

ATI

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- Kristine Liwag: Good afternoon, everyone. Welcome to our next session. We've got ATI with Kim Fields, President and CEO. Thank you. Nice to have you here. And we have Don Newman, CFO. Before we continue, the standard disclosures, I've got one and Don's got one, too. So for important disclosures, please see the Morgan Stanley research disclosure website at www.morganstanley.com/researchdisclosures. If you have any questions, please reach out to your Morgan Stanley representative. And as you guys know, I'm Morgan Stanley's aerospace and defense analyst, Kristine Liwag. Happy to have you guys here. And Don, I know you've got a disclosure, too.
- Don Newman: My lawyers would be disappointed if I didn't. So we'll also probably be touching on some forward-looking statements. I would remind you to refer to our website, atimaterials.com, and we have numerous opportunities to read our forward-looking statement caveats. You can start with the last quarterly presentation deck. You'll also find good information around those risks in our Q's and K's.
- Kristine Liwag: Wonderful, great. So with that, we'll get started. So maybe, Kim, looking at this demand environment, we've seen demand for engines, engine products, engine materials within your aerospace segment for new engines and for spares. Can you give us some context on how this demand signal is different or similar to previous aerospace up cycles? Just because when we talk to the industry, especially in your part of the business, there seems to be more of a demand frenzy than we've seen in previous cycles. If you could put that into context for us, that would be helpful.
- Kim Fields: Sure, sure. So yes, if you look at the industry in this cycle, it is different. I think in past cycles, you saw a very quick ramp-up and then a drop-off, almost predictably, when people bought too much material, they get ahead of it. This one is being paced by the material suppliers, and I think because of that, there's been a nice, slow ramp as it's grown. I think overall, there is going to be some blips here and blips there. So there is still noise as we're looking at it. But it's more of a smoothing trend, and the demand continues to move up, which I think is good for the industry. I think it's good for the supply chain as we build that momentum going forward.

Kristine Liwag: And when you look at the portfolio today, can you talk about your platform exposure, ship set exposure in these new programs versus a previous cycle? And then also tacking onto that, at your August earnings call you mentioned you have limited impact from the Boeing and Airbus production delays. Now here we are and 3Q's almost over. What are you seeing and what your expectations are for the ramp.

Kim Fields: Sure, yes. Over the last 2 years, we've been very deliberate at diversifying our customer and product portfolio. So in the last cycle, it was heavily dependent on the Boeings and GE's of the world. And today we are participating in every airframe and engine program across the industry. We've built really strong relationships. We diversified into multiple material programs as well as multiple frame programs here and also across the pond in Toulouse.

And so what that allows us to do is a couple of things. One, we aren't overly concerned with any one partner that might be hitting a blip or having a pocket of inventory adjustment. We're looking at the overall demand, and we're seeing demand come from those multiple areas that are filling any open spots as we're going forward.

So from a new build standpoint, the industry maybe are taking a breath to catch their breath to get ready for the next sprint. As we look forward into 2025, I'm hearing from customer indications it's going to be very, very strong in the second half, which means it's very strong for us now with our lead times and the first half deliveries.

MRO continues to be really strong from an engine standpoint, running about 2x our historical rate. Some OEMs have been really public around some of their challenges, the GTF program. We are a partner at helping them produce the parts, so they're able to turn around that aircraft and get the AOGs back down. As well as some of the other OEMs also have mentioned, they've talked openly around, "Hey, we've got a lot of MRO demand." They're looking at their own life cycles. Shop visits are up because engines are staying in service longer. So all of those things, along with demand from other markets like defense--unfortunately, tensions are high all across the world, and we continue to see defense applications for Ti armor plate. For ground vehicles there's been a resurgence, given what's happened in Europe.

So all of those demands coming in may get, from our standpoint, an opportunity that we can move through those blips, and we're really looking at the overall trend as it's going. And I think the fundamental underlying demand of this market overall is not changing. It's not going away. What we're seeing is a smoothing, maybe quarter to quarter, not a cancellation or pushing out years.

Kristine Liwag: That's really helpful context. It's nice to know that there won't be a drop-off, right?

Kim Fields: That's what we're hoping. But even this morning, Don and I were talking, Putin came out and said, "Hey, maybe I need to limit exports of titanium and nickel into the market." And so we're continually monitoring these different activities that are happening, because it could be a geopolitical shock to the supply chain again, just like when they invaded in Ukraine. And we're looking at, okay, how does that play? What is the scenario, and how would we accelerate some of the capacity that we've got coming online so that we can meet that demand if this were to come true.

Kristine Liwag: Great. And I do have a titanium question, so we'll get back to that later in the session. Maybe Don, for the convertible note, you guys have known that you're calling them, and then the board of directors also authorized a \$700 million repurchase plan. Can you walk us through the priorities for capital deployment, and do you have a target leverage, and how do we think about these converts?

Don Newman: Sure, I'm happy to do that. For those of you who may not be aware, we announced last week that we are going to be repurchasing up to \$700 million of our stock. It's a multiyear program. It is going to be funded through cash from operations. If you add the \$700 million plus what we have repurchased since early 2022, it brings share repurchases to more than \$1 billion. And we're excited about this. Return of capital to shareholders is a key element of our capital deployment priorities. The other two of our priorities are, number one, let's invest for growth; number two, let's delever and derisk the balance sheet.

The conversion of the convertible notes, and these convertible notes were originally issued back in 2018. Well, those were maturing, and rather than roll that debt, we wanted to take care of it. But we wanted to offset the dilution effect through share repurchases.

So this is a program that I think there's a couple of key takeaways, one of which is our confidence and ability to generate cash. I know we have a spreadsheet-heavy audience, so as you're thinking about, "How do I model that?" what I would do is take that \$700 million. Let's assume for simplicity, spread it out over the next 10 quarters. Of course, by math that means we don't expect this program to continue to be around after the end of 2026. That gives you a little bit of an idea on how to plan that cash flow. It will differ from that flat line. We do have a seasonality in our cash generation.

But we're excited about this. Our board is very supporting of taking care of our shareholders. You shareholders take care of us, and this is the way it works.

So in terms of how to think about leverage, right now we have a gross debt of about \$1.8 billion. And on a net debt basis, I would expect, as you think about the end of the year, we would probably have a net debt ratio between 1.5 and 1.75. And so we are definitely going in the right direction from a leverage standpoint.

There's two ways to answer the question on how we think about leverage. One is how comfortable are you? Well, of course, we're comfortable with leverage above 2x, but we really want to live in the 1x to 2x net debt ratio area. Below 1x, it really feels like we have an inefficient capital structure. We will work our way down to that 1x, I think at a pretty good pace even with the share repurchases. And above 2x, I think we're probably paying more in interest than we ought to, and we ought to get that debt off the books. So that's on balance how we think about leverage.

Kristine Liwag: Thanks, Don. Now Kim, you touched on defense and you touched on the geopolitical environment. Defense is now 10% of revenue in the quarter and up like, I think, 18% year over year, which is pretty strong. How do we think about the trajectory for the rest of the year and also for 2025? You've highlighted a few of those programs, but how do we think about growth and the sustainability of that high-teens year-over-year growth?

Kim Fields: Defense is an area where we have a ton of opportunity to grow, as you mentioned. We were up 23% in 2023, and this year we're up 18% to 19% year to date over that. So we are seeing continued growth.

We participate in multiple branches of the defense market. One is the Ti aero plate that I mentioned, as you said, for the ground vehicles. There has been a resurgence. Unfortunately, the world tensions continue to rise in multiple regions. And in addition to just more tanks being built, we're also seeing lightweighting opportunities where they're looking for ways to take weight out to increase the efficiency of these tanks and protect the occupants. So lots of exciting work happening there.

We also are in the naval propulsions area, the nuclear naval space. And so obviously, with AUKUS there's an opportunity there that we are participating in, supporting that as well as a deterrent, which we all just saw here recently in the Middle East as that continued to be relied on for that.

Clearly we're in the jet engine business, and we're continuing to support those programs. There is more need for that as well as the rotor craft, the CH-53K as well as the Blackhawk that we make forgings for. And those are picking up quite a bit as well, as there's more spare parts and more and more helicopters that are being built.

I think the last area that we see a lot of growth, maybe not all in 2025, but as we look forward is hypersonics. That is really starting to pick up some pace. I see a shifting and a pivoting to more strategic missiles as they're thinking about possible future engagements. And that is an area where we've made material. C103 is the alloy. It's a great application for those leading edges where high heat tolerance as well as integrity and strength. Today it's ceramic matrix composites, but not really well suited for high speeds, where a raindrop can shatter the thermal protection system around these missiles and rockets. So great opportunities where we're today supplying that material, providing additive capabilities, as well as developing the next generation of alloys for that market.

So I think we've got great growth for 2025 and also into the next decade as these new advanced systems come online.

Kristine Liwag: I didn't know raindrops were that powerful.

Kim Fields: I didn't either. It was something new I learned today. All things pass on though, so--

Kristine Liwag: So maybe going into titanium, over the last few years we've seen the industry try to diversify away from Russian VSMPO-AVISMA. You guys have talked about in your previous calls you're giving pace your overall titanium expansion. I think it's like 80% versus 2022, so it's a pretty big step up. And I think for this year, you're slated to be 45% online on that baseline growth.

So on titanium, what are you seeing in terms of the industry behavior? Because we heard Boeing and some of the US suppliers stopped buying from VSMPO-AVISMA. The Europeans have not. So if you could just give us context of what's happened in the workplace and this incremental detail that you mentioned earlier, with Putin saying short,

stop exporting titanium. What could that mean for you? And any sort of numbers around this would be helpful.

Kim Fields:

Sure. So I'll give some color, and then maybe I'll ask Don to share some of those numbers for you. I think if you look at VSMPO, there has been an effort to derisk that supply chain. I think there was a heavy reliance on the titanium and the forgings that come from them. There has been a lot of work to bring in second sources. It's driven a lot of our growth as we think about those European suppliers and increase more rapidly coming to parity with the US suppliers that we've always supported. So there's been a ton of growth for us personally, ATI.

But as you look at the industry, VSMPO is not out, as you mentioned, of the market, and they're still an important part of that supply chain. And so if there were to be a change, a shock to the system, and right now there's increasing pressure coming from both the US and the French government to move away. But if Russia were to decide, say, tomorrow that they were going to limit it, I think that that would create a lot of strain because the reason they're still buying is because there isn't enough titanium capacity today.

You mentioned we brought back an idle asset, increased our capacity about 45%. We will be hitting run rate as we leave the back half of this year. We have a new brownfield asset that's coming online, and it will start up at the end of the year, and it will be qualifying through next year. So the way we think about it as we're looking at that is if there was a shock or a change, we would be partnering with these customers very closely to accelerate those qualifications so that we could continue to support the ramp.

With the wide bodies coming on, there's going to be an even greater demand. Those have about 5 times the titanium of a single-aisle. So we are looking at that and working on it. You probably heard Canada came out and tried to limit or exclude all Russian titanium, and there was a very, very quick reaction from the marketplace because I think there's a recognition that we don't quite have all the capacity online yet to do that and have it all be second sourced elsewhere.

Don Newman:

Okay. Maybe it would be helpful if I dimensionalize it a little bit and give you a sense as to what that additional capacity is expected to add to our business. First of all for context, when you look at titanium as an element of our sales mix, it's typically in the high teens as a percent of sales. Nickel's our number-one category. We have some very, very differentiated products both within the nickel as well as the titanium part of our business.

But in terms of capacity, as Kim said, we've seen a consistent and very strong demand hitting our business around titanium. Our reaction was to be thoughtful in terms of increasing our available capacity to support the long-term demand and really partner with our customers on that. As you mentioned, we are adding 80% capacity when it comes to titanium melts. About 45% of that was tied to the restart of a facility that we had idled in the COVID timeframe. That restart is complete. It was a very modest cost to do the restart. It was in the range of \$10 million of capital cost to get that plant up and running. It's a good plant. We think that if we take the right steps, we can make it an even better plant in a very inexpensive capital plan.

But that restarted facility, the way to think about what it will do for us is we expect that run rate to generate between \$150 million and \$170 million in annual revenue at run rate. And from a bottom line standpoint, think in terms of 35% drop-through. That will give you an idea. The return on that \$10 million that we spent to restart was almost immediate.

We finished that restart on time and on budget, and we should hit that run rate from an income statement standpoint in Q4 of this year. So that's 45% of the 80%. The other 35% is tied to that brownfield project that Kim had mentioned. So there are new assets going into an existing location and placed with people who know how to run these facilities quite well.

And so the good news on that, we started that construction some time ago. We should see first melts off of that facility by the end of this year. It's on time, on budget. We'll spend 2025 largely qualifying the facility, so it will be ramping, and it will contribute some to the top line and to the bottom line. But in reality as you're modeling this, think in terms of that 35% really being visible in our '26 results.

In terms of magnitude, what do we expect that 35% to contribute to the business? Think in terms of proportionate. 45% is \$150 million to \$170 million. 35% would be proportionately less. But the capability that these assets provide to us, the flexibility and the support of the demand that we see continuing to hit the business is pretty important and should be very, very accretive to the shareholders.

Kristine Liwag: Thanks, Don. Maybe taking a step back, it's clear that we have so much visibility in the different end markets. If we look at the second quarter, it was a strong quarter for the company. But I think expectations of sales for engines and even HPMC was maybe a little bit off expectations. Can you give any more color of how we think the rest of the year progresses, and are there other things we should watch out for aside from the workforce additions that you had mentioned before? Ooh, we've got mood lighting.

Don Newman: Sure, I can take that one if you'd like, Kim.

Kim Fields: This doesn't mean we're in the dark on this, by the way.

Don Newman: So if you think back to Q2, we had a good quarter. And if you drill in and you look at HPMC, there were some real positive things that happened in Quarter 1. EBITDA margins were again above 20%, which is what we predicted. And as you also think about the headwinds that dampened that, even though they were above 20%, they would be higher but for a couple of things.

One, of course mix impacts the business from quarter to quarter. That would have been the case in HPMC in Q2. Another headwind that is transitory, but it was real in Q2, and that has to do with the folks that we've added, the new employees to the business.

What we do is not simple. It's very sophisticated. It takes months and months to train new employees to become proficient at producing our materials. And so with the folks that we've added in 2024, we did absorb some inefficiencies related to that. And what I shared during the call was think in terms of between \$5 million and \$10 million of inefficiencies

that were likely baked into Q2 results. So you can think about that as I think we'll still see some of that in Q3. It should be fully behind us in Q4, would be my expectation.

From quarter to quarter, I mentioned mix has an impact to the business. It surely impacted Q2. We do at times see the customers smoothing orders and shipments, which can affect a quarter, especially as you think about the mix. So one thing I am confident in, though, we're going the right direction. So as you take a step back and you say, "Okay, Don, what does HPMC margin look like going forward?" we should be living above the 20%. And then as you look past 2024 into 2025, we've been pretty clear. Our HPMC business should be generating pretty robust margins well north of the 20% threshold in '25, and it's going to continue to expand.

The reason that it's going to continue to expand--there's a few of them, actually. One is the growth that's in this business is in good part tied to our aerospace and defense exposures. Jet engine specifically is a really good product area for us. HPMC is 80%, 80-plus, more than 80%, I should say, aerospace and defense. So they're going to see a lot of growth in some of our richest margin products. So that's going to help our margins going forward in that business and overall. And we're also going to see improved absorption on those assets, and we have a pretty clear and what I think will be an effective strategy to capture price as well as to capture operating efficiencies.

And we talk a lot about debottlenecking in our business. That is a gift that keeps giving because if you think about it, it's a way to get more production off of your existing assets, typically at a very low capital cost and at a faster rate of production than you would typically see. When I say a faster rate of production, I mean if you compare a debottlenecking project to putting in a new facility or a new set of assets, that new construction takes a lot longer. You get the benefits from debottlenecking much, much quicker. So hopefully, that's more clear.

But yes, I'd encourage you to take a look at our 2025 and 2027 targets--not just for HPMC, by the way. Take a look at what we're expecting for AA&S. And then keep in mind AA&S in 2019 posted probably low single digits to mid-single-digit EBITDA margins. That business is heading toward the upper teens EBITDA margins, and our internal targets, what we're really driving, is let's get to that 20% range. We're not modeling it. It's not assumed in our guide, but that's what we think that AA&S segment can do, and that's what we're going after.

Kristine Liwag:

Thanks, Don. Pivoting to the Farnborough Airshow, lots of air shows. At the time you guys had announced \$4 billion of new commitments, so lots of orders. That's a pretty strong one. And you guys indicated that most of these were centered around jet engine. Can you talk about parsing out this opportunity and putting it into context for 2025 and 2027 targets?

Kim Fields:

Yes. As we shared, it was predominantly in the nickel space, and we continue to see demand and opportunities in both nickel and titanium because the supply chains are still continuing to second source, derisk, or maybe a supplier's not performing, they're still moving share. So even at that air show, I was surprised at how much demand and how many conversations were really around, "Hey, we want you to do more, and let's talk about that." Some of them were around, "How can we give you some of our capital so

that we can invest and have a position long term and partner together?" So as we said in that announcement, I believe it was \$100 million to \$150 million incremental revenue that we're anticipating next year from those contracts as we go forward. And as I'm sharing and indicating, there's still more activity in addition to what we announced early that week.

Kristine Liwag: I think you guys are always the most chased management team around at the air shows, people asking, "Where's my stuff?"

Kim Fields: To be honest, I was quite surprised. Don got to see me after the end of the second day, and he was asking, "Well, what's your impression?" And after 2 years of coming out of the ramp, I felt like the supply chain should have been more settled than it is. And so it's less about, "Where's our stuff?" I think we're performing fairly well; at least that's what I'm hearing come back. It's more around, "How can you do more? How can you do--this contract that you're not in today, we want to move that to you," or, "We want you to pick up more shares," if the supplier's not performing. People are asking about hafnium that I didn't even know bought hafnium and said, "Look, we're one of the largest buyers. We want to have a contract," and they're bringing other parts of their organization in. So yes, it was a really high demand and people pursuing us around how do we make sure that we're positioned as we leave this decade, because we see this demand coming and feeling like the material supply is still what's pacing.

Kristine Liwag: And with all this demand, can you put into context the pricing environment? How much pricing are you getting, especially when customers are trying to pull you in to solve some of their problems, and these are not problems that are solved easily. And also, what percent of the business is under an LTA, and are there specific years where you have a roll-off and you get pricing kicking up? How do we think about that dynamic, too?

Kim Fields: Sure.

Don Newman: Want me to take the first part?

Kim Fields: Sure, I'll take it, yes, and then I'll hand it over. So if we look at our LTAs, traditionally you can think 20% to 30% of them are coming off of contracts and getting renegotiated. I'd say the unique thing that's happened over the last 2 years is with those requests and our customers coming in and asking for more, every request is a reopener of that master contract and saying, "We need additional price," or, "We need some derisking around inflation," or, "We need a pass-through mechanism here. We need better terms." And so that continues, and we're continuing to work on those contracts with every ask that comes in. So it's not necessarily as time-based as it maybe is more traditionally.

As we think about price, it's still a seller's market. I think I saw one analyst report that called it a material world. It's still a material-paced ramp. And our strategy is to focus and align with the OEMs. There is some that will get speculative buying or transactional buying, which can be driven by the distribution channels. But as you look at that, by definition anyone at any time can come into that market, and it can become overbuilt and you can get in before any corrections that happen.

For us, staying aligned with the OEMs makes sense because it leverages our material strength, material science strength. And it allows us--we are getting price through mix because we make the hard stuff, and we do that really, really well. And what is supporting us is that consistent demand signal. It's customers saying, "Hey, we've got capital. We want you to invest for us." There are some OEMs that have been very vocal around saying, "We're protecting the supply chain." They're doing that with their strategic partners, not those transactional suppliers.

And as I look at it and as we're talking to customers, nobody wants to feel like they're being taken advantage of in their time of need or they're being gouged. And myself, if I'm feeling that, you look at that and say, "Well, I need to find an alternative." And if an alternative doesn't exist, they'll create one. And so this is a really long-cycle business, People have long memories. I do think our advantage of focusing for long-term, stable growth advantages our customers, our employees, and our investors.

Don Newman:

Maybe I could add a couple of data points just to context, really, LTAs and how to think about them. First of all, when you were talking about the \$4 billion of new sales commitments, some of those sales commitments that we announced go up to 2040. Typical life for an LTA in our business, think in terms of 5 years, generally 4 to 5 years. So these are not short-term relationships. These are long-term commitments between the two parties. For our overall business, think of it as roughly 65% LTA. If you drill in and you look at our HPMC part of the business, we have a higher LTA footprint than that--think closer to 80%.

Now Kim mentioned we're really thoughtful when we design our LTAs. While there are maturity dates, there are actually more frequent reopening dates. If there's a change in need that our customer approaches us on or an addition of another product, what we'll typically do is we will typically say, "Okay, let's reopen the contract, and let's have some broader conversations around things like price, collection terms," all those things. Pass-through revenues would be another important category.

So it's not just about the headline price. It's also about derisking it and putting ourselves in a much healthier business position with that reopening. And we've been very, very, very successful at doing that.

I think another thing to keep in mind is, and Kim touched on this, when you think about an LTA strategy versus, say, a heavy transactional strategy, the transactionals, there's times in a cycle where you can see premium pricing, where that's above the LTA. But everything cycles, and if those prices were sustained at that level, then the LTA prices would also go up.

But for us, the way we look at this industry and our business and our partnership with our customers, to be in a position where we can, as an example, get a 10% price increase in a 5-year contract or take a 15% price increase for something that probably lasts about 1 year, guess what. We think it's best for our shareholders to lock up that 10% for 5 years, especially if it comes with higher commitments from our customers and additional product offerings, et cetera, et cetera.

So that's the way we have approached it. We have given ourselves some upside to the transactional. Like I said, we're 80% LTA or thereabouts in HPMC. That means right off the start, we've got 20% available when it comes to transactional and taking advantage of transactional pricing. We're also unlocking additional capacity to the upside around efficiencies and debottlenecking, which we mentioned. We look at that incremental capacity as another element that we can use to go after transactional opportunities if it makes sense.

Kristine Liwag: Great. And I know we're out of time, but Kim, I really wanted to ask you this question. You've now been CEO of the company for a little over 60 days. You've been clear that the strategy handoff between you and Bob Wetherbee's pretty consistent. But anything you learned in terms of your priorities, and are there any essential items that you want to tackle in the next year?

Kim Fields: Yes, I'd say the one area that we're focusing on is continuing to work together as One ATI and staying nimble. The one thing I am sure of is the environment is going to continue to change. And what I've seen with our team is by recognizing those changes quickly and executing faster than our competitors, we've been able to position ourselves to be successful and to see the growth that we've already demonstrated. So we're going to continue focusing on that and continue utilizing all the strengths of the team across the board.

Kristine Liwag: Well, great. Well, thank you, Kim, and thank you, Don. And this concludes the session on ATI.