Company: **Air Industries Group**

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Moderator: **Kay Shiudat**

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Operator: Good day and welcome to the Air Industries First Quarter Earnings Conference Call. Today's conference is being recorded. Except for the historical information contained herein the matters discussed in this presentation contain forward-looking statements. The accuracy of these statements is subject to significant risks and uncertainties. Actual results could differ materially from those contained within the forward-looking statements. See the Company's SEC filings on Forms 10-K and 10-Q for important information about the company and related risks.

EBITDA is used as a supplemental liquidity measure because management finds it useful to understand and evaluate results, excluding the impact of non-cash depreciation and amortization charges, stock-based compensation expenses and non-recurring expenses and outlays prior to consideration of the impact of other potential sources and uses of cash, such as working capital items. This calculation may differ in method of calculation from similarly titled measures used by other companies.

At this time, I'd like to turn the conference over to Lou Melluzzo. Please go ahead.

Luciano Melluzzo: Thank you, Melinda. Good afternoon, everyone, and thank you for joining us. Our continued progress in driving profitability was fully evident in our first quarter results. As expected revenue for the quarter was lower year-over-year totaling $12.1 million, which is down 12% from the first quarter a year ago. Meanwhile, first quarter 2022 gross profit increased 16% to $2.1 million, and the gross margin increased to 17.2% sales, a full 410 basis point improvement over the quarter a year ago. EBITDA was essentially equal to 2021 first quarter. The major factors that impacted our top line performance were supply chain disruptions that delayed our receiving raw materials, and labor shortages.

On our last call, we discussed four significant contracts won in the first two months of the 2022 first quarter. Beyond their revenue contribution, each of those wins had important strategic value in furthering our growth strategy. Let me recap those contracts beginning with one awarded to our Sterling Engineering subsidiary. Sterling is critical to our overall plan to accelerate our profitability growth. We plan to replicate the successful strategy of optimizing our Long Island facilities by taking advantage of Sterling's capacity and investing in new equipment to expand its capabilities.

In January, Sterling was awarded a life of program extension, an LTA, for the turbine exhaust case for the PW 4000 jet engine, which is used on many Airbus and Boeing commercial aircraft. This is expected to generate revenue in excess of $6 million over its remaining term and it adds to our backlog in commercial aircraft. This contract follows an especially important win in the fourth quarter of last year, Sterling was awarded a new LTA to deliver a chaff pods for the new CH-53K heavy lift aircraft and Sterling's first LTA for a rotorcraft assembly. The contract furthers our goal of transitioning Sterling's business towards making complete products produced under long term agreements.

Our additional first quarter awards included a contract to produce components for the landing gear of the U.S. Air Force's B-1B Bomber. While the order is from a long established customer, it is an aircraft platform that has not been in Air Industry's portfolio for some time. A $12.4 million contract to produce complete main and nose landing gear ancillary components for the U.S. Navy's E-2D Advanced Hawkeye airborne early warning aircraft. We manufacture complete, ready-to-install landing gear as a tier one supplier to the OEM.

And finally, I said on our last call that we were awarded a total of three new LTAs for critical components for the Blackhawk helicopter with an estimated combined value of more than $20 million.

Last week we were pleased to report the award of two separate LTAs for the Blackhawk helicopter which brought the total award to $28.9 million. We believe we won these additional LTAs because of our demonstrated delivery performance for this customer, which is largely attributable to our investment in capital equipment over the past 18 months.

As I noted earlier, Sterling Engineering is critical to our plan for profitability growth. That plan is focused on reaching consolidated EBITDA of $10 million. EBITDA for 2021 totaled $6.3 million on an adjusted basis. So our goal is ambitious, but we believe achievable.

The plan consists of five initiatives. First, expand Sterling's business both through adding new LTAs as well as adding new equipment to expand its capabilities. Second, vertically integrate processes throughout Air Industries Group to reduce reliance on outside vendors and improve margins. This initiative is also underway. We have already invested in a paint facility which can accommodate many of our products, and will be operational in the next few weeks. We're also targeting grinding, non-destructive testing, assembly and other processes. In the past three years, our capital investment totaled $6 million. So far this year, we have written purchase orders for an additional $2.2 million. Our intention is to continually invest and modernize our equipment, enabling Air Industries to manufacture world class product more efficiently and more profitably.

The third initiative is to seek aftermarket opportunities overseas, and bring maintenance, repair and overhaul activities in house. Fourth, expand licensing of products to avoid middlemen and get closer to our customers. Currently we have a license for the F-18 and are considering licenses for other aircraft as well. Fifth, while we expect to reach our $10 million EBITDA target organically, we are also considering strategic acquisitions to achieve two primary goals: adding new aerospace customers and/or new platforms and possibly moving beyond aircraft to submarines, other navy vessels, army vehicles, missiles, electronics, etc.

Let me now turn the call over to Michael Recca, our CFO, for his financial report, which will be followed with questions and answers and some remarks. Mike?

Michael Recca: Thank you, Lou. Lou's already discussed sales and gross profit. So I'm going to add some details as well as some additional operating results and some comments on the balance sheet. As Lou said we achieved a 16% increase in gross profit for the first quarter of 2022 despite 12% lower sales. Gross profit dollars totaled $2.1 million, or 17% of sales as compared to $1.8 million or just 13.1% of sales in the first quarter of 2021. Operating costs for the first quarter were $1.9 million and this is an increase of 6% compared to the first quarter of last year. This is unfortunate but it's not surprising given the economic environment. So in the face of inflationary pressures, we are now increasing our focus on ways to control and hopefully reduce costs.

Operating income for the first quarter of $207,000 is up substantially from $27,000 in the first quarter last year. Again this improvement was achieved despite lower sales. Interest and financing costs for first quarter were $323,000. And they were essentially flat with the prior year. We had a net loss for the first quarter and that net loss was narrowed to $28,000 this year, compared to a loss of $152,000 last year. EBITDA adjusted to include stock compensation for the first quarter was just over a million dollars. This is essentially equal to the prior year, just a few thousand dollars lower compared to 2021. For this quarter EBITDA was 8.7% of sales and that's an improvement from 7.7% of sales in the prior year.

We ended the quarter with a solid balance sheet. Inventory increased 8% to $32 million, the increase resulting from Blackhawk and F-18 programs primarily. Our accounts payable and accrued expenses increased a modest 4% but there were no major changes in sales outstanding. Our supplier relationships remain very good.

Our debt to Webster Bank, which was formerly known as Sterling National Bank, was reduced by $2.3 million or 13% on March 31 compared to year end, and our loan agreement with Webster has only one major financial covenant. We are required to maintain a fixed charge coverage ratio of 1.25 to 1 and that is measured on a trailing 12 month basis. For the 12 months that ended March 31st, 2022 we comfortably exceeded these requirements.

So in summary, we improved profitability in the first quarter, as measured by increases in gross profit and higher operating income. Inventory increased but debt declined. At the end of the first quarter, we remain in strong financial condition sufficient to support our growth initiatives.

That concludes my comments and we turn the call back to you, to Lou, and I look forward to your questions.

Luciano Melluzzo: Thank you, Mike. Let me close this portion of the call by taking a broad look at where Air Industries Group stands today. We have come a long way since my arrival in 2017. We have improved our relationship with customers and suppliers, reduced debt and established a supportive banking relationship. We have rationalized and consolidated our operations and are making critical investments in equipment to further drive our opportunity and profitability. We achieved an important year of growth for Air industry Group in 2021, and demonstrated in the first quarter our ability to add strategic contracts while improving our profitability on every dollar of sales. We said last time that while first quarter sales would be lower than a year ago profit would improve significantly, and it did.

We continue to expect to deliver improved margins throughout 2022. We are focused on executing our plan to take consolidated EBITDA to $10 million. It is an ambitious goal, but we believe it is achievable.

With that I would like to open up the call to questions from participants. Melinda if you could open up the lines, please.

Operator: Thank you. If you'd like to ask a question please signal by pressing star one on your telephone keypad. If you're using a speaker phone please make sure your mute function is turned off to allow your signal to reach our equipment. A voice prompt on the phone line will indicate when your line is open. Again, please press star one to ask a question. And we move right into our first question. Please go ahead. Your line is open.

John: Hi, good morning, Lou and Mike, and thanks for taking this call and my questions. I have just a couple. I was hoping that you would talk about the supply chain issues impacting your first quarter revenues. Would you be able to quantify or roughly quantify how much that you believe this quarter was impacted by that?

Luciano Melluzzo: Well, John, what we're talking about is we take materials in lump sums, and we produce throughout the year. So it's not like we take 10 pieces and we ship them on a monthly basis. But right now we have orders for a material that we're doing at the end of last year that we just received in a few weeks back. And it just seems like there's a big delay now in raw material [inaudible]. We seem to have gotten past our bottlenecks in the shop with the capital equipment that we've purchased over the last year and a half, two years. And we've addressed our internal bottlenecks. We are addressing the tail end of the bottlenecks with the processing we're bringing in house as we see the need and fit. We're staffing up for that. And we're going to be doing what we can internally.

Still that leaves the raw material issues. There are titanium problems throughout the supply chain. I think they're probably going to continue to be there for a while especially with conflict over across the pond. But it's just that some materials that we were able to get in weeks are now taking months and months and months, and materials that were taking months and months are going into next year. So there is -- it's the material supply chain that is a tough one to conquer. We rely on our people for that.

John: Okay. And as far as the labor shortages, those issues what actions do you believe you could take in an effort to help alleviate this? I know you're kind of caught in this labor shortage issue like everybody is but is there anything in particular that you feel that you can address that maybe can help alleviate it?

Luciano Melluzzo: Well, one of the things that we're doing differently is we're probably overpaying, but that seems to be about the only thing that will transplant someone. So for very strategic positions that we're looking to fill we're looking at that. We're looking at increasing the night shift differentials so that maybe we can bring, attract some additional folks to the second shift, which is a -- that's an area of expansion for us without having to order more capital equipment. Our benefits -- we offer free insurance. So our benefits are kind of in line with the industry, in some cases even a little bit better. So we're trying several things to see how we can get people on board.

John: Okay, even with the increases, obviously, you're seeing overpaying, which I mean, you have to do what you have to do, you're still able to maintain actually a 17.2% gross margin in the first quarter. That was on $12.1 million in revenue. So that kind of surprised me on the upside. So I was wondering if there was anything in that gross margin of the cost of sales that actually skewed at higher than typical for this level of revenue. And I was hoping you could be a bit more specific on what you believe gross margins could be for the full year. I know you said that they will be higher than last year and obviously with the first quarter being 17.2% on that revenue. But hopefully, you could just expand on that and what was actually in that component of gross margins. And what would be the driving improvement from last year even if it was like say flat revenue.

Michael Recca: Okay, let me, you would normally expect on a decline in revenue that your gross margin would be lower. And the reason it isn't, is because you look back to 2021, we had a reported gross margin of about 17% for the full year. But that really -- that 17% was the sum of 20% on some products, and a loss of 3% on additional products. We had two products last year that totaled about $3.2 million in revenue, of that $2.7 million of it had zero profit, and the other $500,000 had a $250,000 loss. That was on a termination of a contract for the A380. So you take that out of revenue last year, your gross profit margin was closer to 19%-20% than it was to 17.1. So this year the no-profit product is gone. Second, the A380 is finished. We don't have to; we're not going to incur any more losses on that. So we had a kind of a higher gross margin going into it. But the lower sales kind of tempered it back to even the last year. We expect sales improve.

John: Okay. So this was more or less, more of a true gross margin. Last year was more the anomaly. That's why I wanted to get to like if this was where we should be at this level. So 17.2% is where we should be. There wasn't anything that really skewed it.

Michael Recca: That is correct. There was no one-time benefits that bailed us out. We earned it on [inaudible] gross margin of 17%.

John: All right. And actually the second part of my question was, because I know it's kind of vague. It just says you expect improved gross margins over the last year. But I was hoping you could be a little more specific on that like, let's see 17.2% on what you did with $12.1 million. So assuming sequential growth, what might we look at as far as an annual gross margin?

Michael Recca: I'd be very happy to get to between 19 and 20.

John: Okay. That sounds reasonable to me right now. And just getting into actually a little revenue. Just one last question. You're coming off at $12.1 million first quarter. And with the current backlog I'm not sure where it stands currently. But I know that it's only improved since the end of the year. Is it reasonable to expect a significant ramp in revenue for the rest of the year which I guess it would put you on track for maybe revenue to be near your 2021 level, you did what $58.9. Should we anticipate that happening like a nice ramp and actually second half and three quarters to come to get you up to that level with what you have on the books right now?

Michael Recca: Our goal is have revenue up to equal to last year's $58.9 million. We expect that the ramp up is going to be more in the third and fourth quarter than in the second based on production. Remember, these are long lead time items. So what's in production today ships in November.

John: Okay, but I mean, you have a good idea with a firm backlog, the 18 months, it's a funded backlog. So you should have a good idea of what you expect, going forward. So Q3 and Q4 it's going to be more back end loaded right now. But we should get closer to that $58.9 million level that we had last year. I just wanted to clarify that.

Michael Recca: That's our goal and expectation.

John: Great. I appreciate that. That's all I have. Thanks for taking my questions.

Luciano Melluzzo: Thank you, John.

Operator: Again, if you do have a question or comment today please press star one on your telephone keypad. And we do move on to our next question. Please go ahead. Your line is open.

Speaker: Yes, good morning, gentlemen. I've got a question for Lou. You briefly spoke of additional business going forward. And I'm wondering what's the growth outlook for the company? And what are your plans? Are you wanting to increase the company by acquisition? Are you wanting to add more equipment? As revenue ramps up where do you plan on taking the company? And I will go ahead and let it go with that. Thank you.

Luciano Melluzzo: Good morning. Thank you for the question. So what I put on the table is our growth strategy for the business going forward. There are numerous areas that we're not involved in that are possible avenues for us to grow revenue and continue to grow the company. On the capital equipment side of things some of the equipment is in replacement of older equipment to better and more efficiently do product. Some of the equipment is net added capacity and capabilities that we did not have in the past -- larger sizes, more complexity. We're following that. We've done that here in New York over the last couple of years. And now we're going to follow. We're going to take that blueprint and move it to our Connecticut operations to expand those facilities so that the company organically can grow.

Organically we probably have space constraints to about maybe $70 million. Past that we're going to have to look at additional space and we'll continue to go into company licensing agreements, which kind of puts you in, cuts out a lot of the competition. There is not going to be 6, 7, 8 players in the field when you have a license. There is going to be maybe one or two, potentially three players. So there's an opportunity to better name pricing and margins associated with that work. We are going to look at parallel opportunities. We're going to be, we are a landing gear company. But at the end of the day, we're also a complex machining company. So there's no reason we can't get into naval vessels, army vehicles and other things that we currently don't do. It's precision work. And it pays almost as well as the aerospace industry. So processing, when we process something, not only are we going to take care of our own needs, but we can sell the service. So there might be -- there's probably an avenue to exploit that with painting and shop painting and anodizing and all the other things that are associated with it. There are several possibilities to ferret out to be able to grow revenue.

Speaker: Thank you. So is it fair to say that you are foreseeing quite a few more contracts coming forward?

Luciano Melluzzo: Well, I mean, we're always quoting stuff. So I would say in the course of the year, we've got a lot of irons in the fire, something will materialize.

Speaker: Thank you, Lou.

Luciano Melluzzo: Thank you.

Operator: At this time, we have no further signals. We'll turn back to Luciano Melluzzo for closing remarks.

Luciano Melluzzo: Thank you, Melinda. So with that, once again, thank you all for taking the time to be on a call and for your attention and questions. We look forward to updating you on the progress of Air Industries Group on our next call. Melinda with that we concluded the conference. You may disconnect.

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