

Company Name: Aerojet Rocketdyne Holdings, Inc. (AJRD)
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<<Greg Konrad, Analyst, Jefferies & Company, Inc.>>

Good afternoon. Welcome to the 2022 Jefferies Industrials Conference. I'm Greg Konrad covering equity research at Jefferies. Very excited to have Aerojet with us today and Dan Boehle, CFO, who will give a presentation, then we might have a little time for Q&A. Thanks, Dan.

<<Dan Boehle, Chief Financial Officer>>

Sure. Thank you, Greg. Appreciate it and good afternoon everybody. Starting off with our safe harbor statement. Some of the comments that I'll make today are forward-looking. And different risks and risk factors are attributed to those – the results could vary considerably from the comments that I make today. And I'll also talk about some non-GAAP measures, which are reconciled in the appendix to this deck. If you want to know more about either our risk factors and/or the metrics that we talk about from results, you can look at our SEC filings, which can be found on our website or the SEC's website.

At a glance, Aerojet Rocketdyne is about \$2.2 billion Company. We are involved in innovative manufacturing of rocket propulsion systems for both space and defense uses. Our backlog as of Q2 2022 is about \$6.9 billion, so close to a record high for us. I think the highest we've been is about \$7 billion. It's a record – that's about three years of our sales. So it presents a good forward look as to what our sales are going forward. We have a diversified portfolio of programs and we are investing in line with our nation's space and defense needs and what the priorities of our U.S. government are.

With regards to space and defense systems propulsion, we'll talk about that a little bit more on the next couple slides, but on the bottom right, you'll see that we have Easton Development Company, which is tasked with monetizing some excess real estate property that we have up in the greater Sacramento area related to past production that we've done up there.

Moving to our defense portfolio, we have a strong alignment with the Department of Defense's priorities with our existing portfolio programs. Our core portfolio programs are along the top - the Standard Missile program, THAAD and Patriot. The three of those together represent probably about 30% of our overall sales. And those will represent good solid growth over the long-term, slight low single -digit growth, but those are where we have mature production. And we look at those contracts to grow and increase our margin rates over time. Those are in fixed price contracts now that they're in mature production.

We also are investing in critical technology and capability for the next generation programs on the defense side, those on the bottom, the highest growth coming from Next

Generation Interceptor in the coming years, as well as various hypersonics programs. We're involved in hypersonics, in scramjets, in solid rocket motors and various components of both offensive and defensive hypersonic weapons and defensive missile systems. And we recently set a world record or set a record with our scramjet engine in the HAWC program with Lockheed Martin. We're also developing a new solid rocket motor for the OpFires program. Lastly, the Sentinel or what used to be called GBSD, the Ground Based Strategic Deterrent, we're a main partner with Northrop Grumman on that program, which is the replacement for the Minuteman III nuclear arsenal.

Moving over to our space portfolio. Again here a number of – a couple of very strong core programs across the top there. We are supporting the space launch system, which is to help reestablish the U.S. based human space flight for NASA as well as their deep space exploration hopes going beyond the moon and going into Mars ultimately. We produce the RS-25 engine, which is the main propulsion system on launch for that system, four RS-25's launch that off the ground. We also have numerous other propulsion systems throughout SLS, and then the RL10 sits on top of that. In the Orion spacecraft, we have some other propulsion as well.

So a number of our propulsion systems are on the SLS program. And we're looking forward to seeing the Artemis I mission later this month launch for the first time and orbit the moon. So a lot of excitement there around that program. The RS-25 engines - the ones that are on the Artemis I program are actually leftover space shuttle main engines. So those have been refurbished and repurposed for the space launch system. So long legacy there under the Aerojet Rocketdyne legacy of products.

So across the right, there is another workhorse engine for us, the RL10, which is upper stage engine. It's used on the – currently used for Delta 4 and Atlas program, as well as it's been chosen for ULA's Vulcan Centaur launch vehicle. And we just announced recently that vehicle has been selected for 38 of the launches on Amazon's Kuiper satellite systems. So we got a big 116 engine purchase there. The ULA Vulcan launch system is also used for 60% of the national security space launch arrangement. That RL10 has been a workhorse for generations. It's launched about 300 missions, using more than 500 engines, very reliable and basically a very core business for us. And with the commercial sale to Amazon, we'll see some growth coming out of RL10 as well.

Along the bottom is some of our growth areas in the space area in space propulsion with the way that things are evolving with in-space and needing to maneuver things between and in and out of orbits. It's becoming more and more important to have propulsion on satellites and other assets that are up in orbits. So our in-space propulsion includes electrical propulsion, chemical propulsion. We are developing advanced solar electric propulsion and we are looking forward to developing larger thrusters for larger assets that are up in space. In addition in our space portfolio another growth area is advanced space power. If we're going to establish a base on the moon and a moon gateway to get beyond there, those things need to be powered and so we're working on nuclear fusion power to be on the surface of the moon and things like that. So we've had a history of power. We

did all the power for the International Space Station, and those were just replaced a few years back.

On commercial space, we are the provider of much of the propulsion on Boeing's Starliner offering from the Commercial Crew program. They just had in May their successful Orbital Flight Test, their uncrewed orbital flight test. And later this year, we expect them to be launching their crewed flight test sometime towards the end of this year. So we are a partner, a proud partner of them on that, and looking for other commercial space opportunities as well for growth in the space business.

Moving over to our financials. This second quarter year-to-date, we are about pretty much flat with where we were last year on sales, a little bit of a decrease 1%, but just over \$1 billion in sales for the year. We had a bit of a charge this quarter. We had to reverse some revenue on a particular contract within our Standard Missile program. Just one component of that program, we have multiple components on that program. One of the contracts went from a positive booking rate into a loss position this period, so moving to the right that significantly impacted our adjusted EBITDAP for the period. Our year-to-date adjusted EBITDAP is down 24% year-over-year. That's primarily because of the charge on that one program. We had taken a look at where we were. We got behind a little bit on that program due to some supply chain issues early in the program. We went to the customer. We looked at the manufacturing processes and we looked at where we could make some changes to catch up on that program. We got behind on deliveries due to those supply chain issues. And so we worked with our customer and ultimately with the government customers to see what would we need to do to get our delivery rate back up to the rate it needs to be. And so we chose to invest not only in tooling to increase the capacity, we also hired people, additional training and additional work hours to make sure that we can increase the capacity basically double of what we are doing now to get back on track to actually get ahead of the current period of performance, ahead of the current schedule as well as grow capacity for the growth that our customer and the government has seen in that particular Standard Missile program going into the 2024 and 2025 period.

So we invest in that now. The increased cost estimated from those investments push that contract into a loss position. With that loss position, we had to reverse some revenue, reverse prior profit and then take the whole loss within this period due to cumulative cost EAC adjustments. Excluding EAC adjustments in this period, if you back that all out, we did actually grow period over period from about – for the underlying EBITDAP margin rate would have been 12% last year and it's grown to about 13.5% this year. So the run rate on our underlying programs when you subtract all the EAC adjustments plus and minus is actually positive and going upwards. That's a good sign. We had this one program, this one contract that hit us this quarter. But with that behind us, we do see the second half of the year looking pretty good.

Moving over to cash flow. Another challenging year for cash flow as well, but this is really a – this is the back half of a good story. We have a goal of getting to free cash flow greater than net income, equal or greater than net income. We have a lot of pressure on

that this year and next year, but that's because in 2019 and 2020, we signed a number of big fixed price multi-year contracts within the defense business area. We signed a multi-year on Standard Missile and then THAAD and then PAC-3, all within probably 18 months of each other. And so early on in a fixed price program, you set milestone based payments so that you can collect cash early, get into a cash advanced position and you're working on negative working capital.

If you look at the 2019 and 2020 years, we had quite a bit of good cash. But now as we come down that cycle, we're deploying that cash and burning down those advances. Those won't be replenished until we sign new multi-year contracts probably in 2024. So we'll see a bit of pressure on 2022 and 2023. 2022's cash will probably run negative through the third quarter, and then we'll catch up in the fourth quarter and expect to be slightly positive, but quite a bit below our current year target. We also do continue to have CapEx. As I mentioned earlier, we're investing where we think our customers priorities are. We have some facilities expansion going on in both Los Angeles on our space side for the RS-25 engine and in Camden and Huntsville for some of our defense program units.

Backlog is a great story. We've continued to win, as I mentioned, these large multi-year programs, which shows good support from the customer and from the government for our products and shows both our legacy programs on here like RS-25 and RL10, Standard Missile, PAC-3 and THAAD. Those are all legacy, good, strong growth programs that provide really a steady foundation for our business. The fact that we'll be able to sign multi years and build that backlog to where it is really shows the confidence that our customer has in our products.

And we'll be burning those down over like I said, the next couple years when we expect to sign some multi years again in 2024 and 2025 on those products. I think our book-to-bill for this year-to-date was about 1.2. We've increased \$200 million on backlog year-over-year. Really good story on backlog. And as I said, that shows a lot of confidence from our customers and gives us good visibility into our future sales. As long as we bring that through, you can see that all those are as I said, legacy, good core programs. We should be able to increase profit margins on those programs as we move forward.

Closing out, we believe we have a good, strong macro fundamentals within our business. We have a good strong balance sheet. We're at a negative net debt position. We're in a net cash position. So we've got good dry powder on our balance sheet. We have done some things. Just recently, we've announced that we'll take out our convertible debt. So we'll be reducing our debt a little bit further, and that will also help our EPS. It's a bit of a quasi-share buyback. We'll take out some of the dilution that's being caused by those convertible debts in our EPS calculation.

We have a solid industry foundation and technical leadership within our company. We've been decades and decades on a number of these core programs. We have some of the best and brightest talent and engineers within our company. We have a well-diversified balanced portfolio that we think, as I said, is aligned well with our customers' needs,

aligned well with the department of defense's budgets, as well as NASA's budgets. And they all have good support within those budgets to continue.

We continue to make significant operational improvements to drive both our existing programs and our new development programs with a focus on revenue and profitability growth over the near and long term.

With that, Greg, I will turn it over to you for questions.

<<Greg Konrad, Analyst, Jefferies & Company, Inc.>>

Thank you. On the earnings call, you guys did a good job at kind of laying out the portfolio. And I think there were definitely maybe some incremental opportunities that were out there. I mean, if you think about the intermediate term, how do you think about growth and the balance between space and defense when we think about what's kind of in that core versus some upside potential opportunities?

<<Dan Boehle, Chief Financial Officer>>

Yeah, sure. As you mentioned, over the past couple years, I think we've been saying space is going to be about flat. We do see some growth as I mentioned, as I walked through that from the ULA sorry, the Amazon Kuiper deal. So that was incremental to our plan. We do have a little bit of growth in RS 25. Certainly, we'll have some more growth in the back half of this year, but mostly that program sits about 15% to 20% of our total sales year in and year out. And so that'll be pretty steady over those – over the near term. Where we do see some growth though as well in space is through, as I mentioned in-space propulsion, there's more and more need for maneuverability of satellites and other assets that are in space now.

So the technology we have there is pretty leading edge and we are continuing to develop through IRAD and other technical agreements, additional advanced space propulsion systems, as well as the power system that I mentioned for the first time we're talking about putting a presence on the moon and we need to power the things that are going to be there, the habitats, the systems, the materials, the equipment. So that's where we'll see some space growth, but we also did have the headwind of RS-68, which that program ended last year. So that presents a little bit of headwind to offset some of that. So that's why we have only moderate growth on the space side. And then the majority of our growth is coming from defense.

And as I mentioned, the new – most of the core business there is just going to continue on at about that 30 or 30 plus percent of total sales and slightly grow maybe in the low single digits. But the growth engine of our company will be in those hypersonics, NGI and in the longer term the NGI contract, or, sorry, the GBSD contract now known as Sentinel. So you'll see more growth from there that does put some pressure upon our profit margins because those new development programs are cost type programs. So you're going to see those coming in with a bit lower than our average margin. And that'll put

pressure on our core programs, our core mature, fixed price programs to perform better increase their margins, so we can continue to see that margin growth rate. But those are the systems or the programs that will drive growth over the next near term.

<<Greg Konrad, Analyst, Jefferies & Company, Inc.>>

And then, I mean, I think in the past, you've talked about a mid-single digit growth rate, is that still?

<<Dan Boehle, Chief Financial Officer>>

Yes, certainly. I said, you say low-to-mid single digits, but we are – we did have some tailwind in the first couple years as we talked about that. So this year certainly solid mid-single digits is what we're expecting.

<<Greg Konrad, Analyst, Jefferies & Company, Inc.>>

And then, I mean, correct me if I'm wrong. I mean, I think for the second half, you've maybe talked about 13%, little bit over 13% EBITDA margin, 13.5% to 14% long-term target, pre EBITDA or sorry, pre EACs. I think, you – there's an announcement this morning about Camden facility and some of the consolidation. Can you maybe just walk through the puts and takes? You talked about mix, but what really is going to drive that margin improvement?

<<Dan Boehle, Chief Financial Officer>>

Right. And we've got that Standard Missile contract put behind us, right. So we took that charge, the cost growth there was necessary, as I said, to build the capacity to not only produce on the current program, but build capacity to increase productivity in the future for the demand that's coming. So that was the right thing to do. It was tough, but we've got it behind us. Got it out this quarter.

Moving forward. We do see good – we should see continued profit margin expansion throughout the program, the various programs on the defense side where we have fixed price contracts, the solid core businesses, the remainder of the standard business, the Standard Missile business is still operating quite well. PAC-3, THAAD, you'll see some growth in ATACMS for the latter half of the year. So that's where your margins will continue to operate, to continue to expect margin growth that we've seen in the past. So we do think we'll get to about 13%, between 13% and 13.5% later this year without EAC adjustments. So you still do see that growth.

<<Greg Konrad, Analyst, Jefferies & Company, Inc.>>

And then just because, it's ex-EACs. I mean, I think there's a lot of times some investor confusion around that.

<<Dan Boehle, Chief Financial Officer>>

Sure.

<<Greg Konrad, Analyst, Jefferies & Company, Inc.>>

I mean, how do you think about what drives those, because on that metrics there's somewhat upside to the target. So how do you think about the ability to capture those?

<<Dan Boehle, Chief Financial Officer>>

Yeah, so I guess I should mention. I think, I left THAAD out of that list. That's also another good driver of program performance later in the year. So the way I think of EAC, if we take EACs out of the picture, as a general rule, I think that as we put together EACs, it represents the most likely scenario. Your most likely calculation through mathematical probabilities and regression analysis and everything else about what you think the ultimate total cost is going to be. Then you're out on your profit margin and you get to your price on a cost type contract.

So you – as you go through time, year after year as you're renegotiating new contracts, what I like to see if you take out all the EACs, you originally start a contract off with some conservatism, because you're looking at the potential risk that's in there. But where you go from the beginning of the contract to the end of the contract, when you renegotiate your next contract, hopefully you should be able to book at a higher rate than where you started the previous contract.

So when I look at, I mentioned year-over-year growth from 12% to 13.5% ex-EACs that means your underlying profit booking rates are improving. So year-over-year as you're renegotiating new contracts and you're starting the year accounting for those, you've got more confidence in what your ability is and how you're going to perform on those contracts. So as you see that ex-EAC growth going year-over-year, that's where I think it really shows that we are maturing on our programs. We're building in the profit improvement through our business operating system improvements, our lean manufacturing and improving the efficiency of our manufacturing processes, so that our beginning rates are closer to our ending rates on the prior contract.

<<Greg Konrad, Analyst, Jefferies & Company, Inc.>>

That's helpful. Any questions for the audience? I'll just ask one more then about cash and following up on your comments there. I mean, if I think about your commentary for 2022 and 2023, and then if you go back, you were probably well in excess of a 100% conversion. Is there a way to smooth that out? Because I mean, I think if we average out the years, you're probably at or over 100%, but there's some volatility. I mean, is there a way to maybe improve on that?

<<Dan Boehle, Chief Financial Officer>>

Good question. Yes. Over time, you're always – you average it all out we're going to get to that 100% The anomaly that occurred as we started signing these multi-year contracts, right? If you were just signing annual contracts, then that cycle that I talked about of getting into a cash position and then burning those cash advanced positions down over that life, that would all happen within 12 months.

And so as you layer all those annual buys in, you're going to get to kind of a normalized rate of cash flow. And that should be about equal to 100% of net income. When we started doing the multi-year buys, unfortunately they were all clumped together, right? If you could spread out the multi-year buys, you might solve this problem a little bit. But the three multi-year buys, I mentioned, Standard Missile, THAAD and then PAC-3 were all within, I think, 18 months – 18 months to 24 months of each other. So they all had a similar cash cycle. So we had advances growing up in the beginning building up negative working capital and driving a good cash flow for us.

So in the three years, I think from 2019 to 2021, our cash flow conversion of net income was about 160%, so well above our target. Now we're going to naturally mathematically, we're going to be below that target to level out about the 100% again. We will see that drive back up when we do the next multi years in 2024 and 2025. So, the multi-year is a good problem to have. Obviously, we like getting that in our backlog. We like having the visibility of our programs and our sales going forward. But that cash cycle the way to even that out is to maybe break those multi-year purchases up a little bit is kind of the only way to do that, or go back to annual buys, but there's obviously economic benefits to the multi-year buys.

So we're going to see that trough unless we can sign some other multi-years on different programs, right? So if we can get other programs to come in and sign multi-years during that trough period and get that cash advantages up that could help level out.

<<Greg Konrad, Analyst, Jefferies & Company, Inc.>>

Thank you. Thanks, Dan.

<<Dan Boehle, Chief Financial Officer>>

All right. Thank you all. Appreciate the time.