you put in a lot of hard work this year and, hopefully, cross our fingers, things will only keep getting better each quarter, as we go forward.

Lou Melluzzo
Exactly.

Scott Glassman
Exactly. Thank you.

Lou Melluzzo
Thank you, Howard.

Operator
And as a reminder, if you would like to ask a question, please press "*", "1" on your telephone keypad. A confirmation tone will indicate that your line is in the queue. One moment while we poll for any additional questions.

At this time, there are no further questions. I'd like to turn the floor back over to Lou Melluzzo for any closing comments.

Lou Melluzzo
Thank you, John. So with that, once again, thank you all for taking the time to be on the call and for your interest in Air Industries Group. Our best wishes for the holidays, and we look forward to updating you on the progress on our next call, and Happy New Year to everyone. Thank you. John, you may conclude the call, please.

Operator
Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.