

Air Industries Group
Fourth Quarter and Full Year 2022 Preliminary Results Call
April 4, 2023

Presenters

Lou Melluzzo, CEO

Mike Recca, CFO

Q&A Participants

Howard Halpern - Taglich Brothers

Operator

Hello and welcome to the Air Industries Group Preliminary Fourth Quarter and Full Year 2022 Results Call.

At this time, all parties are in a listen-only mode. A question -and-answer session will follow the formal presentation. If anyone should require operator assistance during the conference, 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 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, are subject to a number of risks and uncertainties, some of which are beyond our control and cannot not 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 would now let to turn the call over to Lou Melluzzo, President and CEO. Please go ahead, sir.

Lou Melluzzo

Thank you, Darrell. Good morning and thank you for joining us today. I would like to discuss the reasons for the delay in filing our 10-K.

Last year, our independent audit firm for many years, actually over a decade, merged with a much larger firm. While the same individual partners are still involved with our annual audits, they and Air Industries are still adjusting to the new review procedures of the new firm.

Mike Recca, our CFO, will provide more specific information later in the call.

While I'm unable to provide specifics, I would like to provide some general comments about our top-line performance for the quarter and the year.

Consolidated net sales were \$13.9 million for the fourth quarter and \$53.2 million for the full year 2022. Sales for both periods decreased approximately 9.7% from the respective periods of 2021.

Our fourth quarter and full year 2022 shipments were impacted by significant supply chain disruptions, in particular, the delayed arrival of raw materials. This has been a challenge for our industry ever since the beginning of the pandemic. While conditions have improved, problems still remain.

At the same time, we enjoyed some important business wins in 2022. During the year, we made deeper inroads into the nuclear submarine component market. This is a substantial and exciting opportunity for Air Industries.

As I mentioned before, one of the key factors impacting our results for both the fourth quarter and the full year of 2022 was the disruption in supplies of raw materials. During 2022, delayed arrival of raw material delayed the delivery of more than \$8 million worth of product. In fact, product that should have delivered to customers in 2022 was now delayed to the second or third quarter of 2023.

Our results were also impacted by losses incurred on a specific product. Between underestimating cost and the inflation impact on processing cost, this contract has become unprofitable. Because these losses will continue as we finish the contract deliveries in 2023, accounting rules require that we estimate our future losses and accrue for these losses in 2022. The total recognized and anticipated losses totaled about \$850,000. The good news is, our 2023 results will not be materially reduced as those losses were readily already accounted for in 2022.

Let me emphasize that we are not satisfied with our 2022 results, and we are fully focused on improving profitability in 2023. We do not believe that our 2022 performance is indicative of the opportunities we see, going forward.

We are seeing a significant increase in sales activity resulting from our business development efforts. The positive impact can be seen in the pickup in new business bookings at both our Long Island and Connecticut subsidiaries in recent months. Our bookings in the last three months have substantially improved over the previous nine months.

Let me highlight a few of the accomplishments in winning increased business during 2022.

One of our key corporate objectives has been to transition a larger percentage of the product mix at our Sterling Engineering Unit into longer term agreements, LTAs. To further tap the potential of this subsidiary, in that regard, contracts wins for Sterling in 2022 included: a \$6 million life-of-the-program program extension for turbine case components for the PW4000 jet engine used on many Airbus and Boeing commercial aircraft; a new \$2.8 million order for engine components for the popular F404 jet engine; and a new contract for a long-established customer for a Support Nozzle used in high-pressure turbine engine to generate onboard electric power on large ships.

Our Long Island subsidiary, Air Industries Machining Corp., also had important wins in 2022; notably, a \$12.4 million contract award to produce complete main and nose landing gear and ancillary components for the U.S. Navy E-2D Advanced Hawkeye Airborne Early Warning Aircraft. The contract is expected to be completed in 2024. We have been making landing gear for E-2D for many, many years.

Additionally, during the course of the year, we won a total of 12 LTAs for the Blackhawk helicopter with a combined estimated value of over \$30 million. The Blackhawk has been a mainstay of our business for many years. There has been some concern expressed about the effect of the U.S. Army selection of the Bell, the Valor as a future replacement for the Blackhawk. Based on the current timeline, the replacement helicopter is not projected to begin initial low rate production until 2030, seven years from now. Over the next five years, the Blackhawk production is forecasted to total over 500 new aircrafts.

Beyond producing product for new production, there will be continuing opportunity in aftermarket sales. The fleet of Blackhawks operating both in the U.S. and in foreign countries is estimated at some 4,000 aircraft. Because they have more moving parts than any fixed-wing aircraft, helicopters require more maintenance and replacement of parts. We estimate that 50% of our business is aftermarket. With 4,000 aircraft in operations, there is a considerable long-term opportunity.

We have also previously announced a \$5.2 million long-term agreement for Chaff Pods for the CH-53K heavy lift helicopter, a program that is just now entering full rate production, now ramping up.

Each CH-53K is four or five times the cost of a Blackhawk. Deliveries of nearly 100 aircraft over the next five years are expected in the armed services, principally the Marine Corps is pressuring to increase this rate.

Beyond the LTA for the CH-53K, our Sterling subsidiary is currently producing, under single purchase orders, two first articles products, and is expecting a purchase order for a third product. We are hopeful that these purchase orders will lead to larger LTAs in the near future.

We have been targeting the nuclear submarine market, a new market for us with exciting potential, for some years now. This initiative is reflective of one of our major growth strategies, to expand our portfolio beyond aerospace platforms we currently serve to include non-aerospace components. The nuclear submarine industry is rapidly expanding to meet what is projected to be a 50% increase in demand from the Navy. We see substantial opportunities for suppliers such as Air Industries that can deliver to the ultra-high-quality standards required.

We have recently won two contracts from two suppliers to Electric Boat, one of the two submarine builders. We are optimistic that our successful execution of this project will lead to larger and more significant opportunities as the submarine industry is continuing to seek new suppliers to support the forecasted ramp up in the years ahead.

In summary, 2022 was a year of substantial challenges, as well as significant strategic business wins.

Looking ahead to 2023, while we expect Air Industries and the overall aerospace sector to continue to experience supply chain delays, we are also encouraged by our inroads into several exciting and expanding platforms.

We look forward to reporting our full results for the fourth quarter and the year in due course. We are vigorously executing our stated strategy and excited about the opportunities we see for Air Industries Group.

At this point, I'm going to turn the call over to Mike Recca, our CFO, for his report and then we will follow up with question-and-answers. Mike?

Mike Recca

Thank you, Lou. I share your frustration that the 10-K has been delayed. And again, I reiterate that the delay is really caused by the shift from our smaller accounting firm combining with a larger one and everybody getting to know the new procedures that we have to go through.

I would like to provide some specifics on the issue that's caused the delay.

In valuing our inventory, we have a policy that we reserve, that is write-down, the value of inventory that is aged. And by age, we mean inventory that has not moved either back into production or has been sold and for which we do not have existing purchase orders.

In several steps over time, over a number of years, this write-down reduces the value of the inventory to zero. In reviewing this policy, our auditors are considering whether a more appropriate policy might be to write off the total value of this aged inventory, after a period of non-movement.

So, if we conclude that additional write-down of our inventory is more appropriate, then we will incur a non-cash charge and expense. We do not have an amount of that expense yet, but again I emphasize that it is a noncash expense.

I'd like to reiterate also that, as Lou discussed, our full-year revenues for 2022 were about \$53.2 million. That's a reduction of about \$6 million or close to 10% from 2021. The effect of the raw material that caused the delay that Lou discussed in shipping two orders was worth \$8 million, so this clearly illustrates the impact of the late receipt of material.

While I wish I could share more detailed financial information, the resolution of the inventory issue will affect almost all our income statement categories. So, I really cannot and do not want to provide what might turn out to be inaccurate information, now.

But I will say that our liquidity remains strong. We have substantial availability on our primary credit line. And also, we are in compliance with our bank covenants. We have one single covenant, the most important, called a fixed charge coverage ratio with our bank, Webster Bank. For 2022, the ratio has declined, and that's due in part to poor financial results on our part and in part to higher interest rates induced by the Federal Reserve. That said, we remain comfortably above the minimum requirement.

And so with this, I'll turn the call back to Lou for some closing remarks, and we look forward to your questions.

Lou Melluzzo

Thank you, Mike. Darrell, I would like at this time, to open up the lines for our shareholders' questions-and-answers. So can you do that, please?

Operator

Thank you. We will now 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 questions come from the line of Howard Halpern with Taglich Brothers. Please proceed with your questions.

Howard Halpern

Good morning, guys.

Lou Melluzzo

Good morning, Howard. How are you doing?

Howard Halpern

Okay. Based on your commentary, we're looking at, I guess, the second half of 2023 revenues should be--should grow compared to the first half revenues. Is that a fair assumption?

Lou Melluzzo

Well, Howard, it depends on raw material, incoming raw material. We have a product right now, which is one of our better running products in the shop that has a three-month lag in material receipt.

So, we're working not only with the distributor, but we're working with the mills, directly, to see how we can do this because the line will go dry in the next month or two, and then the next batch of material will not be scheduled to come in until sometime in September.

Now keep in mind that these products have a 16-week window, or a 16-week lead time. So, we're doing whatever we can to pull that left. But that's what I can put out there for right now. So there is this material at all phases.

Howard Halpern

Okay. But as far as you're concerned, the customers are in place. The orders are in place. It's really just the raw materials and the timing of the shipments of those raw materials, because the customers have nowhere else to go.

Lou Melluzzo

That is correct, Howard, 100%.

Mike Recca

And the customers are working with us to try and solve the raw material issues.

Howard Halpern

Okay. And from previously, is all the machinery in place so that when you start producing all the product, that the run rate, the leverage you're going to see some of that in 2023, and beyond?

Lou Melluzzo

So, all the equipment that we have purchased is in place with the exception of one piece of equipment that is due in the later part of July, early part of August.

And that particular piece of equipment was purchased for our thrust strut line. So, basically to double capacity and keep up with demand, those are, the thrust struts are being forecasted to go to around a 720 units per year, and it will start up from that.

So it's a substantial ramp-up this year that, unfortunately, we can't get material for, right now. So hopefully, by the time that machine comes in and gets set up in our shop in New York, the material issue with that will kind of alleviate itself.

That's what the mills are saying, but you also have to look at the 16-week lead time. It's an important product and important to have that line there all the time.

Howard Halpern

Okay. I don't know if you care to share what your current backlog is and/or what are you seeing in the pipeline in terms of the request for proposals and what kind of activity is going on for the future?

Lou Melluzzo

So our--like I made a comment earlier in my presentation, the last three months, we've had substantial increase in bookings and sale wins over than the last nine months of last year. So, there is definitely more activity out there, both in our rotorcraft and the nuclear submarine. I mean we're being pretty choosy as what we do with the submarine work. Currently, our orders are for valves, which is kind of a cream of the crop in the sub. So, we're seeing a significant uptick in interest in that, which is very positive for us.

The CH-53K, as I alluded, we have two CH-53K parts in-house that we're going to first article, as a spot buy. Those, hopefully, can materialize into LTAs, which we have a high degree of comfort once we show success to our client. So, there is definitely an uptick in activity in the market.

Howard Halpern

Okay. Okay. Thanks. And well, keep up the work in managing everything that's going on. There's a lot on your plate, it appears.

Lou Melluzzo

Thank you, Howard.

Operator

Thank you. As a reminder, if you would like to ask a question, please press "*", "1" on your telephone keypad.

I'm showing no further questions at this time. I would now like to turn the call back over to Mr. Melluzzo for any closing remarks.

Lou Melluzzo

Thank you, Darrell. So with that, once again, thank you all for taking the time to be on the call today and for the interest in Air Industries Group. We look forward to updating you on our progress on our next call. Darrell, I'll turn it over back to you for the conclusion.

Operator

Thank you. This does conclude today's teleconference. We appreciate your participation. You may disconnect your lines at this time. Enjoy the rest of your day.