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# Allegheny Technologies, Inc. (ATI)

Q3 2021 Earnings Call

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**Donald P. Newman**

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

**Robert S. Wetherbee**

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

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## OTHER PARTICIPANTS

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good day and welcome to the ATI Third Quarter 2021 Results Conference Call. All participants will be in a listen-only mode. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Scott Minder, VP, Treasurer and Investor Relations. Please go ahead.

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**Scott A. Minder**

*Vice President, Treasurer & Investor Relations, Allegheny Technologies, Inc.*

Thank you. Good morning, and welcome to ATI's third quarter 2021 earnings call. Today's discussion is being broadcast on our website.

Participating in today's call are Bob Wetherbee, Board Chair, President and CEO; and Don Newman, Senior Vice President and Chief Financial Officer. Bob and Don will focus on our third quarter highlights and key messages, but may refer to certain slides within their remarks. These slides are available on our website. They provide additional color and details on our results and outlook. After our prepared remarks, we'll open the line for questions.

As a reminder, all forward-looking statements are subject to various assumptions and caveats. These are noted in the earnings release and in the slide presentation.

Now, I'll turn the call over to Bob.

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## Robert S. Wetherbee

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

Thanks Scott. Good morning and thanks for joining us today. It feels great to report that we returned to profitability in the third quarter, three months ahead of our expectations. This was no small achievement as we overcame pandemic-induced disruptions, a three-plus-month labor strike, and the challenges inherent in significant business transformation.

Our success is due in equal parts to accelerated rates of recovery in our diverse end markets, our significant business restructuring and transformation efforts, and the perseverance of the ATI team.

Our third quarter adjusted earnings per share were \$0.05. EPS improved to \$0.35 per share, when you factor in the net positive impacts from settling our recent labor strike, including the benefits from our new collective bargaining agreement and a lingering strike related costs, as well as the gain from the Flowform Products divestiture. I'm proud of what our team has accomplished, overcoming the challenges of the past two years.

We're winning on the top line through new business and by capturing share gains. We're winning on the bottom line by tightly managing costs and solidifying our financial foundation. We've begun to pivot to growth. We're excited about what we can achieve as the commercial aerospace recovery accelerates and our business operates at high utilization levels.

Before I dig into our performance and outlook by end market, I'll provide a progress update on a few of our strategic initiatives. First, we took another step in our ongoing business transformation. We sold our Flowform business for \$55 million, resulting in a gain on sale of nearly \$14 million. While this business primarily serves the defense market, it had little connection to the broader ATI. There were few material synergies, and its long-term success was linked to specific program volumes rather than our material science. The new owner will be better placed to invest for its future.

Second, we've built upon our firm financial foundation by taking steps to reduce earnings volatility and cash flow variability and increase financial flexibility. I don't want to steal a lot of Don's highlights here, so I'll limit my comments.

We successfully tapped the favorable debt markets to our advantage. We significantly extended our debt maturities by redeeming notes due in 2023. At the same time we added new notes due in 2029 and 2031. A portion of these proceeds were used to support a voluntary pension contribution. As a result of these third quarter actions, annual interest expense will decrease by about \$6 million and pension funding levels improve.

Third, as a visible next step in our continuing journey to become one ATI, we've promoted Kim Fields to serve as Chief Operating Officer effective January 2022. This officially recognizes the role she's been serving in since December 2020 leading both business segments. Kim is doing a great job aligning the businesses, accelerating execution and streamlining material flows. As markets recover and asset utilization increases, we're better positioned to expand margins and improve cash generation under her leadership.

Lastly, we continue to make progress on strategically transforming our Specialty Rolled Products business, taking deliberate actions to create a competitive cost structure. This began last December when we announced our plans to exit low margin standard stainless sheet products. It includes closing five facilities and concurrently

streamlining and upgrading our high-value material flow paths. Those efforts are largely on track. I'll have more on that in a moment.

In July, we reached agreement with Specialty Rolled Products Union representative employees ending their 3.5 month strike. Together, we signed a contract that rewards our employees for their important contributions to ATI's overall success. The SRP business is now positioned to be successful in the long term. I'm pleased to say that by the end of September, we've ramped SRP's production rates back to pre-strike levels with one exception that we're working hard to address. The SRP team did an outstanding job safely getting back on track, accelerating production to meet strong customer demand. You might wonder where we stand on our decision to exit standard stainless sheet products, given the current strong market demand. History reminds us this is a temporary upswing in a highly cyclical business with chronically low margins and high fixed costs.

Our commitment to exit hasn't wavered, but our timeline is extended by three to five months due to the strike-related impacts. First, the strike caused us to slow aerospace qualification activities across SRP operations. It also created a significant product backlog destined for strategic customers. As a result, our facilities slated for closure will extend a few select operations into the second quarter of 2022.

I would have preferred to stay on our original timeline. We're committed to better position our customers for the accelerating economic recovery and take near-term advantage where current market conditions offer a valuable upside. The savings capture will be slowed by a quarter or two. But let me be clear, the overall favorable economics attached to our transformation over the long run remain in place.

Turning to our third quarter performance and outlook by markets, we're seeing clear evidence of recovery. Momentum is building as volumes return to pre-pandemic demand levels.

Let's start with our largest end market, commercial aerospace. Expansion continues unevenly across our product portfolio. In the jet engine market, forgings demand grew for the fourth quarter in a row. This expansion was driven by demand for narrowbody engines, coupled with our 2021 market share gains. Our Q3 results included initial LEAP 1-B volume increases to support the expected 737 MAX production ramp. In contrast to forgings, our sequential jet engines specialty material sales declined somewhat. While it appears that our customers' jet engine material inventories are nearing a low point, it's clear that pockets of inventory exist. We also believe there's widespread customer desire to tightly manage year-end inventory levels.

We predict these inventory stockpiles will be fully depleted soon, as OEM production rate increases materialize. We expect customer hesitancy to wane over the next few quarters and order patterns to reflect underlying demand once again.

Lastly, on commercial aerospace, our airframe business expanded sequentially for two reasons. First, post-strike recovery efforts in our SRP business; and second, the increasing orders associated with our new European OEM long-term agreement.

Year-over-year, airframe sales declined. We expect this market to continue at low levels in Q4 and into 2022 as international travel rates recover more slowly and 787 deliveries remain on hold. Despite the mixed third quarter aerospace performance, there's good news on the horizon. As the COVID Delta variants impact slows and international travel restrictions ease, customers are once again returning to the skies. This market is already displaying strong recovery trends in the form of increased domestic passenger travel, higher global cargo volumes and accelerated fleet retirements.

Moving to the defense market. Revenue declined sequentially, largely due to customer shipment timing and the sale of our Flowform business. Year-over-year growth was strong. What's driving growth in the near term? Titanium armor for land-based vehicle programs in the US and the UK, military jet engine sales and the expansion of new helicopter programs. Longer term, we remain highly confident in ATI defense growth. Our confidence stems from a wide range of new programs and opportunities that can benefit from our advanced materials development and production capabilities.

Turning to the energy markets, we saw significant growth sequentially and year-over-year in both business segments. This occurred in oil and gas as well as specialty energy. In our Advanced Alloys & Solutions segment, we produced and shipped most of our large nickel alloy project destined for offshore waters in South America. In our High Performance Materials & Components segment, strong demand continued for our nickel products used in land-based gas turbine production in Asia. The near-term outlook for our energy markets is solid.

Global GDP growth and higher travel rates will increase energy demand clearly. Sustainability trends will drive exploration and production of more environmentally friendly energy generation and transmission technologies. All of these are best served with our unique high-performance materials.

Let's wrap up our markets discussion with our critical applications used in medical and electronics. In medical, sales grew sequentially and year-over-year. Increased demand for biomedical implant materials was driven by low post-pandemic customer inventory levels and increased elective surgery volumes. In Q4, we expect these trends to continue and likely expand to include MRI-related materials.

The electronic sales were lower compared to the record-setting levels of the previous quarter and last year, but still very strong. The strong demand for other key end markets required production allocations within our China precision rolled strip facility constraining within the quarter available capacity for electronics products. We also had a planned Q3 maintenance outage at our Oregon facility. Underlying customer demand for electronics remain strong and should continue.

I'll wrap up my opening comments by saying I'm confidently bullish on ATI's future. Our end-markets are recovering. We're growing our market share. We've aggressively locked in cost structure improvements. We have significant growth opportunities on the horizon. We've put ourselves in a position to accelerate growth and expand margins. We're executing to win. It's an exciting time for ATI and proud to lead this team as we achieve our goal of becoming a premier supplier of aerospace and defense materials.

With that, I'll turn it over to Don, to cover our financial results in more detail and provide you with our Q4 financial outlook. Don?

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## Donald P. Newman

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

Thanks, Bob. Bob already gave you my opening line. ATI returned to profitability in the third quarter, three months ahead of our expectations. A lot of hard work went into rightsizing the business and putting us on this path for growth. We'll celebrate for a moment but in reality, we've already shifted our focus to capitalizing on this momentum, further expanding our business and generating shareholder value.

Now for the details. Overall, Q3 revenue increased to \$726 million, up 18% sequentially and 21% year-over-year. Q3 adjusted EBITDA grew to \$80 million, up 49% sequentially and up 381% year-over-year. Q3 performance suggests a revenue run rate approaching \$3 billion and an adjusted EBITDA run rate of \$320 million.

On a reported basis, ATI earned \$0.35 per share in the third quarter. We earned \$0.05 per share in the quarter after adjusting for a net \$43 million of special items. These included gains for postretirement medical benefits resulting from the new SRP collective bargaining agreement and from Flowform Products divestiture. Strike-related costs were also excluded.

To better understand our results, I'll provide some color around each segment's performance. Starting with AA&S, sales grew by 35% sequentially and EBITDA by nearly 60% versus the prior quarter. Within this segment, the SRP team did an outstanding job accelerating post-strike production levels. This was against a backdrop of strong customer demand and elevated pricing opportunities. Their efforts produced tangible results, bringing us back to first quarter 2021 production rates by the end of September, as we had predicted.

Our precision rolled strip business in China once again had record sales and earnings due to continued strong demand across a variety of end markets. AA&S segment Q3 performance also compared favorably to Q3 2020. Revenue increased \$49 million and EBITDA increased \$46 million. This impressive earnings growth was powered by increased market demand, higher HRPF total conversion volumes, streamlined cost structures and metal price tailwinds.

HPMC Q3 sales and earnings were in line with the second quarter and much improved from the third quarter of 2020. Sequential forgings growth from commercial and military jet engine sales was offset by a quarter-over-quarter decline in specialty materials jet engine revenues, and the impact of selling our Flowform business in Q3. Earnings and margins were consistent sequentially.

We offset the weaker product mix driven by increased energy market sales with operational cost improvements. HPMC sales were higher year-over-year in every major market led by commercial aerospace. Earnings and margins expanded significantly in Q3 versus the same quarter in 2020. This is a result of our decisive 2020 cost-cutting actions, jet engine share gains, and contractual margin improvements.

Let's move to the balance sheet. Late in the third quarter, we issued two debt tranches totaling \$675 million. \$325 million of the notes are due in 2029 and bear interest at 4.875%. \$350 million of the notes are due in 2031 and bear interest at 5.125%. Proceeds from these notes were largely used to redeem \$500 million of notes due in 2023, bearing a 7.875% interest rate.

The financing brings several benefits including \$6 million in annual cash interest savings, significantly lower interest rates, and a much improved debt maturity schedule. Excess proceeds from the financing were largely used to support a \$50 million voluntary pension contribution in the quarter. I will come back to our pension guide path in a moment.

After redeeming the 2023 notes in mid-October, we have more than \$800 million of liquidity including approximately \$440 million of cash on hand. Third quarter managed working capital levels improved sequentially but remain above our target. This was largely due to SRP's strike recovery efforts. Q3 SRP sales were backend loaded, increasing quarter and accounts receivable. We also ramped production in the quarter, but we're unable to fully eliminate inventory backlogs before quarter end. We expect significant reductions in managed working capital levels well below 40% of revenue across the company in Q4.

Returning to pensions. Our \$50 million voluntary contribution is the latest action in our plan to improve pension funding levels and reduce related expenses and contributions over time. In the third quarter, we completed our fifth pension annuitization effort. This lowers overall participation by nearly 1,000 people and shifts approximately \$70 million of assets and liabilities to a third party. We have seen favorable asset returns and planned discount

rate movements so far in 2021. If that holds through the end of the year, we may see a meaningful improvement in our pension funded status at the close of 2021.

Now, let's take a few minutes to discuss fourth quarter outlook. In HPMC, we expect a jet engine-driven recovery to accelerate and broaden across our product portfolio. After several strong quarters, sales to specialty energy markets will likely decline. We anticipate continued commercial aerospace forgings growth. We also expect additional defense sales and to benefit from a large discrete, commercial space project. These changes should result in improved mix sequentially. For AA&S, we anticipate improved financial results in our SA&C business. This is due to defense and medical volumes increasing and expenses decreasing after our seasonal Q3 maintenance outage.

In our SRP business, several pieces of equipment will take extended outages in the fourth quarter in support of our strategic transformation. First, we'll idle a finishing line to upgrade its high value specialty materials capabilities. And second, we'll idle a melt asset to allow finishing operations to process post-strike backlogs. The outages are expected to negatively impact cost absorption and increased cash expense in the fourth quarter.

We anticipate a return to normal capacity levels in Q1 2022. Lastly, we anticipate our China precision rolled strip business to experience its normal seasonal slowdown in the fourth quarter due to lower post-holiday electronics demand. Additionally, we expect to recognize a \$7 million benefit in the fourth quarter from a retroactive 2021 tax credit in China.

In aggregate, we anticipate building on improved Q3 results on both the top and bottom line. We expect to report adjusted earnings between \$0.07 and \$0.13 per share in the fourth quarter. Despite the SRP strategic outage cost, incremental margins will fully reflect our cost structure leverage as sales expand largely in our HPMC segment.

This growth should propel our fourth quarter earnings to 2021's high point and lead to further profit expansion in 2022. This guidance range translates into a year-end EBITDA exit rate that's more than three times greater than year-end 2020. In other words, in four quarters, we've more than tripled our earnings trajectory. As Bob said earlier, it's an exciting time to be at ATI. We are back in the black and see a steady climb out of the 2020 earnings drop.

Before I hand the call back to Bob, I want to affirm the free cash flow guidance provided in early 2021. Excluding pension contributions, we expect to be free cash flow positive for the full-year 2021. The team has worked hard to put us in a position to be successful and they are committed. Work remains to close out the year, but I'm confident that we'll hit the mark. We demonstrated significant progress in the third quarter and fully expect to exit the year on a high note.

With that, I will turn the call back over to Bob.

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## Robert S. Wetherbee

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

Thanks, Don. I'll close with four important points. Number one, ATI is focused on growth with the cost structure we need for success. Number two, we're well positioned in key markets to achieve higher than GDP growth over the long-term. Number three, transformation of our product mix is largely on track and will deliver significant benefits. And number four, our people, the ATI team are the core of our competitive advantage. Together, we've accomplished much during an extended period of uncertainty, challenge and change.

I laugh a little when I hear financial experts and market pundits describe what we've collectively weathered as headwinds. That's a tad bit understated. The ATI team has persevered to do what needed to be done, working safely and responding with urgency always with the long term interest of the company and our shareholders in mind. Has it been easy? Nope. Have we occasionally had to first convince ourselves it was possible and that we could do it? Yes. But to be clear, we've done what needed to be done. I'm proud of what we've accomplished together. Most importantly, I thank our team for all they've done and the enthusiasm they have for everything that is yet to come. With a clear strategy and consistent focused execution, we're accelerating our velocity to a very successful future.

With that, I'll ask the operator to open the line for questions.

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## QUESTION AND ANSWER SECTION

**Operator:** Thank you. We will now begin the question-and-answer session. [Operator Instructions] We please ask that you limit yourself to one question and one follow-up. If you have additional questions, you may re-enter the questions queue. At this time, we will pause momentarily to assemble our roster. And the first question will come from Richard Safran with Seaport Research Partners. Please go ahead.

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**Richard Safran**

*Analyst, Seaport Global Securities LLC*

Q

Bob, Don, Scott, good morning. How are you?

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**Robert S. Wetherbee**

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

A

Good morning, Rich.

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**Richard Safran**

*Analyst, Seaport Global Securities LLC*

Q

So, I had two questions. First – the second one is a bit more strategic in nature but first is, I just wanted to ask for a bit of a clarification at HP. It was interesting sales driven by energy, aerospace was flat, defense down. You noted and you spoke about Bob, higher forgings offsetting – offset by specialty materials. Now, correct me if I'm wrong, but materials are more of a long-lead item. And if aerospace production is increasing, why would materials be declining? I take it just from your remarks that it's strictly due to destocking. And the other thing is, I think you said the issues would be resolved soon, so do I interpret that to mean you probably have a 4Q impact but not likely 2022?

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**Robert S. Wetherbee**

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

A

All right, Rich, I'll take that question. A couple of things. You're right. The forgings business, a great example of that was the LEAP 1-B. I'll give you a little factoid there. So in Q3, we shipped more LEAP 1-B forgings than in all of 2020, right? So when you think about that, what you're seeing is the accordion effect of the supply chain. So, the first thing we had to do is get the forgings to the customer.

Now, we're pulling through kind of some trapped inventory that was there, the billet – that we supply or other supply. And then as that gets depleted here at the balance of the year and end of the year, which I think is a fair

assumption that it'll be gone – towards the end of the year. So by the time we get to 2022, we should see a better synchronization of forgings and that longer lead time billet item.

There's still some pockets out there, customer specific, alloy specific, depending on batches and pull rates. But, we're definitely seeing it in the engine side where the demand in the order book – we're booking – if you wanted to order today, it'd be early Q2 probably for some of the longer, just forgings and some of the billet. So we're starting to see that demand build. We're, obviously, adjusting our crew and capacity to accommodate it.

So, I think, I answered your question which is, is the accordion effect of pulling inventory out? And, yes, we expect that supply chain that we're part of to kind of be back to – kind of quarter demand levels and in sync with demand as we enter into 2022.

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**Richard Safran**

*Analyst, Seaport Global Securities LLC*

**Q**

Okay. Thanks for that. Second one, Don, I want to know if you'd be willing to expand on some of your cash flow remarks, and not just 2022, but maybe if you would take a long-term view here. Could you discuss the major moving pieces that contribute to your cash flow, not just – like improvements in net income, et cetera. But for example, you mentioned – you made a brief mention about cash pension, working capital trends, also D&A, CapEx, et cetera. And I'm using these as examples, but I'm looking for trends in the big pieces that really kind of drive your long-term cash flow outlook. And, if you could just tell us how you're thinking about it?

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**Donald P. Newman**

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

**A**

I'm happy to do that. Of course, you said not to include earnings, but of course I have to, right? So the first major movements [ph] a number (28:27) that's going to really drive cash flow generation is going to be profitability. We've talked in the past, Rich, about the trajectory around our ability to generate increased profitability as our end markets recover. So, that is a key.

And, we've walked you through the math, walked everybody through the math before. This is a business that 2019 volumes and mix that should generate an excess of \$600 million of EBITDA. That's important. Then, you think about the other key drivers around really cash flow. First thing that comes to mind after earnings is managed working capital.

We are myopically focused on achieving our sub-30% target. What does that mean? What that means is that, that we're going to work down our managed working capital levels to be below 30% of revenue. We've been there before. It should take us probably a couple of years to get there from where we're at right now. We ended this last quarter north of 40%. We should end Q4 probably, certainly well below 40%, maybe mid-30s.

And then, as we think about achieving that 30% target over the next couple of years, one way to think about it, Rich, is you take our exit rate out of Q4 of this year and then you think achieving sub 30% two years from now and draw a line, right? That will be directionally how we think about continuing to work down our working capital investment. So that's important.

Another key driver, of course, is CapEx. The way to think about CapEx, I'm going to give you a little bit of a, kind of a, bifurcated view of CapEx. One is to carve off what is our maintenance CapEx view. How should you guys think about maintenance CapEx. It is a moving number. It's not a steady number from quarter-to-quarter. But one thing that you'd probably want to do in your models is think in terms of, ATI has about \$70 million to \$80 million a year, use it as a placeholder, but \$70 million to \$80 million a year in maintenance CapEx. Okay? Then you got

total CapEx once you add the growth CapEx to it. What's a way to think about growth CapEx? Well, I think 2020's early guidance, the pre-COVID guidance that we gave on total CapEx is an interesting data point.

If you remember, we'd said that in 2020, before COVID hit, we were going to spend about \$200 million to \$210 million on CapEx. And so, obviously a lot of that was growth CapEx. We only ended up spending in the range of \$150 million, something like that. So we had an amount of our capital that we deferred.

So, as you think about coming out of the trough and getting into the recovery, we will finish the projects that we had started before COVID hit. So, but then as you look past that, as you think about, okay, how should we think about what ATI might spend on an all in for CapEx, I think number one, the maintenance CapEx target will give you a good sense of where to start. Number two, remember that whatever we're spending on growth CapEx is in support of LTAs and demands that we're seeing in the market from our customers. And so, it'll be a sensible number but certainly will be north of that maintenance target.

So, those are kind of the major targets that we think about when we – or the major levers rather we think about when we think about free cash flow generation. Is that helpful?

**Richard Safran**

*Analyst, Seaport Global Securities LLC*

Q

Oh, yeah. Thank you.

**Operator:** And the next question will be from David Strauss with Barclays. Please go ahead.

**David Strauss**

*Analyst, Barclays Capital, Inc.*

Q

Thanks. Good morning, guys.

**Robert S. Wetherbee**

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

A

Good morning, David.

**David Strauss**

*Analyst, Barclays Capital, Inc.*

Q

This – the Q4 adjusted EPS guidance, let's just take the midpoint at \$0.10. Bob, is that a good way to kind of – is that a good place to build off of as we think about next year given all the moving pieces here with the exit from stainless and metal prices and – kind of how should we think about building off of that as we model out next year?

**Donald P. Newman**

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

A

This is Don. I'm going to take a run at the question and Bob can mop up if it's needed. But, yes, I think to think about our exit out of 2021 from an earnings standpoint, that's \$0.07 to \$0.13 of guidance is a helpful and interesting data point. But you want to consider a couple of things. First of all, we did note that we've got a planned strategic outage in Q4 in our SRP business. It's part and parcel to the transformation of that business to a specialty products business. And so, we're going to have some out-of-pocket costs associated with that in Q4, probably the right way to think about those out of pockets and under absorption impacts. I'm guessing it's something in the \$10 million range just as a placeholder.

And then, we also noted that we've got a \$7 million good guy on the tax line. So, if you're looking at EPS and projecting out EPS, that \$7 million good guy in the tax line, you wouldn't want to extrapolate to all quarters in 2022 because it is a – it's a kind of once in a year item that we pick up in Q4. But as you think about our trajectory, what I would encourage you to think about and consider as you think about our future earnings, we're at – our Q3 run rate almost \$3 billion of revenue and \$320 million of adjusted EBITDA.

It is a dramatic turnaround in this business, but it's not by accident, it's not by accident because, a meaningful portion of this is because of the changes we're making in the transformation. It's also the cost takeouts that we executed throughout 2020 and efficiencies that we're continuing to capture. And in addition to that, of course, we are expecting recovery in our key end markets, aerospace, of course, is the star in that – in those end markets from a profitability standpoint for us. So, hopefully that helps you.

**David Strauss**

*Analyst, Barclays Capital, Inc.*



Yeah, it does. And I guess trying to put a finer point on the cash flow question. You're projecting, Don, this \$600 million in EBITDA. Would you – at what rate can you convert EBITDA into cash? Is it a – including pension, I mean, is it 30% conversion? Is it 40% conversion? What do you think about as kind of the rate conversion rate of EBITDA into free cash?

**Donald P. Newman**

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*



Well, for that I'd kind of – I'd prefer to – instead of giving you just a blunt percentage what I'd like to do is just, again, give you a little bit of data point, right? So if you're starting with EBITDA, you want to remember that there's cash interest that you'd want to consider on that. Our interest expense runs in the range of about \$100 million right now annually. So you want to consider that. We are tax shielded. So taxes shouldn't have a big impact on what you're projecting.

And then the other important part of it is working capital, right? So as you're modeling it, you want to consider our target. We wholly and completely believe we can get back to where you already been. It doesn't sound very heroic when you say it like that. We were at 30% before. And so we've got some work to do to do that structurally and consistently. But we believe we can get there.

And then the big question that you're going to want to strike an assumption on is how much growth CapEx is in a given period, right? You already know our maintenance CapEx because I just shared that. So if you're thinking about 2022, for example, what you can – what I would do is I'd go back to the data point that we gave you at the beginning of 2020 before COVID raised its head, and that was \$200 million of total CapEx. So I think – with all those data points, you probably can take a view in terms of how to think about conversion.

**David Strauss**

*Analyst, Barclays Capital, Inc.*



Okay. And sorry, last one. Next year, including whatever you do from a pension perspective, would you expect free cash flow to be positive, so including pension, not excluding pension?

**Donald P. Newman**

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*



Well, that is certainly our target. Positive free cash flow is always our target, right? We understand that the value creation that comes with positive cash generation. So one thing, another data point that might be helpful to you, by the way, is and you had asked, I missed it, how to think about pension contribution. So, we're on this pension glide path and I can't tell you how excited we are to see the potential to be out of the pension business.

And we expect that, we contributed \$67 million to our pension plan in 2021. Our minimum required is more like \$10 million or \$12 million. What you should expect as you're thinking about free cash flow generation and conversion, is that we'll probably continue to make contributions in \$50 million to \$70 million range for the next two or three years.

But it's all going to be driven by this ultimate objective of driving our net pension obligations to a de minimis level and making them irrelevant to you guys and to ourselves. And we're on that glide path. So, very, very positive.

**Operator:** Thank you. And the next question will come from Phil Gibbs from KeyBanc Capital Markets. Please go ahead.

**Philip Gibbs**

*Analyst, KeyBanc Capital Markets, Inc.*

Hey, good morning.

Q

**Robert S. Wetherbee**

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

Hey, Phil.

A

**Philip Gibbs**

*Analyst, KeyBanc Capital Markets, Inc.*

So the way that we're essentially looking at the fourth quarter with all the moving pieces here, and I think you hit on with David and I don't want to get expectations too far out of balance is that, EBITDA plus or minus should be reasonably similar to 3Q because you got HPMC moving up and you have AA&S moving down, largely on the outage. Is that the way to think about it?

Q

**Donald P. Newman**

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

I think that's good now.

A

**Philip Gibbs**

*Analyst, KeyBanc Capital Markets, Inc.*

And then, on your free cash flow being modestly positive – breakeven to modestly positive for the year excluding pension contributions. Is that pension contribution number \$67 million this year?

Q

**Donald P. Newman**

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

The first part of your question, Phil, broke up. Can you repeat the first? Can you repeat?

A

**Philip Gibbs**

*Analyst, KeyBanc Capital Markets, Inc.*

Q

I was – yeah. I was saying in your free cash flow guide for the year of breakeven to modestly positive?

**Donald P. Newman**

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

Yeah. Sure.

A

**Philip Gibbs**

*Analyst, KeyBanc Capital Markets, Inc.*

Excluding pension contributions? Is the pension contribution number \$67 million? Is that the number...

Q

**Donald P. Newman**

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

Yeah. That's it. We're not anticipating anything – any additional pension contributions in 2021.

A

**Philip Gibbs**

*Analyst, KeyBanc Capital Markets, Inc.*

But that's the right number to be used that \$67 million?

Q

**Donald P. Newman**

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

Yes.

A

**Philip Gibbs**

*Analyst, KeyBanc Capital Markets, Inc.*

Okay.

Q

**Donald P. Newman**

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

That's right. Yes. You got it, Phil.

A

**Philip Gibbs**

*Analyst, KeyBanc Capital Markets, Inc.*

And then, in your filings recently, you've been providing backlog for the business. What should we be thinking about in terms of the backlog at the end of this quarter versus the last quarter?

Q

**Donald P. Newman**

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

I think what you would expect we're – for our SRP business, we – I mentioned that we built our managed working capital for SRP. We were still working through the strike-related backlog. You would expect that we will be through that backlog by the end of this year. Beyond that, I would say, backlog is generally in the same range at the end of Q4 as we saw at the end of Q3 just generally. What would you add to that, Bob?

A

**Robert S. Wetherbee**

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

A

Yeah. I think that's right. I think so. The way we're looking at it is kind of where our lead time is going and what's going on in the industry. So, what we see – for our specialty materials business is that lead times – through the pandemic were less than 90 days. Now, they're moving out to closer to Q2. So, 120, 150, 180 days, so we're getting to the point where we're starting to see the orders actually aligned with this demand ramp. So, from that backlog perspective, I think that the lead times are the best indication that HPMC is really seeing the increase in the order book.

**Philip Gibbs**

*Analyst, KeyBanc Capital Markets, Inc.*

Q

Okay. And then last just from a housekeeping perspective. On debt reduction, the refinancing didn't fully gel in 3Q in terms of the actual balance sheet. So how much debt including accrued interest and other things should we expect to be coming out of Q4 as those bonds are retired? Thank you.

**Donald P. Newman**

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

A

So the headline numbers on that would be, we had \$500 million [ph] of par (42:09) outstanding at the end of Q3 that we took out. We also paid about a \$70 million premium to execute that redemption. That's both of those events obviously happened in mid-October. And then from an interest standpoint, there's about \$6 million of interest that we ended up paying related to that redemption.

**Operator:** And thank you. The next question will come from Seth Seifman with JPMorgan. Please go ahead.

**Seth M. Seifman**

*Analyst, JPMorgan Securities LLC*

Q

Great. Thanks very much and good morning.

**Robert S. Wetherbee**

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

A

Good morning, Seth.

**Seth M. Seifman**

*Analyst, JPMorgan Securities LLC*

Q

I just wanted to ask first about HPMC and the forging ramp that's ahead. Obviously, we've heard in a lot of different places about some of the challenges in ramping. It's historically been a challenge in aerospace forgings. I guess how prepared do you feel for what's there in Q4? And what kind of work do you have to do for 2022?

**Robert S. Wetherbee**

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

A

Yeah. So, I think we're in good shape in our forging business for Q4. We actually supply a lot of the billet that goes into our forging. So we feel we're in a pretty good shape there.

We do have – isothermal forging and heat treating capacity that we slowed down during the pandemic. That's coming and getting qualified here. So we feel really good going into 2022, 2023 with the capacity that we're going to have in place.

And the things we're working hardest on at the moment are getting our workforce and our labor force back. We have a pool of prior employees or people that got laid off as we went in. So, we're in the process of calling them back – in Q4. Our head count issues probably we're going to end up increasing our head count as we go into next year by 5% or 6% from where we are today, mostly on the direct labor side. And that's where we're spending most of our time. And if the hiring and then followed by the requisite training to get them in the right spot.

But, we recognize the importance of getting our staffing in place. I would say our HR team is fully engaged in making sure we get people back. And our team has done a great job to avoid a lot of the COVID-related disruptions, but we obviously keep our eye on that too. So I think the number one issue for us is making sure our crew is in place as we go into 2022.

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**Seth M. Seifman***Analyst, JPMorgan Securities LLC*

Q

Okay. Great, great. And then, Don, I think you mentioned that if the year ended today, the pension liability would – will have shrunk from year-end. Can you tell us what that would be if the year ended today with today's discount rates, and returns and the contributions that you made?

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**Donald P. Newman***Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

A

It's a fair question, but I'm actually not going to fully answer it, largely because there's a lot of science, a lot of work that has to be done around that. But what I can say is that we love the direction that key movers are going. And just for some context, when you look at the discount rate and the volatility around discount rates, for every 50 basis point move in discount rate, it has \$150 million impact on the liability.

And so, if we were to see just a 50 basis point move in discount rates in our favor, then we would see \$150 million good guy hit our balance sheet, right? And I don't want to share with you how much have they moved so far this year because then that kind of, I think, takes us into a level of detail I'm not prepared to talk about.

But they are indicators of good guys and we're certainly managing with the expectation that we'll continue to have very good returns on our investments. I think our advisors and our team have done a good job on that. And then, there's not a whole lot we can do about discount rates, but we can at least cross our fingers and hope they hold or maybe even go even more in our direction.

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**Seth M. Seifman***Analyst, JPMorgan Securities LLC*

Q

Okay. Great. Thank you very much.

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**Donald P. Newman***Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

A

You bet.

---

**Operator:** And the next question will come from Gautam Khanna from Cowen. Please go ahead.

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**Gautam Khanna***Analyst, Cowen and Company, LLC*

Q

Hey. Thanks, guys.

**Robert S. Wetherbee**

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

Hey, Gautam.

A

**Gautam Khanna**

*Analyst, Cowen and Company, LLC*

And good results.

Q

**Donald P. Newman**

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

Thanks. Good morning.

A

**Gautam Khanna**

*Analyst, Cowen and Company, LLC*

Yeah. Hey. And so, a couple of questions. First, just what are you guys seeing with respect to titanium demand in 2022 given like all the noise around the 787 inventory overhang at Boeing and then the 737 ramp, how that plays out? I'm just curious, are you – do you guys have pretty good visibility from the Boeing supply chain on what your titanium shipments will be next year? And are they going to be up or down year-over-year relative to 2021?

Q

**Robert S. Wetherbee**

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

Yes. Good question and we probably have more visibility than we'd like at times as to what's going on with titanium. So, I'm going to limit the titanium question to airframes specifically. And then if you want to follow-up, we'll go further.

A

But, so, I would say that 2021 will – is pretty much the low point, but 2022 will probably be flat to that. On the titanium, I'll call it the mill product side, it goes into airframe from the big B perspective. One of the benefits we have that offset some of that is a growing share position with European OEM with our new-long term agreement there.

So, we should actually see our shipments be flat to up in 2022 for titanium mill products. But I think the industry will see flat through 2022. And it's really going to take as you suggested, the 787 is going to have to come back to have some level of confidence. And certainly, the 737 needs to get to 2031. Although from a titanium standpoint, it's really the 787 decision that I think we're all waiting for. Now, we've taken a lot of – our in-process inventory down but there's a lot still in the pipeline. Does that help?

**Gautam Khanna**

*Analyst, Cowen and Company, LLC*

Okay. And just...

Q

**Robert S. Wetherbee**

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

Yeah.

A

**Gautam Khanna**

*Analyst, Cowen and Company, LLC*

Q

Absolutely. No, it's very helpful. And then to expand that on the engine side titanium and maybe also just on industrial side, like do you guys have a view on 2022 with respect to both of those?

**Robert S. Wetherbee**

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

A

Gautam, I think on the engine side we see going up. And we see it going up for a couple of reasons. One is obviously the planes that are flying are the next generation engines for sure. Obviously, that's a big nickel part for us. In the industrial titanium area, we actually see very strong global demand there which has been positive. We don't talk much about that because most of the questions we get are aerospace related. But, I would say industrial titanium will be up.

And I think, on the engines, we should see similar kind of growth rates as we're seeing in the forgings and billet business. Not stellar in titanium because of the airframe problem, but other than that should be [indiscernible] (49:48).

**Gautam Khanna**

*Analyst, Cowen and Company, LLC*

Q

And last one before I turn it over, just there's obviously Special Metals Corp has a strike. I don't know if there's any – are you seeing any share gains not – kind of unrelated to the GE contract that you signed that obviously conferred more share. But just because of competitor challenges due to whatever, whether it be strikes or supply chain or what have you, are you seeing kind of an improvement in emergent demand in any of the end markets? And if so, if you could just kind of how long might that last? What's your expectation there?

**Robert S. Wetherbee**

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

A

Yeah. All right. I always – to make sure my attorneys are happy when I speak on a call like this, Gautam, but I'll answer your question. The answer is yes. We are seeing opportunities emerging from other competitors' supply disruptions. And I would say it's hard to quantify how long any of these labor disruptions or these supply disruptions will last. But we are seeing it and it's good business for us.

And then about half of what we get in emergent gets converted to LTAs, right? So the first calls you get are transactional calls and then the next opportunities are certainly converting those to LTAs, which is our goal.

So I think it's the combination of nickel and titanium opportunities across the board, but is it going to move the needle significantly for the company? It's probably going to be in our specialty rolled products business is where we're seeing a lot of opportunities, a little bit in specialty materials, but it's been positive for us. We're just glad we resolved our issues and have moved on.

**Operator:** And thank you. The next question will be from Josh Sullivan with The Benchmark Company. Please go ahead.

**Josh Sullivan**

*Analyst, The Benchmark Co. LLC*

Q

Hey, good morning.

**Donald P. Newman**

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

A

Good morning.

**Robert S. Wetherbee**

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

A

Good morning, Josh.

**Josh Sullivan**

*Analyst, The Benchmark Co. LLC*

Q

Just to follow-up on the titanium theme. Your raw titanium supply agreements, have you seen any impact from the magnesium shortages or, as you just noted, are current inventories in demand for 2022, just not a huge pull on that right now anyways?

**Robert S. Wetherbee**

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

A

Yeah, I think the simple answer to the question on mag is, nope, we haven't seen any major issues yet. We watch it because it's an indicative issue of all other kind of supply chain issues that are out there, but not yet.

**Josh Sullivan**

*Analyst, The Benchmark Co. LLC*

Q

And then on the commercial space project, the discrete one that you mentioned, is this an existing customer that's switching material or is this a new customer?

**Robert S. Wetherbee**

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

A

Let's see, that's a good question, it's a long-term customer that's been in the space business. They're supplying obviously the commercial space activity. I would say it's kind of a bulk buy right there, kind of buying ahead. And I think that's prudent because the capacity they want will probably get sucked up by the increasing commercial aerospace recovery. So it's an exaggerated buy from – it's a multi-year buy, it's probably what I would say. And so, we're glad to have that and leverages our material science and advanced process technologies pretty well. So, I think that answers your – is that close enough, Josh, to answering your question?

**Josh Sullivan**

*Analyst, The Benchmark Co. LLC*

Q

Yes. Yes. Thank you. Thanks for the time.

**Operator:** The next question will be from Paretosh Misra from Berenberg. Please go ahead.

**Paretosh Misra**

*Analyst, Berenberg Capital Markets LLC*

Q

Hey. Good morning, Bob, Don and Scott. Just I guess, the question on 787 given the issues they had in Q3. Do you think your shipments for that program were in line with five per month production or you were running lower than that during Q3?

**Robert S. Wetherbee**

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

A

Good question. I think they were still a ways away from being in line with five. I think we're probably lower than that. I mean the situation I think on titanium with COVID and various other things kind of got out of whack. I think it's probably – I don't know if it's the worst that the industry has ever seen, but it's pretty significant in terms of working that through.

So, I think what the difference between double-digit 787 and five was the biggest gap we were running into. I think it's probably going to extend the destocking, what we thought would probably be by third quarter is probably going to extend it through the balance of the year. And it's really the destocking issue. Yeah, I think there's a desire by that particular OEM to smooth out the solution so people can do it as economically as possible. And we're seeing that. But it's to a degree. But I think the answer to your question is no, we hadn't gotten just to five. We were still trying to work on the destocking issue. And so, it's just an extension of that titanium recovery from midyear to probably the end of the year to catch up.

**Paretosh Misra**

*Analyst, Berenberg Capital Markets LLC*

Q

Got it. Got it. And then, how should we think about your specialty rolled product sales in the next two quarters as you exit some commodity business? Should it be down say about \$100 million sequentially in Q4? Because you idled, what, \$400 million, \$500 million of capacity or some of that is already captured in your Q3 results?

**Robert S. Wetherbee**

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

A

Yeah. I think it's – I would say I don't see it going down. I think the issue that we're dealing with is we're going to end up with some margin compression because of the work we're doing with the outages to get prepared or finish off our transformation, which is actually ongoing now. But I think in general we'll probably see 10% growth in the top line, and why Don was signaling the outages issue is that if I have this \$10 million issue that we're dealing with for the maintenance issue. Is that right, Don?

**Donald P. Newman**

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

A

Yeah, right. And then the outage of course was related to SRP.

**Robert S. Wetherbee**

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

A

Right.

**Donald P. Newman**

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

A

But it will be a headwind relative to our [ph] otherwise (56:15) performance...

**Robert S. Wetherbee**

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

A

Right.

**Donald P. Newman**

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

A

...of the overall business.

**Paretosh Misra**

*Analyst, Berenberg Capital Markets LLC*

Q

I see. Okay. Thanks. And maybe last one, just in terms of 737 MAX ramp-up, is your exposure to that platform similar to your exposure to 320neo or MAX is bigger or much bigger than that?

**Robert S. Wetherbee**

*Board Chair, President and Chief Executive Officer, Allegheny Technologies, Inc.*

A

Let's see. So, I think it depends on a couple of things. We do – we like every airplane ever built that flies today, period. So, we're on every program. We love them all. I would say when you look at the A320 series, there's clearly engine preferences that people have and some of them don't always pick the LEAP. But we're – I think we might go with the geared turbofan.

So, I think that's the biggest differential between them is 100% LEAP on one program and probably 60% LEAP plus geared turbofan on the 320. So – but it's a – we're getting to the point where we're happy when every airplane – any airplane gets built anywhere in the world. So, our material is there, so – but maybe a slight advantage to LEAP-powered airplanes versus geared turbofan powered airplanes. But we love them. We love them all.

**Paretosh Misra**

*Analyst, Berenberg Capital Markets LLC*

Q

Got it. Got it. That's very useful. Thanks, guys.

**Operator:** The next question will be from Matthew Fields from Bank of America Merrill Lynch. Please go ahead.

**Matthew W. Fields**

*Analyst, Bank of America*

Q

Hey, everyone. I don't want to beat the working capital horse to death here. But your receivables kind of jumped up a lot this particular quarter. Is that kind of initial deposits on the LEAP engines that's going to reverse when you get the cash in the door? Is that something else? Can you just talk about kind of why the accounts receivable was so dramatically higher in the third quarter?

**Donald P. Newman**

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

A

Sure. Of course, we had the growth in the revenue, but I also mentioned that for SRP, SRP, of course, was coming out of the strike and the recovery in Q3. And so, they were ramping throughout Q3. A lot of their sales were back-end loaded in the quarter. And because of that, that drove the ARR balance up at quarter end. That will, of course, be collected in Q4. And so, we should see that release.

**Matthew W. Fields**

*Analyst, Bank of America*

Q

Okay. And that's part of the working capital flip in the fourth quarter that will get you to...

**Donald P. Newman**

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

A

That is. Yes.

**Matthew W. Fields**

*Analyst, Bank of America*

Q

...the cash flow guidance?

**Donald P. Newman**

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

A

Yeah. That's a great interpretation. And we'll see a similar good guy on the release of inventory for SRP, similar in mechanic or direction, not similar in magnitude.

**Matthew W. Fields**

*Analyst, Bank of America*

Q

Okay. Great. That's helpful. And then, kind of next up. You chopped a lot of wood on the balance sheet, getting rid of that near-term maturity. What – can you talk a little bit about the next kind of couple of steps of the deleveraging plan you mentioned, \$50 million to \$70 million pension contributions for the next few years? After that, is it kind of paying down the 22 converts at maturity or hopefully with equity from hopefully from the credit side? I know there's other parties on the call, but what are the kind of next steps in your mind towards kind of de-leveraging the balance sheet?

**Donald P. Newman**

*Senior Vice President-Finance & Chief Financial Officer, Allegheny Technologies, Inc.*

A

Sure. Well, step one, first and foremost, maximize our earnings and the drop-through-to cash conversion, right? So – but – when you get past that, what are we going to do with the cash? Well, we think in terms of – we know we're going to de-lever in the normal course because of the ramp that's already happening on our profitability, right? From a net debt ratio standpoint, we took our net debt-to-EBITDA ratio down 130 basis points in just the last quarter. That is going to continue to drive down that metric. So we have that benefit.

And when you talk about the maturity profile, you're right. Our treasury team did a phenomenal job with this refinancing, pushing maturities out, and really solidifying a pretty strong maturity schedule. The nearest term maturities we have, two are prime – two maturities that are in the more near term are convertible debt, right? So the likelihood of both of those converting is very, very high.

The nearest term on that is about \$84 million and that gets us in 2022. Again, we expect it'll convert. If for some reason it didn't convert, we're in a healthy financial position to deal with it. But believe me, I am expecting it's going to convert. And, beyond that, other actions to take, what we would love to do is not just rely on the net debt ratio. It's great to just work it down because we're more profitable. But we've got \$1.6 billion of debt, we want to pay it off. So, we'll, over time, attack these maturities with cash and pay those down at the appropriate times.

Of course, you also need to make sure you're not blunting your growth opportunities by over allocating to reduce your net – your debt positions, so we balance the net. Then as far as other de-levering, the pension, I mean, we've already said we're on a glide path. I shared, as you had mentioned, what we're going to do around contributions.

We think that we're on a very natural plan to see that de-levering happen without any extraordinary efforts on our part. Maybe another – just a question – answering a question you didn't necessarily ask yet. But as we think about our leverage levels, I'd like to see our balance sheet levered at below to 2 times net debt. And we are definitely on that glide path to work down there over, not-too-far-distant future, just with what's happening in our business in the normal course.

**Operator:** Thank you, sir. And ladies and gentlemen, this concludes our question-and-answer session. I would like to turn the conference back over to Scott Minder for any closing remarks.

## Scott A. Minder

*Vice President, Treasurer & Investor Relations, Allegheny Technologies, Inc.*

Thanks to everyone who's joined us today. We appreciate your continued interest in ATI. This concludes our third quarter 2021 earnings call.

**Operator:** The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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