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<<Greg Konrad, Analyst, Jefferies Group>>

Good morning. Thank you for coming to Jefferies Global Industrial Conference. I'm Greg Konrad, Vice President of Equity Research at Jefferies. Very excited to have Aerojet Rocketdyne with us and Paul Lundstrom, VP and CFO with us, will do a quick presentation and then we'll have Q&A session. Thank you.

<<Paul Lundstrom, Vice President and Chief Financial Officer>>

Okay, thank you very much Greg, very happy to be here. Maybe a quick comment on, just to keep our attorneys happy. There are some potentially forward-looking statements that we'll talk about here in some non-GAAP measures as well. If you have questions about our risk statements, all that stuff is available in our filings at www.rocket.com.

So aerospace and defense, Aerojet Rocketdyne in aerospace and defense, for those of you unfamiliar with the name, we are A&D company focused primarily on rocket propulsion. Top line last year about $1.9 billion, that's what we've done over the last 12 months or so as well. A broad portfolio of programs from traditional solid and liquid fueled propulsion systems to chemical and electric propulsion as well, those are typically used for more for satellites and in-space positioning of satellites.

We do air breathing. Air breathing is an important theme for us over the next several years, probably, if you follow space you have heard about Hypersonics and the development of some of the next-gen Hypersonics technology in some cases, air breathing is an enabler for that.

If you look at the history of the company and as the company has evolved over the last several decades, we have found ourselves with a fairly significant amount of excess real estate, primarily in the Greater Sacramento area. We are actively working to monetize that, much of it has been entitled and is ready to go and so that's probably a little bit of a monetization upside opportunity for us.

If you look at the business, two broad end-markets or segments that we service, biggest piece for us is defense. And that's nationally and globally critical missile programs for the most part. Some of the big programs that you probably have heard about Standard Missile, THAAD, the acronym stands for Terminal High Altitude Area Defense, Patriot also a big and important program for us here in the U.S. and also abroad.

You look at our customer mix, on the defense side, largest customer by far, Lockheed Martin, which is primarily missiles, a little bit of space in there with the Orion program, but by and large Lockheed Martin for us is defense. Raytheon also is a big important customer, you look at the mix then between those top two customers, about half the overall business in defense, just specifically dedicated to Lockheed and Raytheon. You sprinkle on top of that sales to the Missile Defense Agency that we have through our prime relationship in the Coleman Aerospace Company. More than half of the overall Aerojet Rocketdyne portfolio is specifically defense, that's a little bit of a mix shift compared to what you may have heard us talk about in years past. We've historically talked about a roughly 50-50 split between space and defense. And so I would say you look ahead over the next six to nine months and it's going to be more like 60-40 weighted to defense.

Good business, it's growing and I think there's some next generation programs on the horizon that will be very important to Aerojet Rocketdyne, two of them you may have heard of GBSD, stands for Ground Based Strategic Deterrent, that's the replacement to the U S Minuteman Fleet. That will likely be a very large program for us. And then also Hypersonics, which I mentioned before, next generation, extremely fast missile or aircraft technology and we have a lot of great technical acumen to facilitate that.

Space, top two customers on the space side, NASA and ULA, big program running through the factories right now supporting NASA and that would be the SLS program, what you see in the slide is the RS-25. That's the main engine for the SLS program. SLS stands for Space Launch System. That's the NASA next generation launch vehicle that will take astronauts to the moon in 2024 for the first time in quite some time. So that's an exciting program that is doing well. For ULA, ULA stands for United Launch Alliance, that's a 50-50 joint venture between Lockheed Martin and Boeing.

Couple of programs that we run right now for ULA, one is Atlas V, we have the upper stage engine for the Atlas V. And then the Delta IV, we have the main engine and the upper stage as well for Delta. You may recall last year, we had a nice press release, with a key program win for ULA’s next generation launch vehicle, that will be the upper stage engine for the Vulcan, a good program there.

Around the same time, we also announced a big program win with what formerly was Orbital ATK, now is Northrop Grumman Innovation Systems, for their next gen launch vehicle called the OmegA, also the upper stage engine for that. So a lot of good work out there for both NASA and ULA. We also have a number of other programs including crew capsule. We got numerous in-space propulsion programs for satellite repositioning. As I mentioned before, it's a great business, it’s fun to be part of it and it's particularly setting knowing that we're going to be part of the moonshot here coming up in a few years.

Couple of comments on the financials. It was a good first half, top line just under $1 billion at $977 million up 2%, we were up 4% in Q2. Maybe a comment on backlog not on the slide but significant backlog growth in the quarter. If you look at the sequential change from Q1 to Q2 backlog was up $800 million, nice backlog growth there, $4.6 billion was the total backlog as of the end of June. To get ultra-precise with you here the number was $4.648 billion, we just barely missed the round on $4.7 billion, but I'll add that is literally the highest level of backlog that we've had in the history of the company, so that gives us confidence in the next couple of years.

Right hand side, profit performance adjusted EBITDAP, that is our profit metric. Nice growth in the half, of 21% with some nice margin expansion as well. Just looking back to margin and margin rates, if you recall our EBITDAP ROS return on sales, looking back to 2016 was a little over 11%, I think 11.3% was the number, at the time we talked about aspirations for 200 basis points of margin expansion. If you look at what we printed at the end of 2018, even excluding a big gain we had on the environmental side, margins were 13.8%. So there's your 200 basis points of margin expansion, plus we did what we said we would.

Question that we get now is, is there more runway? Is that 13.8% sustainable? I would say the answer to that is yes, I do think there probably is a little bit more runway. I am happy to talk about that, but we're just going to keep our heads down and continue to focus on keeping costs in control and executing on our programs and we believe that good things will come.

On cash, first half up versus last year albeit on small numbers, as you know we tend to be back half loaded on cash. We aspire to cash flow greater than net income. You've heard us talk about that, we certainly have delivered on that the last few years and then some. We're very focused on driving continued working capital improvement that helps to offset some investments that we are making in the business right now, perhaps a little bit of CapEx headwind as we move through the back half of this year and likely into 2020 as well. As we continue to make investments in facilitizing in some of our growing facilities. Two in particular, Huntsville, Alabama, where we have some high-end manufacturing work and continue to facilitize for that, and also in Camden, Arkansas where we continue to make investments in our large diameter solid rocket propulsion technology.

Looking ahead to 2020, just as a place holder for those of you keeping track, we will have some pension contributions that will likely resume as we get into 2020. So you want to book-keep for that. Bottom line, lot of strong macro tailwinds, we're pretty excited about the business. I think technically we're very well positioned to capitalize on those tailwinds. We're going to continue to drive operational improvements. You have seen our focus there over the last couple of years and I think you've seen it in the performance which is just going to keep our heads down and focus on making this business better. With that, Greg if you want to...

<<Greg Konrad, Analyst, Jefferies Group>>

Thank you. I mean I just wanted to follow up on something you said. I mean you said a little bit of runway on margins, I'm trying to figure out what that number is or how do you kind of quantify the runway you have with margins?

<<Paul Lundstrom, Vice President and Chief Financial Officer>>

Sure. So we have – we do a lot of benchmarking and if you'll pardon me mixing metaphors, let's talk about EBITDA. EBITDAP is a little unique and if you look at the benchmarking of the aerospace and defense primes they typically will talk EBITDA. If you look at the last five, six, seven years for A&D companies, whether it's Orbital ATK, when they used to report separately or Northrop or Lockheed or Kratos, just do a pareto of margin rates for those A&D companies over the last many, many years and draw a straight line through the middle. And you'll see that on average over the last five, six, seven, most of those A&D companies tend to median at about 14.5%, somewhere between 14% and 15%.

I look at our EBITDA last year and it was 12.8%. Do I think we could do better to get closer to that median? Yes, I do, it's not going to happen overnight. We run very large programs. You can have programmatic perturbations you look at that same list of A&D companies over a seven year period, you'll have one year where somebody is well above 14% and you'll have one year where they're well below, that's just the nature of big programs and that's how we are. But I do believe there is upside potential and we're just going to continue to keep our heads down and focus on that.

<<Greg Konrad, Analyst, Jefferies Group>>

And then a number of contractors have kind of talked about maybe a near-term/longer-term growth outlook and when you think about margin expansion, what are the assumptions around the next – let's say three or five year growth outlook?

<<Paul Lundstrom, Vice President and Chief Financial Officer>>

So more top line? Sure. So, going back to what we said a couple of years ago. We talked about aspirations to grow mid-single-digit organic. I continue to believe that is a likely outcome for us, even with a little bit of pressure that we've had with the sunset of the AJ-60 program that was the solid rocket booster program for Atlas V, even with a little bit of top-line headwind, I still believe that that mid-single-digit is reasonable. And the reason that I believe that is, look at what's happening in defense. Even our core book of programs is strong and growing, you couple that with some of this next generation work, the two in particular Hypersonics and GBSD, those will be big.

GBSD, I'm highly confident that we'll have significant content on GBSD. And in terms of Hypersonics, we're playing in all aspects of Hypersonics as well. So I think those are two significant growth wedges as you look to the next three to five years.

<<Greg Konrad, Analyst, Jefferies Group>>

I'll try to get a little bit more on those two points. We'll see if this works. I think it was a little surprising this quarter, a number of the prime contractors actually quantified their Hypersonics opportunity in terms of the size of the business. I mean given your focus on the propulsion and the sizing of the prime opportunities, is there any way to think about what the size of that business is and maybe where it could go or at least the rule of thumb that maybe we could try to estimate.

<<Paul Lundstrom, Vice President and Chief Financial Officer>>

So, I'm not going to give you a number on that one, so nice try Greg, but maybe a little bit of color. First, would just be the statement that a lot of this stuff is in the classified environment and so you're not going to hear us out there, beating our chest, talking about it too much, other than to say that we have the capability and we're participating in numerous areas.

We are working with all the primes that you would expect to be in Hypersonics for a number of different programs. We're also working with some specific DoD departments, don't want to get too much more specific on that, but plenty of opportunity. And when I say we're participating in all aspects, Hypersonics is broad – that's a broad category, it can be strategic missiles, it can be tactical missiles, it could be aircraft, it can be targets, it could be the reentry vehicle, I mean there's all sorts of potential aspects of Hypersonics and we are participating in all.

<<Greg Konrad, Analyst, Jefferies Group>>

And then you mentioned GBSD is being a large opportunity and with Boeing saying they're not going to bid and we don't know necessarily how that's going to play out, whether it's rebid or if they change it or if they sole source it. I mean, you seem pretty confident that GBSD is a large opportunity and then how do you kind of handicap that program?

<<Paul Lundstrom, Vice President and Chief Financial Officer>>

I do think it's a large opportunity and I say that because, so first of all, on Boeing no-bid, I don't know what to think of that. And I only know what I read in *Space News*, I guess, but we are going to continue to operate under the assumption that there's likely two, we have partnered with both Boeing and Northrop Grumman since this and even Lockheed before they were down selected on this next gen program. We are actively working to help them with their bids, more so now Northrop, now the Boeing has made that decision. But given the conversations we're having with those primes, yes, I do believe that we will have significant content on GBSD.

<<Greg Konrad, Analyst, Jefferies Group>>

I mean, and then more broadly speaking on that point, just consolidation on the industry, whether it's your direct competitor getting bought out or maybe some of your customers UTX, Raytheon, what are the broader opportunities or risks that you see from consolidation?

<<Paul Lundstrom, Vice President and Chief Financial Officer>>

Consolidation happens, it happens in every industry and I think aerospace and defense isn't dissimilar, we've seen it in A&D and you'll look at even our M&A pipeline, I mean, some of it is just consolidation. I mean there is things that we could probably do more in terms of vertical integration. And one important theme for aerospace and defense that I believe has made consolidation quite prevalent, is look, scale matters, particularly in government contracting where there is a tremendous amount of scrutiny over costing and pricing data and roll-ups.

So if you have more scale and you can spread your overhead cost over a bigger base, that does make you more competitive. And so there is things that we're looking at. In terms of competitive dynamic, haven't really seen anything since the acquisition of Orbital ATK, Northrop's acquisition of Orbital ATK, I don't think it's directly affected us. There was some chatter over the last few weeks about the impact on large diameter solids for GBSD and I think there were some implications by some of the trade rags that that might be a bad thing for us, but it absolutely is not, it's what we're, like I've mentioned before, we're partnering with the primes and I think we got tremendous, not only capability, but we are extremely competitive on the solid rocket motor side, given the investments that we've made, both in restructuring programs but also in facilitizing some very modern capabilities both in Huntsville and in Camden, Arkansas. So…

<<Greg Konrad, Analyst, Jefferies Group>>

And then just maybe talk about a little bit more about pieces of your core business. I think you booked a couple of large orders around THAAD. But I mean when we think about THAAD, Standard Missile, PAC-3, what type of tailwinds are you seeing on the missile defense side?

<<Paul Lundstrom, Vice President and Chief Financial Officer>>

So, I mentioned the sequential growth in backlog and a big piece of that was THAAD, we – you and I have talked before, Greg, about Kingdom of Saudi Arabia in particular as being a pretty significant pending award, nice to see that drop in Q2, so that was big. We also talked about GMLRS, which I would put into the more tactical category. PAC-3 or Patriot has been strong for us as well, we didn't disclose it, but just to give you a little bit of color, we are seeing upticks in other programs on the tactical side, it can be a little on the lumpy side. But – and by the way I broadly define tactical as not just stuff measured in meters of range, but up to 100 miles would like things like ATACMS which is also, we've seen strong booking rates and top line growth for that as well.

But ATACMS, GMLRS, Javelin, all of those programs we have seen nice growth from increasing budget spend or budget dollars.

<<Greg Konrad, Analyst, Jefferies Group>>

That kind of covered the next question. So yes, I mean, I think that tactical munitions, you don't talk about enough even GMLRS, but I mean it seems like production is kind of up across the board. I mean transitioning to the space business, SLS, RS-25, I think at some point you'll get a production award. I mean, how do we think about the cadence as it transitions from restarting the line to building the 17th motor?

<<Paul Lundstrom, Vice President and Chief Financial Officer>>

Sure. So we are – SLS is progressing quite well. In terms of cadence, we had the – I guess call it refurbishment of the existing shuttle main engines and we are progressing very nicely on that. That first launch vehicle, that first launch is going to be called Artemis 1. Artemis was the twin sister of Apollo kind of a cool name. But those four engines have been delivered, the engines and the controllers. So we're ready to go on Artemis 1.

Artemis 2, we should deliver some time towards the back half of 2019, so that's the second mission, also should be ready to go here. We don't work on a bunch of things in batches, we try to get flow as best we can. And so we are already making new engines. So, perhaps that's a myth to dispel. We are producing new RS-25 engines now, they're running through our factory as we speak. So that's important for the program. That program is doing well. We – particularly for us, I think we’re hitting our metrics and pretty excited about the future of the program.

<<Greg Konrad, Analyst, Jefferies Group>>

And it just brings me back to kind of the growth that you had mentioned before. I think in the past maybe you talked about space being flattish and defense up high single-digits to get to mid single-digits. Is that kind of…

<<Paul Lundstrom, Vice President and Chief Financial Officer>>

I still believe that to be true. I think space is flattish, you'd look at it over a five year period, you're going to have an up year, you're going to have a down year, but generally speaking, I think it's flattish for the next few. We will see growth in defense and certainly given what we talked about with some of these growth wedge programs in hypersonics and GBSD.

<<Greg Konrad, Analyst, Jefferies Group>>

And then just to go back to the launch market, I mean, I think at one point people were kind of counting you out, but you won the RL10 on OmegA, you won the RL10 on Vulcan. I mean, what type of opportunities are you seeing in that market as the air force kind of competitions, at what one point it was kind of a monopoly?

<<Paul Lundstrom, Vice President and Chief Financial Officer>>

Yes. So we are very pleased to win the upper stage, thank you for mentioning that. Very pleased to win both the OmegA and Vulcan upper stage engines, that's a big deal for us. If you look at the LSA as it was originally intended, you had four main competitors, two commercial guys and then ULA, and what now is NGIS, that went from four to three. So as it stands today, it's Blue Origin, ULA and NGIS. And then ultimately there will be another down select, and that will be two.

So we will have some share of that market for sure with the RL-10 upper stage. And then we're going to continue to pursue other opportunities, certainly, anything that we can do to help NASA in their future, that’s important to us. Once you get into the – some of the truly in-space stuff, Moon and beyond, there is a tremendous amount of work that we could potentially help with, in terms of landers and gateway and thrusters for that. And then maybe on AR1, which is not in our calculus at all, when I say mid single-digit organic, but we continue to progress quite well on the AR1 engine, which was a potential alternative to the first stage for Vulcan. That first stage engine as it stands today is going to be Blue Origin, okay fine. But we continued to progress on the AR1, we'd like to do a hot fire test of that engine sometime early next year, that program has been progressing nicely.

And so that’s going to sort of sit on the shelf as a backup engine for Vulcan. But you talk to our – the head of our Space Business, he believes there is opportunity in the more medium launch vehicle size, just a matter of finding it. And if you have a highly efficient kerosene LOX engine that's ready to go, brilliant, that’s going to help a launch provider in their quest for the next-gen rocket. So we'll continue to watch it, I think there is some upside levers, but we're taking a more conservative stance on the space outlook right now.

<<Greg Konrad, Analyst, Jefferies Group>>

That was helpful. And then, I think there is always a lot of confusion around EACs and I think people discount what they really are or what they mean. I mean, when you think about the productivity that you've been able to drive, I mean, how do you think about quarterly EACs versus maybe the long-term productivity that you're seeing across the business?

<<Paul Lundstrom, Vice President and Chief Financial Officer>>

Sure. So quarterly EAC adjustments is stock standard in the aerospace and defense industry, you'll see every A&D company talk about them, that's just how our program accounting works. We are using ASC 606 and POC accounting, percentage of completion accounting. So every A&D company you evaluate is going to have quarterly estimate at completion adjustments. If you look at ours, our pattern over the last couple of years, but for a quarter, there in Q1 of last year, they've all been positive.

What that means is we tend to run conservative accounting. So the way I would think about EAC changes in a given quarter, it might not all relate to the existing quarter, just making up a number Greg, if our average contract life is two years, and so on average you're halfway through your two year contracts. Take, say you had a $20 million EAC adjustment in one quarter, divide by four and then blow back $5 million each quarter, that's one way to look at it very simplistically. But, you mentioned productivity, all this focus on cost out, the restructuring programs we've been running CIP1, CIP2, a lot of that has flowed back to the customer, but some of that has dropped through as well.

<<Greg Konrad, Analyst, Jefferies Group>>

And that's helpful. And then just one more in terms of longer-term targets. I mean structurally what type of free cash flow generation do you think you guys can convert?

<<Paul Lundstrom, Vice President and Chief Financial Officer>>

We're going to continue to focus on free cash flow greater than net income, I think that's a good aspiration, you've seen us deliver that the last couple of years, that's going to continue to be a big push. And this is a business that tends to have good pay habits that helps. There can be programmatic perturbations and because we run large programs, performance-based milestone payments can be material and move you from quarter-to-quarter. So cash will be lumpy, but if you look at the business over the long-term, I'm targeting us to be greater than net income.

<<Greg Konrad, Analyst, Jefferies Group>>

Okay, fits in nicely. I mean, if you think about the leverage it's come down, and net cash position, what do you expect to do with the cash?

<<Paul Lundstrom, Vice President and Chief Financial Officer>>

Yes, nice little upgrade by Moody's a week or two ago as well, that was nice to see. So we continue to be very focused on capital deployment, there is a fair amount of cash sitting on the balance sheet for a company our size, I think end of Q2 we are just under $750 million, which I know is a large number. That's the product of strong cash generation over the last couple of years. We continue to look at all options, I mentioned – actually you mentioned before consolidation in the industry and I made a point that scale does matter, the ability to spread your overhead costs over a broader base helps with competitiveness.

You look at some of the cost headwinds that our business has just based on 50 years of history in aerospace and defense, two of those headwinds are pension and environmental, those are costs that are in our rates. Good news is, the preponderance of those costs are recoverable through our rates, it doesn't drop straight through to the bottom line. But if you're head-to-head with another company that doesn't have those legacy costs, you're at a small disadvantage.

So to the extent that we can spread that over a broader base, it does help us with competitiveness. So I expect us to continue to pursue M&A, it just has to make sense for the shareholders, it has to be an adequate payback and it has to be the right fit.

<<Greg Konrad, Analyst, Jefferies Group>>

That makes sense. And then just two quick follow-ups. In terms of – you had mentioned CapEx in some of the investments in both Huntsville and Camden, how does that kind of run out? I mean, I think you've seen a lot of contractors kind of have climbing CapEx at least for maybe another year. What do you think about the progression?

<<Paul Lundstrom, Vice President and Chief Financial Officer>>

I look at although you didn't see it in the first half, you will likely see it in the back half CapEx pressure this year, we'll see some CapEx pressure next year. If I look at the rate we should likely be at, because we are a company that continues to invest in its business, it's not like we have decrepit factories, they are in brilliant shape for the most part. We've just been moving facilities around. So I suspect you get to 2021 and beyond CapEx to sales is somewhere in the order of 2%.

<<Greg Konrad, Analyst, Jefferies Group>>

And then you touched on it briefly, but any update on real estate?

<<Paul Lundstrom, Vice President and Chief Financial Officer>>

Sure. So, for those of you who aren't familiar we have a significant excess real estate that goes back 50 years when we had significant buffer and noise abatement land, when we were doing big rocket testing up in Sacramento, We’ve got north of 11,000 acres up there about half of which we have moved completely non-operational, it's part of our Easton group, which is different segment specifically focused on monetizing that. We've got about 3,900 acres right now that are fully entitled and ready to sell, it's just a matter of finding the right buyer. That's a little bit challenging, we – it's not like you want to just dump all that into the market, you’d just get crushed in terms of price and we want to maximize the value of this to create max shareholder value.

So we're going to continue to be patient, we're actively working it, and when I say actively, I mean we're actively working it. We're talking to developers and a whole bunch of different potential structures to get this thing moving.

<<Greg Konrad, Analyst, Jefferies Group>>

Thank you, Paul.

<<Paul Lundstrom, Vice President and Chief Financial Officer>>

Okay, great. Thanks, Greg. Appreciate it.