Air Industries Group
Fourth Quarter and Full Year 2023 Earnings Conference Call
April 1, 2024

Presenters
Lou Melluzzo, President and CEO
Scott Glassman, Chief Financial Officer

Q&A Participants
Howard Halpern - Taglich Brothers

Operator
Hello, and welcome to the Air Industries Group Preliminary Fourth Quarter and full year 2023 Earnings Conference Call.

At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If you would like to ask a question at that time, please press "*", "1" on your telephone keypad. If anyone should require operator assistance during the conference, please press "*", "0" on your telephone keypad.

As a reminder, this conference call 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 business strategy and growth strategy.

Expressions which identify forward-looking statements speak only as of the date the statement is made. 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 in, 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 now like to turn the call over to your host, Mr. Lou Melluzzo, President and CEO. Please go ahead, sir.

Lou Melluzzo

Thank you, Rob. Thank you, everyone, for joining us, today. The fourth quarter of 2023 marked a robust conclusion to a year filled with significant progress and strategic positioning for growth. Notably, Q4 reflects the highest net sales of 2023 outperforming all of the quarters of this year.

We also achieved our peak quarterly operating income and adjusted EBITDA for the year.

I will let Scott, our CFO, discuss our preliminary financial results in more detail. But before I do, I just want to say it is clear to me, our results are showing progress and are tangible evidence of the success of our strategy. Based on the strength of our bookings, backlog and growing opportunity set, I have no doubt that fiscal 2024 is shaping up to be a year of growth.

Let me dive right into why I'm so confident. First, during fiscal 2023, we booked 62.3 million of orders, compared to 40.2 million in 2022. This represents a 55% increase. That is quite an accomplishment.

Second, our book-to-bill ratio, which is simply bookings divided by net sales, was a ratio of 1.2:1, a significant improvement over the 0.75:1 we achieved in 2022.

Given the opportunities we see and although timing is always difficult to predict, I believe it is likely we will exceed the 1.2 ratio for 2024, which is a good indicator that not only 2024 will be a year of growth, but 2025 will be, as well.

Third, our backlog, which can be considered funded backlog stood at $98.3 million, marking a 14.7% increase from the $85.7 million we had on December 31, 2022. Our funded backlog represents the net future sales we expect to realize from funded orders received. These funded orders approved by our customers come from long-term agreements, spot buys and other contracts that are for essentially machine components--essential machine components and assemblies used in key platforms and programs we serve.

Importantly, our backlog excludes what is sometimes referred to as unfunded orders. Unfunded orders represent future orders possible under existing long-term agreements or other contracts. When you take a step back, the total value of contracts awarded to us as of December 31, 2023 including our $98 million of funded backlog, was $191.1 million.

As I have said earlier, although timing is difficult to predict, the $191.1 million amount provides a multiyear visibility into our future revenue and validates the key partnerships we have with our customers.

The fourth and final reason why I'm so confident is the support and dedication of our entire professional staff. We employ over 180 people, many in manufacturing, production and quality control. The dedication of our employees was key to our facing and overcoming the challenges of recent years.

We have come a long way. And I believe our year-end backlog position in 2023 bookings are the best form of tangible evidence that our strategy is on track and things are looking bright.

When I took on the CEO role, the company was in distress. If you look--if you go back to 2016, we--we began a 4-year period where we lost a combined $51.7 million. Today, I believe we have the right products, the right capital equipment, the right team and have a requisite capability to grow our business, for many years.

Relationships with our customers are much better and new ones are being nurtured. We have come a long way. In addition to our employees, customers and suppliers, I do want to thank our Board of Directors for their support, wisdom and insight during the several challenging years we had.

Importantly, and before I forget, I want to mention that in July of 2023, our Board announced that Pete Rettaliata would become a Chairman. Pete has served as a Director of the company since 2005 and, in fact, served as President and CEO of Air Industries from 2005 to December of 2014. I appreciate his guidance, and I am glad he accepted the role.

As I look to fiscal 2024, our business strategy is geared towards competing and winning programs that enable us to achieve sustainable and profitable growth. We will also continue our unwavering commitment to generate quality and exceptional reliability.

For those of you who are new to Air Industries, our rich history dates back to 1941, producing parts for World War II fighter aircraft. Since then, we have maintained an impeccable record with no known incidence of part failure leading to mission failure resulting in a fatality. I'm so proud of that. And in 2023, we added yet another year to our track record.

As a critical supplier to the aerospace and defense industry, sales to customers are highly concentrated with four customers, RTX, Lockheed Martin, Boeing and the U.S. government, representing 67.8% of 2023 sales. We serve these customers proudly.

Although some may view sales concentration among a few customers as a risk, I view it as an opportunity. These companies are much larger than us, so when we partner with them, we have room for growth on many new programs they have.

With that, let me briefly discuss some of the key platforms and programs that we supported during fiscal 2023 and that we will continue to support in 2024. Here the top four, based on 2023 sales.

First, the F-18 Hornet program, which accounted for 24.3% of our sales. Secondly, 18.9% of our sales in 2023 came from the E-2D Hawkeye. Third, another 18.1% of sales came from the UH-60 Black Hawk Helicopter. And finally, the 10.5% came from sales of critical components for geared turbofan engines. The first three programs cover a range of DoD military branches, whether it be the U.S. Army, the Navy, the Air Force, Marine Corps, as well as foreign governments.

Additionally, the Geared Turbofan engine is one of the most successful programs introduced in modern times and is in use by many global commercial airlines. So from where I stand, our revenue base is actually pretty diversified when you consider the different end users we actually support.

One important point to make, in the past several years, we have expanded our sales and marketing efforts with a sharp focus on partnering with existing customers in cultivating new ones. In 2023, our strategy yielded significant results. And during the year, we secured an initial $700,000 order from a foreign-based aerospace company for specialized components.

This customer is one of the largest providers of land and gear systems in the world. As we continue to develop and strengthen this new relationship, we are optimistic about securing additional orders, over time.

Now let me provide some comments on the supply chain front. As everyone knows, industry-wide supply chain issues overall remain challenging. Whether it was COVID, or securing raw materials from other countries, I have never seen such industry-wide supply chain difficulties.

We remain vigilant in working through specific issues that impact us. And I'm pleased to report that in the last several months, we have largely worked through one major supply chain issue on one key program that impacted us in 2022 and 2023. We are confident that this issue has been largely resolved. In fact, not only have we begun to receive raw materials from the supplier, but a second source has been identified. Initial deliveries have occurred in 2024, and we expect delivery, products throughout the year.

Now as I promised, let me turn it over to Scott for a few remarks on our financial results, and I'll be back to provide a bit more color on our 2024 business outlook. With that, Scott.

Scott Glassman
Thanks, Lou. Q4 was a really solid finish to the year. Consolidated net sales for the fourth quarter ended December 31, 2023, with $13.5 million. This was comparable to the amount we achieved in Q4 of last year, but was also the highest quarterly level of sales all year long.

For the year, sales approximated $51.5 million. Gross profit as a percentage of sales in Q4 was 16%. For the year, our gross profit was 14.4%, which was slightly higher than the 14% we achieved in 2022. As a reminder, in Q4 of last year, we only achieved a 5.1% gross margin, which was due to the write-down of obsolete inventory.

Operating expenses in Q4 of 2023 were $1.6 million, comparable to the amount in Q4 of 2022, but lower than earlier fiscal quarters of 2023.

Our Q4, 2023, results benefited from a change in the way we administer our bonus programs. Although I won't go into specifics for competitive reasons, our Board is in the process of finalizing bonus plans to incorporate more equity for senior executives to further align them with shareholders. At some point, we will share the specifics.

Our Q4 operating income was a positive $587,000, compared to Q4, 2022, where we had a loss of $820,000. For the year, our operating loss was $295,000, as compared to the $194,000 operating loss we experienced in fiscal 2022.

Interest expense in Q4 was $448,000, as compared to $403,000 in Q4 of 2022. For the year, interest expense was $1.9 million, up significantly from the $1.4 million in 2022. This increase was almost entirely attributable to the increase in interest rates by the Fed, which impact the applicable interest rates we pay on our credit facility.

Finally, on the bottom line, net income was $181,000 for the quarter. This was the first quarter of net income when looking across the past eight quarters. For the year, we reported a net loss of $2.1 million, compared to the $1 million loss of 2022. With respect to adjusted EBITDA, we generated $2.7 million in 2023, compared to $3.5 million in 2022.

A detailed reconciliation of this non-GAAP financial metric is included in our press release that we issued earlier today.

Now let me give some highlights on the balance sheet. Accounts receivable at year-end was $7.9 million, and inventory was $29.9 million. Both amounts reflect a reduction from the prior year.

We finished the year with $346,000 of cash, which was up from the $281,000 in 2022 and total indebtedness of approximately $23,310,000 million, which was a reduction of $1,958,000 million from last year's balance of approximately $25,268,000.

As of December 31, 2023, we were in full compliance with our financial and business covenants related to our credit facility with Webster Bank. I recognize that today is April 1 and Q1 is technically over, but we have not yet prepared any financial statements.

Based on initial calculations, it appears that we are in compliance with our covenants as of March 31, 2024, as well.

Our credit facility does not mature until December 30, 2025, and our subordinated notes are not due until July 2026. However, given our growth prospects and better visibility, we have started the process of negotiations with our bank and others to extend and/or refinance this facility to provide additional stability and strength to our balance sheet. It will take several months or more to come up with a win-win, and we will keep everyone up to date as appropriate.

Finally, before turning the call back over to Lou, I wanted to mention that the company intends to file a notification of late filing on Form 12b-25, tomorrow, Tuesday, April 2, 2024, with the SEC. With everything going on in our small finance team, we need additional time to complete Item 9A related to internal controls and conclude our assessment with respect to growing concern language in our notes. We are currently finalizing these items, and then the auditors will need to complete their work.

Our conclusions will be included on the Form 10-K, which I expect to file with the SEC on or before April 16, 2024. Based on what I know today, the finalization of these items will not have any impact on the preliminary unaudited Q4 and 2023 results announced in our press release issued earlier today, or as were discussed on this conference call. Of course, our Form 10-K will include a complete set of financial statements, as well.

And with that, I will turn the call back to Lou for some closing remarks on our 2024 business outlook, before we have our Q&A. Lou.

Lou Melluzzo
Thank you, Scott. All in all, I want to reiterate my confidence in 2024. With strong bookings and continually expanding opportunities, I am confident about our future and expect 2024 to be a year of growth. As everyone knows, the timing of orders, the receipt of raw materials and the delivery of goods are challenging to predict, especially given the industry-wide supply chain issues.

From my perspective, net sales for the fiscal 2024 are expected to be at least $50 million, if not slightly higher than those of 2023 levels and adjusted EBITDA in 2024 being significantly better than the 2023.

Given everything that's happening globally, I am excited about our position to achieve such growth. As the year progresses, we intend to provide updates, as appropriate.

With that, I conclude my remarks, and at this point, I would like to turn it over to Rob to open the lines for Q&A portion. Rob, would you please do the honors?

Operator
Sure, thank you. At this time, we will be conducting a question-and-answer session. If you would like to ask a question, please press “*”, “1” on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press “*”, “2”, if you would like to remove your question from the queue. For 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.

Our first question comes from Howard Halpern with Taglich Brothers. Please proceed with your question.

Howard Halpern
Congratulations on finishing off a challenging year in a very good way.

Lou Melluzzo
Good afternoon, Howard. How are you, today?

Howard Halpern
Okay. Could we talk, I guess a little bit about the backlog and how you go about, I guess, incorporating new customers that may be small in nature now but you'll be able to grow in the future in terms of maybe new programs. Could you give a little perspective on, I guess, customer acquisitions, basically?

Lou Melluzzo
Absolutely, Howard. As you know, we--and I made a comment on this call, predominantly, our work is centered around four big customers who—also, Lockheed has the Lockheed portion and they have the Sikorsky portion. RTX has Collins and it has Pratt & Whitney and several others. So, the clients that we were pursuing and the clients that we pursue are not usually third or second--even second tier.

These are large OEMs or government direct that for a company our size, once we get into these companies, it seems like there's a lot of areas that we can get involved into.

So it just doesn't limit us to--between the engine side of things and the landing gear side of things, the resting side of things, the rotorcraft side of things, any typical company will have several avenues for us to pursue.

So, our main motive in the last two years has been customer acquisitions. We came off--we did the Farnborough Air Show, two years ago. We did the Paris Air Show, last year. We're going back to England for Farnborough this year, where--to acquire a customer in a place like that, you have one sitting, and we'll make 50 appointments in the course of a couple of days that we visit, so you could hit a lot of clients or potential clients very quickly and efficiently.

And we've been successful, and that's not surprising. That's kind of what we do. We offer a very complex type product that--and our--one of our biggest attributes is that we cannot only make the product, if we can't--it's not that we just make the component. We have the engineering, we have the assembly and actually even a redesign, a small redesign ,if need be.

So when a client sees the capabilities that we have and put on the table, it's relatively easy to see the value that they can get by dropping their product off at Air Industries.

Howard Halpern
Okay. And based on how now you've structured the company, what kind of leverage could you create? So in terms of, I guess, the backlog and continue to grow the backlog, what kind of production can you--can we assume, without a material increase in CapEx spending or operating costs increasing?

Lou Melluzzo
Well, our 2024 CapEx is, obviously, minimal. We spent close to $13 million in the last several years on CapEx to get the company to a point where we are now. I mean, you walk our shops, you see brand-new machines, you see a lot of shiny new stuff. We're investing money in--we've invested money into refurbishing older equipment in preparation for--we were going down this road in 2020. We are predominantly an 85%, maybe 90% military company.

We service all the military programs. Our commercial content is very, very low. And in 2020, we were going to expand the commercial offerings that we could potentially get involved with and COVID hit and commercial fell through the floor. But commercial for us is almost like the unexplored ground.

There's a ton of opportunities, and it could all be done across the same machines that we have now, if we stay within the limits. Obviously, we're not going to make pistons and cylinders for the big airliners, just too big for our equipment, but there's a lot of stuff that we can do on the commercial side that we have just not done in the past.

And those are going to be things that we could bring to the table, without really a huge investment or any investment in CapEx. So, the next couple of years, Howard, it's going to be about filling the capacity in our shop and streamlining efficiencies and trying to do more with less.

Howard Halpern
Okay. And just one last one modeling question. Would it be fair to say that the fourth quarter gross margin is something that you hope to achieve at a minimum for the full year '24 and improve on, going forward?

Scott Glassman
Hi, Howard, how are you? I would say that what we achieved in the fourth quarter by itself, the 16% is something that we are anticipating will be what--where we are for 2024, if not better. It of course, depends on product mix, availability of material, and so forth.

As Lou said, we have resolved, thankfully, the supply--a lot of the supply chain issues, but material is still on short supply and very long lead time. So, we anticipate that the 16% will hold throughout the year, if not be better each quarter, and we'll see where it goes each quarter, but I'm extremely confident in that.

Howard Halpern
Okay. Thanks, and keep up the good work, guys.

Scott Glassman
Thank you.

Lou Melluzzo
Thank you for your questions, Howard.

Operator
As a reminder, if you would like to ask a question, please press "*", "1" on your telephone keypad. One moment, please, while we poll for questions.

There are no further questions, at this time. At this point, I'd like to turn the call back over to Lou Melluzzo for closing comments.

Lou Melluzzo
Thank you, Rob. Thank you, all, for taking the time to be on the call today and for your interest in Air Industries Group. We look forward to updating you on the progress on our next call. With that, Rob, I think the call--you can conclude the call.

Operator
Thank you. This concludes today's conference. You may disconnect your lines at this time, and we thank you for your participation.