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## ATI

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**Seth Seifman:** Good afternoon, everyone. Welcome back to the aerospace defense track at the 2024 J.P. Morgan Industrials Conference. I'm Seth Seifman, the US aerospace/defense equity research analyst. We are very glad to have ATI with us now and very grateful that Don Newman is here, CFO, and Dave Weston from Investor Relations.

We're going to start off. Don is going to talk a little bit about, give us a little bit of lay of the land for ATI right now. Then we'll do some Q&A. I'll ask a few questions. We'll open it up to the audience as well. Don, welcome. Thanks for being here.

**Don Newman:** Thank you.

**Seth:** Maybe if you want to start us off at a high level of how things are going at ATI.

**Don:** Very good. I'll give a short introduction as well, as to what ATI is, if that sounds OK.

**Seth:** Yeah.

**Don:** First of all, of course, my general counsel would be disappointed if I didn't give some sort of forward-looking statement comment. What we're going to talk about today, no doubt, with Seth's good comments or questions, we're going to get into forward-looking statements.

I would just point out, obviously, that future performance could be different than the statements we're making today, for various reasons, including things we don't know about today that could happen.

I would ask that you guys refer, if you would, to the risk section of the 10-K we recently filed, just to get a better idea of how we think about risks in our business and can be thoughtful around assessing that.

First, ATI. What is ATI? ATI is a very special business. We have some extraordinary capabilities

and produce products that are sold into aerospace and defense. Our products include titanium and nickel applications, for example, used in some of the most extreme performance requirement applications that you can imagine.

We have significant share with OEMs, both in the airframe as well as in the jet engine area of commercial as well as military. Our end-market growth is on a very nice upward and to-the-right trajectory in terms of aerospace and defense, but we're not just about aerospace and defense.

While aerospace and defense is responsible for about 63 percent of our sales -- that was a Q4 number just this last year -- we also sell 10 to 15 percent of our products into what we call aero-like end markets. Those are specialty energy, medical, as well as electronics.

Those involve, as well as titanium and nickel, we produce some really amazing products that are based on things like hafnium, and niobium, and zirconium, that are all extreme, high-performance alloys that are used in things like thermal management for high-chip applications, hypersonic weaponry, propulsion systems, things of that sort. Pretty special business.

From a financial performance standpoint, it might be helpful to share where we're at. This is a transforming business that is certainly going in the right direction. If you think about back in 2019, this business did \$4.2 billion at 10.7 percent EBITDA margins.

Just this last year, we were at, again, \$4.2 billion in revenue, but our EBITDA margins had expanded about 400 basis points. We see them increasing significantly over the coming few years. That has a lot to do with those end-market exposures and the profitability actions we're taking in our business. We do see this business growing, continuing to grow at strong double-digit rates.

If you think back to 2022, our top line, if you exclude the effect of pass-through metal impacts, our top line grew almost 30 percent in 2022, grew almost about 10 percent in 2023. We expect growth again this year, overall, in the upper single digits. We expect that that growth is going to continue, largely, again, because these really special end markets that we play a key role in.

We see 2027, this business getting north of \$5 billion in revenue. From a margin standpoint, EBITDA margins should live north of 20 percent by 2027. Even by 2025, I expect we're going to be pretty consistently in the upper teens when it comes to this business.

All that's great. It doesn't matter if you're not putting cash in the bank. From a cash conversion

standpoint, we're making significant headway in terms of cash generation. The guide that we just gave around 2024 is an excess of 70 percent increase in free cash flow generation versus just last year.

We expect to consistently see our free cash flow to net income conversion ratio north of 90 percent. Very significant improvements to the business. Really, ATI is the right business in the right place at the right time. Our end market exposures are broadly to end markets that we expect significant growth, and we're bringing the capabilities that are critical to each of those end markets.

**Seth:** With that overview, maybe we'll dive into some Q&A and I'll start and then we can open it up to the group. Maybe one significant piece of news that we learned this year since earnings was planned for CEO transition at ATI.

Kim Fields is going to become the CEO in July. She had been president CEO. Maybe not a complete surprise that was going to happen at some point. We can talk a little bit about why this is the right time for that transition and the capabilities that Kim's going to bring to the job that will further the transformation of ATI that you're talking about.

**Don:** Sure. I'm happy to talk about that. First, is an exciting change for ATI. Bob Wetherbee has been our CEO for several years. Has done an amazing job in helping to develop a real winning strategy for this business, and really moving us away from commodity-type products. Transforming some of our business units from low profitability to very strong profitability.

No surprise. Bob is approaching 65 years old by the end of this year. As part of that, he's anticipated and been planning for his eventual retirement. What was announced just recently was the promotion of Kim Fields, who's our president and chief operating officer into the CEO role.

Clearly. Kim is going to be responsible, like you said, beginning of July onward for the strategy of the business as well as running the data day-to-day operations. Good news is Kim is extraordinarily capable of doing that. This has been a thoughtful transition and preparation process that Bob and Kim have gone through over the last several years.

If you think about it, because Kim has been our chief operating officer, she has had her hands on running the vast majority of the business from a day-to-day standpoint for a number of years. Her style is to get into the business is really understand how they work and build relationships. That is going to equate to a really smooth transition for us.

A lot of consistency and executing the strategy that's in place. Sometimes, Seth, we get the question, "Hey, with this change to Kim, is there going to be a change of strategy or outlook?" The short answer is this is not really Bob's strategy.

This is a strategy that both Bob and Kim developed together. Kim has had a very key role in executing over these past years. I do not see any material changes to the strategy that we're deploying, which is aerospace and defense value-added products.

From an outlook standpoint, again, Kim's had her fingerprints on the setting of the outlook for the business. I do not expect to see any significant changes in those 2024, 2025, or 2027 targets that are out there.

The good news is we're going to be in very capable hands with Kim. The team is very supportive of her. She's got great relationships with our key customers. It's been done very thoughtfully and then we'll still have Bob as our executive chairman.

He'll oversee the activities of the board as you would expect, but he'll also continue to be involved with things like our government outreach to Washington, D. C., and other special projects that Kim may ask him to take the lead on.

We've had a very collaborative team. That collaboration is going to continue, and it's to the benefit of our shareholders.

**Seth:** Turning to the last quarter and coming out of the last quarter, we learned about some outages in the business both in the HPMC business and in the ANS business. I guess can you update us on how that capacity is coming back online, and how that compares to the plans that you had?

**Don:** Sure. I'd be happy to do that. Just a refresher for those folks that aren't familiar with what Seth is speaking about. In Q4, and it was largely in December, we took some planned outages largely around melt assets. That's the typical timing for those activities.

When our teams go home for the Christmas break and the machines are down, we open those machines, and we do some maintenance. We have been driving our assets pretty hard, very intentionally, by the way. There's significant demand for our products.

The reality is we're also, as part of our transformation of the business, trying to nail down what are the capabilities of the assets that we have. We know we have world-class assets, but you need to know where their limits are. We've been running these assets hard for those reasons.

When we took the outages, we found that there were some additional work on some of the assets that was required. In other cases, it was exactly according to time and scope.

For those assets that required some additional work, you're talking about, "Hey, it was a planned seven-day outage. There's some additional work we needed to do to set us up for a stronger future run, it took eight days, 10 days, 12 days, whatever it is." That impacted.

Now, we also had a press outage, and that press, and I'll talk about another press here in a minute, which has de-risked this situation from happening again, but that press had an unplanned failure. Fortunately, it wasn't a major failure, but it caused a kink in our production process. The combination of those carried over to Q1.

What it meant was that we had less inventory that we would be using to finish products in Q1, and it created that divot for us. One thing I want to be clear on is these are not mistakes. Some things happen when you're running a business that are unplanned.

It's not because we're underspending on maintenance. I don't see a trend of that at all. We're trying to be thoughtful in making sure that we have consistent production.

We are asked at times, "OK, does this mean less outage time or less outage expense later in 2024?" In general, the answer is, "Yeah, for HPMC, I would expect that would be marginally beneficial to us."

Also, keep in mind, some of these outage cycles are three- and four-year cycles, and so you're seeing them happen a little bit earlier in, say, end of 2023 versus at some point in 2024 isn't a dramatic change to the long-term production profile for the business.

Now, I mentioned we had a press failure, and that press was unplanned, but the good news is, one of the things we announced in our Q4 call was that we were bringing a new press online, and it's a billet press. It's a special asset. It's an asset that we started constructing before COVID.

We shut that project down during COVID because we didn't need their capacity. Why spend the money, right guys? With the demand that came back and at the right time, we restarted that

construction to finish that asset off, and it's finished. It's running now.

If that asset was in place at the end of 2023, when that press outage happened, we wouldn't have the situation. What that points to is that we're investing to do a number of things.

Number one, we want a stable and predictable production platform. Number two, we are de-bottlenecking this business. Number three, we are de-risking it. We are eliminating single points of failure risk happened at the timing on this one wasn't exactly perfect, but good news is that world-class asset is now up and running.

It's going through qualification processes, and that will be an asset that contributes to the bottom line for many, many years to come. We're excited about that. That was one of the outage situations that we talked about in our Q4 call.

Another outage situation that impacts our Q1 was tied to a weather event that occurred in Oregon. I do not like to refer to weather as an excuse for an impact to your bottom line. In this case, it's a unique situation. What happened?

Well, think about the arctic snap that we had on the West Coast in January. It was pretty severe. For our business, as you picture that business out there, we have part of that activity that...picture a refinery, a bunch of exposed pipes doing refinery-type things. In January we had a situation where the temperature was below freezing for 20, 21 days in a row.

That's a tough situation for a geography that's not used to that sustained cold. Guess what? Our plant reflected that unusual weather. We had roughly, last I heard, 50 pipes, five-zero pipes that burst. Guess what? They have to be replaced, and they have to be repaired, and all those good things.

That was something we got on right away, and that's progressing extremely well. We did announce that we expected that weather impact to be about three cents in Q1, another three cents in Q2. It's still my expectation that we're going to see that impact, but we're doing our best to reduce that negative.

Good news is I do believe we're doing the right thing for our assets and for the production capabilities of the business. That in combination with the capacity that we're adding, that I'm sure we'll talk about a bit, sets us up in a strong position going forward.

**Seth:** Excellent. To bring it into the financial statements, the challenges in Q1 and the guidance for the full year point to a fairly steep margin ramp as we exit the year. What gives you confidence and the ability to achieve that? Are there any other seasonal dynamics to be aware of as we move through the year?

**Don:** Normal seasonality for us is a couple of things I would point to. One is we have a working capital cycle, that typically means we have a greater use of cash in Q1 and then build cash through throughout the year, and especially in Q4. That's one seasonality item to note.

I expect a similar pattern, although less of a divot in Q1 this year than we've typically seen. We've shared our cash generation targets, which, like I said, North of 70 percent increase year-over-year. I think there's going to be a good outcome there.

Another seasonality thing to keep in mind is we very typically in our A&S segment, specifically specialty rolled products typically take outages in Q3. Generally, that's been about \$10 million of additional expense as well as some marginal impact on sales. I would expect similar pattern in terms of those outages. Those are really the seasonal things I would note. Then your other question?

**Seth:** With that, you started off, then some challenges from the outages in Q1. We've got maybe some specialty rolled downtime in Q3, but being able to ramp that margin through the year off of Q1.

**Don:** The key question is, why are you so comfortable with your second half? That's really what's at the bottom of that. There's a couple of things that are causing the inflection. Seth already touched on one of them with the outage divot that we have in Q1 that we've been pretty transparent on. Guess what? That's behind us in the second half. That's good.

Another thing that's happening is, when you get to the second half of the year, we have some capacity that we brought back online. It's titanium melt capacity that has a meaningful impact on the inflection that you see in our guidance.

Let me give you some context around the economics tied to that plant. This is a plant that we restarted throughout 2023. It is expected to generate between \$150 and \$170 million of revenue at run rate. Think in terms of roughly a 35 percent contribution margin. Incremental margin, rather.

With that, that's at run rate. The way that plant really ramps, there is a lag between when the product is produced out of that facility and when the product comes out the back door and goes to our customers.

A way to think about that is, between production and shipping, upward of probably four or five months, sometimes six months. Because the plant was ramping and hit its product ramp rate at the end of 2023, we would expect that it's going to hit its income statement run rate in the second half of the year. There's also another element.

I said it hit its production run rate at the fourth quarter. That was true for the main three pieces of equipment. They're called VARs, VAR melt. That was true. We're restarting a fourth VAR. That restart is going to happen at the beginning of this year. We're in the process of doing that now. That means, again, you have the ramp, and you have a lag between production and income statement.

When you think about that fourth VAR impact, that's going to hit you in the fourth quarter. Those are important contributors to that inflection you see in the second half. What's another one? Here's another one. In the second half of last year, we saw a reduction in demand on some of our industrial end markets.

With the transformation of the business, we've significantly reduced our exposure to commodity markets like standard stainless. While we made a lot of progress there, we still have a stub of exposure related to the industrials. We saw that demand dampen in the second half. In Q4, we saw it stabilize.

What we shared with investors is, hey, we expect full recovery in those industrials. Industrials cycle. We all get that. We expect that first half of 2024, those industrials will probably see some early stages of recovery. Really, it's the second half of 2024 where you'll see a more robust recovery through those sales. Those are a couple of things to note regard to first half/second half.

Maybe just one more thing I would add for context. We haven't guided on every quarter. One thing I've shared with folks is if you think about the pattern of our earnings generation first half to second half, think in terms of general numbers now, you guys, not precise but 40 to 60, 40 percent first half, 60 percent second half as an indicator of how to think. Hopefully, that's helpful.

**Seth:** Yeah, absolutely. It anticipated my next question which was about the ramp in the industrial end markets in AA&S and, in terms of the demand signals, or the order books, or

anything like that, whether you're starting to see some of that now. Maybe that's the first part.

The second part, would we include in that the precision rolled strip business in that industrial sort of subset of businesses? The reason I ask is it's very much outside my A&D wheelhouse. From the filings, it looks like that business was down fairly significantly last year.

It seems like it's a nice contributor to the profitability of that A&S segment. We saw pressure on A&S margins through the year and it seemed to be coincident with that precision rolled strip contribution.

**Don:** Just to make sure I'm going to answer your question correctly. That precision roll, are you referring to the Asian precision?

**Seth:** Yeah.

**Don:** Let me give you an idea. Two-parter on this one. First of all, for the industrial demand, so are we starting to see recovery? Again, at the end of last year, we saw stabilization, which was great. We expect second half of this year to see a nice recovery, but what happens in between, right?

What we're seeing, I would say, are certainly continued stabilization and green shoots that would indicate the recovery is going to happen like we expected it to. It's not broad-based. It's not like it's screaming in, "Hey we're up 30 percent between January and February."

I'm not saying that at all, but what's encouraging is you got to start seeing the green shoots of recovery before you start seeing the more robust recovery. It's playing out about like we expected and reflected in our guidance. That's very encouraging.

Then in terms of our Asian precision rolled strip business, it's just for context. This is a joint venture. We own 60 percent of it. It is located in China. It serves the electronics end markets and automotive generally.

Precision rolled strip is a really interesting product. Starting in latter 2022, as I recall, that business saw a downturn. This is a business that before that downturn, think of it as revenue in the \$300 million range, certainly EBITDA margins accretive to the overall business.

For a placeholder think in terms of 20 percent-ish and a really good business, but it's tied to the

China economy. As you guys know, China started to have some headwinds around COVID, then it's had some general economic headwinds. That absolutely affected our joint venture. You noted that.

What we saw was the revenues declined to a range instead of 300, more like 250. Of course, that carried through on the EBITDA where now the EBITDAs are banging around in the upper teens versus, 20 or maybe even above 20 percent.

That business absolutely stabilized. We saw that in 2023 our expectation is that we could start seeing some recovery in 2024. To be quite frank, our guidance assumes it's pretty flat. The reason we're doing that is we don't want to jump the gun in terms of assumed recovery. We've done that. We've seen that. Usually, it's not helpful to our investors.

For guidance purposes, think in terms of, we put in some modest recovery, but it's super modest you guys. There is one point of seasonality to, again, just keep in mind on this joint venture specifically, and that is Chinese New Year.

As you look at the performance of that business, you have a good idea of what the EBITDA for the full year is based on what I shared. Because of Chinese New Year, which happens every Q1, we would typically see a modestly lower EBITDA and sales generation out of that business in Q1. Again, that's just for note. Does that help? Does that answer your question?

**Seth:** Absolutely. Moving back to the Aero business, 737 has been in the news a lot this year. Maybe if you could tell us the signals that you're getting with regard to the content that you produce for that program on 737.

I guess if there's any context you can put around, maybe in broad terms, the impact on your growth expectations if it was a longer ramp on 737, if it took longer to get that rate up.

**Don:** Fair question. You won't be surprised to hear that we've heard that question before. When you think about our business, our business is in a fortunate position. We have shares on a lot of platforms, all the key platforms really. We have a significant share with both airframers.

We have a significant share with each of the jet engine OEMs. We're not reliant on any one model that's out there. Certainly, the 737 is an important platform. To answer your first question, are we seeing any demand signals as a result of what we're seeing in the headlines these days?

The reality is we have seen sustained high demand signals across the airframe and the jet engine OEMs and their respective supply chains. It hasn't let up. Order activity remains very, very strong.

The discussions that we have with those key customers, and imagine their weekly conversations, just the nature of what we do for those important customers, they remain very, very positive. We expect that that key OEM is going to find the solutions necessary to stabilize and make sure that they stay on their trajectory for growth.

I would remind folks that when it comes to our outlook, we try to share, number one, our true views as to what we expect, and also to lean toward conservatism when it comes to our outlook. With that, one place you can look is our '25 and '27 outlook. We gave our '27 outlook at the end of November at our investor conference.

We were very transparent. Our anticipated build rates and our outlook numbers are based upon lower build rates than the OEMs have indicated. That doesn't answer the short term, but it certainly gives me comfort in the longer term. That's what I would say.

**Seth:** That's very helpful and good color. A related question, thinking more broadly about your work in aerospace on engines and airframes, how have lead times been trending this year in both of those areas?

**Don:** Lead times have continued, I would say, to generally extend. We've seen this. It's not current phenomenon. To give you an indication, when we think about aero, nickel, and titanium, billet, and bar, we're looking at lead times roughly a year.

Sometimes, depending on the product, out, say, 70 weeks. I would anticipate that with a strong continued demand that's hitting our business, despite the production, that we'll continue to see extended lead times. In terms of our forgings, for aero forgings, we're seeing 12 to 15-month lead times.

As you think about lead times, when we talk lead times in combination with what's happening with our backlog, if you look at either one in isolation, you can draw some bad conclusions. Our backlog has the fingerprints of these extended lead times, despite good production levels.

What's happened with our backlog? Our backlog at the end of 2023 was nearly four billion dollars. That increased roughly 30 percent from the beginning of 2023. Just in Q4, it increased nine percent. I'm not surprised by the math. It's a strong indicator that aero demand is hitting us

really strong.

I think with the ramp trajectory that we anticipate happening, this growth is going to continue for some time.

**Seth:** Maybe to take things in a little bit of a different direction and ask about cash deployment. You talked earlier about expecting cash conversion over time in the 90 percent-plus range. This year, the midpoint of the guidance is probably in the high 200s or so, in terms of free cash flow.

There's not a lot of debt to repay. Talk about your plans for that cash and whether there's potential to see more than 150 million or so that you penciled in for share repurchases this year.

**Don:** Fair question. You're right. Our cash generation trajectory is going in a positive direction and should continue to build momentum. One of the important targets that we have is we want to be converting cash, again, free cash flow over net income at a rate of 90 percent or better.

That's our target, and we are absolutely heading there. From a cash generation standpoint to go from 165 in 2023 to about 300 million in 2024 is good progress, and I'll call it a good start. We're certainly not done with it. It's a fair question, what are you going to do with all the cash?

We've been very, very clear. There's three destinations for our capital. One is we're going to invest for growth. We have guided at roughly \$200 million of average CapEx for the next five years to take us through 2027. Of that, if you split it between maintenance CapEx and growth CapEx, it's about \$80 million of maintenance CapEx on average, and the rest being growth.

I don't see that as changing materially. The demand is strong. We're very disciplined in how we execute that. I love to talk about capital deployment because it is critical to everybody in the room. That's on the growth side. We also deploy to delevering.

Last year, if you're following us, we delevered through our pension plan. We transferred roughly 85 percent of our defined benefit pension obligations, \$1.4 billion. We transferred that to a third party, and then fully funded the remainder of those liabilities, which a gross liability of \$250 million remains with us.

That saved us \$50 million in pension expense from where we were before those actions. Pretty excited about that outcome. Beyond that, we don't have any near-term debt maturities. That gives us a lot of flexibility. I will say that I would prefer to not have \$2.2 billion in our capital structure as

a permanent element of the capital structure.

We want to reduce gross debt. We want to do it in a disciplined and rational way. That de-risks the balance sheet and it saves us on interest. We will work toward that. We just don't have any requirements. We only have choices, which is a nice [laughs] position to be in.

Then that leaves the remainder at well, what's going to our shareholders? Seth was right. We have \$150 million program. It was approved by our board at the end of 2023. That'll be executed in 2024. Add that to what we did starting in early 2022, and we've repurchased almost \$400 million of shares under those programs. I consider that again, a good start.

Do I expect as we're generating more and more cash that we're done with share repurchases? Of course, not. I think our shares are very undervalued and it would make perfect sense for us to buy shares or have the cash to do it.

Our board has shown great support in doing that, and the management team has consistently made recommendations in that direction. Don't expect that the current \$150 million program is the last repurchase program.

**Seth:** I can continue asking questions all afternoon, but we're at time. We'll wrap it up here. Don, thanks so much for being here, really appreciate it, and for talking with us about ATI.

**Don:** Very good. Thank you everybody.

**Seth:** Thanks.

[applause]



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