ATI

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Matthew Akers: Thanks, everybody, for joining us. The next session is ATI, and we've got Don Newman, the CFO, with us. So Don, thanks very much for coming.

Don Newman: Thanks for having me.

Matthew Akers: Maybe just to kick it off, do you want to give us a very brief overview of ATI?

Don Newman: Sure, happy to do that. So ATI is an advanced materials, forgings, and components manufacturer. Our focus is on aerospace and defense, and that represents almost 65% of our revenues. We also have some other end markets that we serve that have similar growth and margin profiles that also represent really markets that value materials that have pretty extraordinary performance characteristics. And those end markets are tied to medical, electronics, and some specialty energy.

Really, when you think about ATI, you want to think about a business that is really leveraging material science. Our products are used, as I said, in aerospace and defense. Those product use cases are things like the hot section of the jet engine. We produce materials that are critical to commercial space travel in the rocket engine dealing with thermal management, which is pretty doggone critical when it comes to rocket engines. And then beyond that from a forging standpoint, we are, I believe, the number-one isothermal forging business in the world, which is a critical process and capability to the jet engine space. So that's generally how to think about ATI.

Matthew Akers: Great. That is helpful. Thinking of commercial aerospace, obviously there's been some disruption with some of the OEMs. Boeing, got the delivery numbers today, still working to get back to up where they need to be. What are you seeing there in terms of any disruption from your demand?

Don Newman: It's interesting. We did talk about this a bit in our last earnings call. As a team, we've been very, very focused on diversifying our business. Even though we are certainly an aerospace and defense supplier, we saw opportunity to diversify our product base as well as our customer base, the end markets that we were serving, et cetera. And it's put us in a good position.

When we talked about the impacts of Boeing on our business in our last earnings call, what we shared was really the impacts of a slower build rate for Boeing, things that have been announced, it's really marginal to our business. It's not a headline kind of impact. And that's really encouraging. If you think about it, Boeing is one of two pretty significant airframers, and we have been focused on not just increasing our business with Boeing, but also very focused in increasing our book of business with Airbus. And we've been very, very successful in that regard.

So the way to think about ATI and aerospace, we're on all of the airframes, and we are in each of the engine platforms. So when you think of it in that context, for LEAP, for example, it doesn't really matter to us whether it's a LEAP A, B, or C. So if there's a slowdown in LEAP-1B, for example, well, gee whiz, we're seeing strong demand in things like 1A.

And then we also have some pretty extraordinary capabilities in the defense space. And so we're, if you think of it this way, I think the national defense budget last year increased by 4%, growth in our defense business was 18%. And we ended the year in the fourth quarter with what I believe was a 21% growth rate within our defense mix. And our applications in that area include things like titanium plate. We support rotative demand as well as surface and sub requirements that are pretty advanced. So we've got a nice, diversified book of business which is serving us well.

Matthew Akers: Yes. Any big difference between the narrowbody and the widebody side in terms of seeing demand come through, or is one better off than the other?

Don Newman: Yes, it's interesting. So first of all, both the narrowbody and widebody are good parts of our business. As you guys know, the widebody builds really haven't hit yet. And so once they do hit, the way to think about that is the titanium content, and for our business, nickel and titanium are two critical materials, and we've got a suite of products and alloys that are tied to those two key materials. And so the widebody content of titanium is anywhere from, say, 3 to 5 times per plane versus what you would see in a narrowbody. So once those builds start, even though it looks like a pretty modest number of builds per month, when you start thinking 10 over here and 5 over there, whatever numbers you have in your model, even at those levels it's a pretty impactful demand for our business.

And for context, if you go back to, say, 2018, this is a general comment, but what you'd want to think about for ATI is we made about as much EBITDA in the widebody as we did the narrowbody back then because the content was so much higher, even though the number of builds was much, much lower for widebody.

But as far as trends go, of course, the narrowbody build rates have started, and we're certainly seeing strong build numbers with Airbus, and we saw a ramping with Boeing. Boeing has some challenges at the moment that they're working through, which we believe completely that they will work through that. So we've been seeing over the last couple of years a ramping, and early stages of ramping for the narrowbody and an inkling that the widebody is going to be really taking off.

So that's one of the reasons, if you look at our long-range forecast and the targets that we put out, you see a significant ramp in our earnings in good part because we're participating in the ramp in that part of our commercial business.

Now one area where we did see meaningful growth from a widebody standpoint, and this started really a year and a half to 2 years ago was in MRO, which kind of stands to reason. If you're not building new planes, then your existing planes are growing older, and we all know that's happening. I think the fleet is about as old as it's been on average. Well, that means you're doing more repairs, more maintenance. And when it comes to the jet engine part of our business, we do serve the MRO end market. Normally, you would expect MRO in our business to be 20% to 25% of our jet engine sales. What we've seen is more like 40%, especially for widebody. But we've also seen a ramping begin in the narrowbody, which we think is a trend. And if you think about when the first LEAP engines went on wing, some of those engines are going to start to come in for their overhauls. And so we see that as a significant potential source.

We also, like I said at the beginning, we're on all of the engine platforms and airframe platforms. So when you think about, say, your turbofan, that's also a source of opportunity for us that I would point to as. It's not really a trend on build rates, but it's certainly having an effect on demand.

Matthew Akers: Got it. That's helpful. Can you talk a little bit about the CEO transition? So Kim's taking over for Bob. Just a little bit of the last several years, the path he's taken us through and what Kim's goal is here going forward.

Don Newman: Yes, happy to do that. So Bob Wetherbee's our CEO. He's done an amazing job in leading the organization through an establishment of an aerospace and defense strategy. That is the focus of our business. And beyond that strategy, it was a very interesting transformation that came from setting of that strategy and really putting the business in a position where we could create significant value for our shareholders. And so Bob did an incredible job, really pointing the organization in the right direction. Bob would be the first person to say that the ATI strategy is not a Bob Wetherbee strategy, and that goes to Bob's style. Bob is very inclusive and collaborative. And so when you look at the strategy that we're deploying to, it is ATI's management strategy.

And so you think about Kim, and Kim brings an incredible operational and business acumen to ATI, and she has been our Chief Operating Officer, done an amazing job in that role. And as a CEO, she's, I believe, going to continue our focus on aerospace and defense and really look for ways to accelerate that, which we believe there are significant opportunities in our business to improve performance, accelerate growth, et cetera. And you should expect to see Kim driving that in our business.

Matthew Akers: Got it. One of the operational things you've talked a little bit about is debottlenecking the process. And you have the new press you've put online. If you could just talk a little bit about that and what the opportunity is there.

Don Newman: Yes, I'd be happy to do that. So we have got some very, very interesting opportunities in growing our business. And one of the opportunities that we've talked about is debottlenecking. And if you think about it, picture the production process like a river or a

stream. Upstream for us is melting. We melt titanium sponge and revert, scrap. We melt nickel at scale. That creates some pretty extraordinary materials.

Well, that's not the end of what we do. Our first prize isn't necessarily creating ingots. We like to transform them into forgings and other components. And so the stream is from melt through the finishing process that material is flowing. Well, if you think about it, if you're unlocking melt capacity that exists or you're adding melt capacity, which we are, then in order for that capacity to really make its way out the door as a finished product, it's got to flow down that river. It's got to flow through your processes.

Well, when you think of it as a river, there are bottlenecks that exist within that flow that didn't exist before you maybe found efficiencies and added capacity in melt or actually put in new melt assets. And so the opportunities around debottlenecking to us are material. And in many cases, the debottlenecking investments that we make are really modest in dollar amount, but they release the flow of the products and have very, very good returns because the revenue that's generated by the additional flow is very strong relative to the capital cost.

And so one of the assets that we put in place that we recently announced was a new billet press. And the billet press is a really special asset. It is located in our North Carolina facilities. It is special in a couple of ways. One way is that it can actually press or process both nickel and titanium products. So that is a dual-use facility or equipment for us that is pretty powerful. And when you add the additional capacity that we've added to our production footprint, whether it's new or whether it's finding efficiencies in existing equipment, that's an important part of increasing the revenue.

But what it also does is it derisks the production process because it allows us to have some redundant capacity in those downstream functions that allow us, if there's outages, that we're able to continue to process and generate revenues, whereas without that press, for example, we wouldn't be able to do. But that's just one example of the debottlenecking efforts that we have.

Matthew Akers: Got it. That's helpful. Let's talk a little bit about the guidance for this year and the increases in ramp through the year. Can you talk about what gives you confidence in that? Specifically, I think some of the industrial parts of the business are smaller, but just what you're seeing there when those bounce back.

Don Newman: Sure, sure. For context, I know not everybody follows our financial results every day. And so if you think about last year, last year we generated about $635 million of EBITDA. Our guide this year is EBITDA at the midpoint of our guidance range is about $725 million, so a nice step up.

But as you look on a quarter-to-quarter basis, in 2024 you can see that from Q1 to Q2 there's a meaningful increase, from Q2 to the second half there's a meaningful increase. And as you think about the Q1 to Q2, one of the impacts that we had in Q1 is we had some outage impacts. And those are behind us, so that will be a contributor in the step up from Q1 to Q2. In addition to that, we have unlocked some additional capacity. We talked about debottlenecking. The very asset that you were talking about, that billet press,

is allowing us, even as early as Q2, to increase production, and we're beginning to unlock that in Q2. And so that's additive to the performance of the business.

We have picked up price, and the price performance that we've had will be one of the contributors. We also, as you think about going into the second half of the year, we're going to see more of those things in our run rate, but there's also some good guides around titanium melt capacity. So there's an 80%--80%--increase in our titanium melt capacity. And that's off of our 2022 baseline.

The way to think about that is there's two baskets. One is turning on some idled assets, and we've made some modest improvements in those assets to increase efficiency and productivity. The capital cost to restart those assets was about $10 million. They represented roughly a 45% increase in our titanium melt capacity. So on a run rate basis, let me give context, on a run rate basis that represents $150 million to $170 million in annual revenue. $150 million to $170 million. Think in terms of around 35% contribution margin.

So if you do the math on that on a very conservative end of the mass scale, it's about $10 million a quarter in EBITDA at run rate. Well, that asset, that facility that we restarted, is really ramping in its contribution to the income statement. So we're going to hit the income statement run rate for that facility in the second half of this year. And for context, if you think about Q1, what it contributed, and you think about the run rate in the second half of the year per quarter, it's about a 50% increase in EBITDA contribution between Q1's level and Q3 and Q4's level. So that's a good guide for the second half.

And so this is all underpinned with continued strong demand across our end markets. And certainly having the outages behind us is helpful. Debottlenecking is a contribution. It's all adding to a business that we would expect to be on a run rate basis, as you think about the second half of the year, it should be running at something in the $800 million a year range from an EBITDA standpoint. And then from a margin standpoint, the margins that we would expect exiting 2024 going into 2025, I would expect consolidated EBITDA margins to be in the 16.5% to 17% range. So a lot of building strength in this business, and we don't expect, by the way, that it's going to stop in 2024.

And if you look at our 2025 targets and you look at our 2027 targets, what those reflect are some of the very same drivers that I talked about, plus it's all about meeting the underlying demand on aerospace and defense and our other key end markets.

Matthew Akers: That's really helpful. Talked a little bit on the engines, but think of some of the challenges that we're seeing on the new narrowbody engines--the recall, the GTF, just durability, time on wind issues. How much of an opportunity is that for ATI, either directly for more content or just the older stuff is flying more, like you said, and that's more spare material.

Don Newman: So geared turbofans specifically, or just narrowbody in general?

Matthew Akers: Yes, engines, new engines in narrowbodies as well.

Don Newman: Okay, so first, if you think about the LEAP engine, which obviously is a critical engine for the narrowbodies, they're a great engine. We are a very important supplier to that

value chain. We support not just the new builds, but certainly the MRO demand that exists. And to your point, some of those early LEAP engines, time on wing I'm talking about, the early engines that were hung on the wings are going to be coming in for overhauls. And so that's going to be a critical, critical part of our business going forward. And we think it's going to be an area of sustained demand.

In terms of the geared turbofan, on that it's interesting. We have a very, very good relationship with that OEM. And the things that ATI does extraordinarily well--there's a lot of things that we do well--but one of the things we do well is we manufacture these high-performance powder materials. And so as you think about the MRO demand that they're going to have, part of that's going to be driven by a need for material. Another thing that is going to be important in meeting that MRO demand is forging capacity.

And then finally, testing is going to be critical. We have a great relationship with Pratt, and we are a proven supplier of each of those areas. Now, we haven't been a producer of the materials for them, but we could be part of their solution. We have been a producer of forgings, and we would expect that we could be helpful to them in the surge of demand that they're going to be seeing.

And then finally from a testing standpoint, it's easy for us to forget about testing. Testing in this industry is incredibly comprehensive, and it's done consistently. And you're not talking about simple, elementary testing. These are very advanced testing techniques. This is one of our core competencies. And so we've actually added capacity, because this was about bottleneck to the industry, we've added capacity around things like sonic testing. So those testing capabilities we have, I think, would also be a great help to meeting the demand that they're likely to see.

So all that, you add it all up, and I think the way to think about the geared turbofan situation that exists is I really think and I believe that we'll have an opportunity to be a part of the solution. And so that will be a benefit to the business going forward.

Matthew Akers: Got it. You mentioned earlier the unplanned outage late last year and early this year. Could you talk a little bit how you manage those? Is it an opportunity to, whether it's through maintenance or whatever, to prevent those from happening in the future?

Don Newman: So for context, what we're talking about is in Q4, we had some planned and unplanned outages. And those outages actually impacted our Q1 2024 sales because the products available for sale were impacted.

There's a couple of things to just keep in mind as you think about those outages. First of all, they're behind us, which is great. The outages, I don't see these outages as a reflection of us underspending on maintenance. That is not something that we choose to do; for example, if demand is high, "Let's just defer maintenance, kick it down the road." That's really not our model. Because in the long run, that doesn't put you in the best position. And so this was not a choice in terms of run versus maintain. This is, I think, a reflection of you can have planned outages like, for example, we had a press that was down. We expected it to be down for a week to a week and a half. It was down a week beyond that, and so that was impactful. And there was an asset that went down that wasn't expected, so we took care of that.

Now we talked about debottlenecking. Remember that press we were just talking about? Well, if we had had that press turned on a couple of months earlier, then the outage profile that we're talking about would have been different because we would have had the capacity to offset that outage that was down for a little bit longer than expected.

So it's our goal to be very thoughtful and very wise in how we maintain our assets. And in doing that, we certainly do not intend to underinvest in maintenance. And if you look at our spending plan, we're going to spend roughly $200 million in CapEx each year over the next 5 years, $80 million of which, plus or minus, $80 million of which is major maintenance. So it's not light-duty spending for the business.

Matthew Akers: Got it. Maybe touch a little bit on the defense business, talk about some of the growth you're seeing, but just the biggest drivers of that going forward. What kind of growth rate do you see for that?

Don Newman: I would be happy to do that. So we're fortunate in the opportunities that we have around defense. And I had mentioned earlier, but I'll go ahead and repeat it, as you think about defense in our business, it's about 10% of our revenue. And the growth rate for that space for us has been very good. And for all of 2023, the overall growth rate in our defense business was about 18%, and we were building momentum at the end of the year. So that's a good indicator.

Our exposures around defense are really interesting. So first of all, titanium is one of our key materials. And armor for things like tanks and other rolling vehicles, that titanium plate is pretty important. As you can imagine, the demand that's hitting our business around titanium plate is really, really strong. Also imagine that demand isn't expected to just end. And so it's things like that that drive the growth rate in our business at a rate well above what you see in the defense spending growth in Washington.

And it's not just the titanium plate. I mentioned that we provide materials that support our naval activities, both surface as well as below the surface. And some of those things are confidential, very confidential, and so we don't give a lot of details. But they're good positions to be in. We also support rotatives, and that's a space that we've been in for quite some time, and we would expect, because we're on some important platforms, that that will continue.

Then there's other growth that we can foresee coming that fits really well with our material science capabilities, things like hypersonics. So one of the things that is really important when you think about hypersonics is thermal management. There's heat built up the faster you go. And so the materials that you need in order to manage that heat buildup have to be, in this case, pretty extraordinary. And we happen to have some of those materials. And so we see hypersonics as a real growth opportunity for us, not in the short term, but certainly in the longer term.

And that hits what we've called aero light. It's utilizing hafnium-based materials. Niobium is also a key material that goes into these very high-performance, hyper-high-performance kinds of alloys. And so a lot of positive things happening in defense, and I think it will be there for a long time.

Matthew Akers: Got it. Could you touch on capital deployment? So you guys did a pretty good amount of repurchases first quarter. What's the priority?

Don Newman: Yes, happy to do that. So the way to think about it is in Q1, we repurchased about $150 million of shares. And since the beginning of 2022, I think we're almost at $400 million of share repurchases. But it's important to understand how we view capital deployment, and it's a pretty consistent strategy that we're deploying to. Think of it as a three-legged stool.

So the first leg is invest for growth. And in investing for growth, really we have a strong bias toward organic growth. We have a long list of organic opportunities, but a long list of organic opportunities does not mean an open checkbook for limitless spending. What we've indicated is that our investors should anticipate about $200 million a year in CapEx. And I have already said that of that, about $120 million is growth-related, and about $80 million is maintenance-related, generally. And then from year to year it can be plus or minus, but that gives you some idea.

The second leg to the stool is delevering. And the delevering that we're doing is multi-pronged. We had a significant amount of pension obligation that existed. Certainly, when I started with the business in 2020, we were working that down. And then in 2023, we executed an annuitization that reduced our gross pension obligation by $1.4 billion. And we have excess funded the remaining roughly $250 million of remaining pension liability, which that remainder is all of our active employees. So it took care of that.

But that's not our only goal around delevering. This business is going to grow. EBITDA's going to get bigger. Our debt metrics are going to go in the right direction. I suspect that we'll have a net debt to adjusted EBITDA below 2 times by the end of this year, and I would expect to rapidly delever from there in 2025. So going in the right direction.

I don't want to just reduce our net debt ratio. I want to take some of that gross debt off the capital structure, save ourselves some cash flow because of lower interest, and derisk the balance sheet some more. And we're going to generate enough cash we can do that. We'd funding the CapEx. There will be ample cash to reduce our gross debt as things mature and become available.

Then that leaves the third leg to the stool. Third leg to the stool is returning capital to our shareholders. Our preferred vehicle for doing that is, at this point, buying back shares. And we've been very, very active. And as you think about the $150 million that we spent in Q1, typically what we do is when we get a mandate from our board, that is done on an annual basis, and we would execute it at the end of the fiscal year, which is when we generate the bulk of our annual cash flow.

We were comfortable with the liquidity of the business. We were comfortable with the cash generation that we expect in this year. And between Bob, Kim and I and the board, we decided, "Hey, why wait? Let's go ahead and bring those shares in," which worked out really, really well. We finished that mandate in Q1, didn't wait until Q4. And the way I describe it to investors is we've been active on share repurchases. The mandate that we just wrapped up I don't expect will be the last mandate by any stretch. But at the same

time, I'm not going to get ahead of my board. That's not fair. But it's important for us to return capital to the shareholders, and that's why it's one of the legs on the stool.

Matthew Akers: Got it. Maybe just to wrap it up, because I think we're almost out of time, but any way we should think about pricing opportunities? If you have LTAs rolling off, is there opportunity to use pricing?

Don Newman: Yes, the short answer is that we've been pretty successful in capturing price. We talk to the market a great deal about our LTA position. And if you think about our high-performance segment, a high percentage--and think in terms of around 80%--are under LTA. So the conclusion when people hear that is, "Oh, my gosh, you're missing all that transactional upside." That is not really the way to think about it, and here's what I mean.

Our commercial team did an extraordinary job. As you think about the demand for titanium, for example, when Russia invaded Ukraine, the demand increased significantly, and customers were concerned with ensuring that they had capacity to meet their needs. It's a fair request. And so what we did is we honored our contracts with our customers. But when there was the opportunity to talk about a new contract, even if there was an LTA in place, one of the things that our team did a really good job on was saying, "Okay, if we're going to talk about future capacity, we're going to talk about current capacity. And so if you want to ensure yourself that you have what you need, then there are things that we really want to talk about." And one of those things was a lot of the contracts in this industry are share-based. So an OEM says, "I'll sign an LTA with you, but I'm not going to do a take-or-pay. I'm going to sign you up for a percentage. You get 25% of my--if I'm buying this group of materials, you get 25%, you get 50%, or whatever it is." That's how it's worked.

So you think about this high-demand environment where demand, we expect, is going to ramp higher, one of the things our team did was they said, "Okay, we're going to cap the amount, the pounds that you can buy under this LTA." Still share-based, but it hits that limit. Above that limit, it's transactional pricing. We talked about the pricing, and that allows us to take advantage of the upside for these LTA contracts.

Another thing that our commercial guys did that was extraordinary was they added material pass-through, which material pass-through mechanisms in our industry, for nickel it's very common. For titanium, not as common. And so we now have about 60% of our titanium contracts that have some sort of pass-through mechanism.

Matthew Akers: Great. This is a good place to end it. I think we're over time. But Don, thank you very much.

Don Newman: Thank you.