



Aspen Aerogels, Inc.

First Quarter 2018 Earnings Conference Call

May 3, 2018

CORPORATE PARTICIPANTS

John Fairbanks, *Vice President, Chief Financial Officer and Treasurer*

Don Young, *President and Chief Executive Officer*

CONFERENCE CALL PARTICIPANTS

Eric Stine, *Craig-Hallum Capital Group, LLC*

PRESENTATION

Operator:

Good afternoon. My name is Rob and I will be your conference operator today. At this time, I would like to welcome everyone to the Aspen Aerogels' First Quarter 2018 Earnings Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question and answer session. If you would like to ask a question during this time, simply press star, then the number one on your telephone keypad. If you would like to withdraw your question, press the pound key. Thank you.

Mr. John Fairbanks, you may begin your conference.

John Fairbanks:

Good afternoon. Thank you for joining us for the Aspen Aerogels' conference call. I'm John Fairbanks, Aspen's Chief Financial Officer. There are a few housekeeping items that I would like to address before turning the call over to Don Young, Aspen's President and CEO.

The press release announcing Aspen's financial results and business development, as well as a reconciliation of Management's use of non-GAAP financial measures compared to the most applicable GAAP measures, is available on the Investors section of Aspen's website, www.aerogel.com. Included in the press release is a summary statement of operations, a summary balance sheet, a summary of key financial and operating statistics for the quarter ended March 31, 2018. In addition, the Investors section of Aspen's website will contain an archived version of this webcast for approximately one year.

Please note that our discussion today will include forward-looking statements, including any statement regarding outlook, expectations, beliefs, projections, estimates, targets, prospects, business plans, and any other statement that is not a historical fact, and such statements are subject to risks and uncertainties. Aspen Aerogels' actual results may differ materially from those expressed in these forward-looking statements. A list of factors that could affect the Company's actual results can be found in Aspen's press release issued today and are discussed in more detail in the reports Aspen files with the SEC, particularly in the Company's most recent Annual Report on Form 10-K. The Company's press release issued today and filings with the SEC can also be found in the Investors section of Aspen's

website. The forward-looking statements made today represents the Company's views as of today, May 3, 2018. Aspen Aerogels disclaims any obligation to update these forward-looking statements to reflect future events or circumstances.

During this call, we will refer to non-GAAP financial measures, including Adjusted EBITDA. These financial measures are not prepared in accordance with U.S. Generally Accepted Accounting Principles, or GAAP. These non-GAAP financial measures are not intended to be considered in isolation or as a substitute for results prepared in accordance with GAAP. Definitions of and reconciliations of these non-GAAP financial measures to the most directly comparable GAAP financial measures and a discussion of why we present these non-GAAP financial measures is also available in today's press release.

I will now turn the call over to Don Young, President and CEO of Aspen Aerogels.

Don Young:

Good afternoon. Thank you for joining us for our Q1 2018 Earnings call. I will start by providing comments about the business and our performance. Next, John will review our Q1 financials and update our 2018 guidance. We will conclude the call with a Q&A session.

I plan to cover two topics in my prepared remarks. First, I will review the first quarter and describe the current commercial environment. I will also comment on how we see the market shaping up for the remainder of 2018, including our outlook against our three 2018 performance indicators. Second, I will provide an update on the execution of our strategy, which is to leverage our Aerogel technology platform across our core, adjacent and new markets.

With respect to Q1, revenue of \$23.1 million was slightly above revenue for the same period in 2017. While not robust growth, we showed improvement in gross profit and margin, in average sales price and in Adjusted EBITDA. The activity levels in North America were especially strong, both in Q4 2017 and in Q1 2018. The performance of the U.S. market in particular often is a leading indicator for the emerging strength of our core and adjacent markets. As we have described in the past, insulation in the energy infrastructure market is a late cycle product and therefore if current market conditions continue to gain strength through 2018, then we would expect to feel the full positive impact later this year and during 2019 and 2020.

Our products are well established in the market. Our installed base of Pyrogel and Cryogel is expected to surpass \$750 million by mid year. We believe that if we can get in front of business in a timely way then we will drive growth in revenue. By year end, we will have increased the size of our sales force by 25% in order to take increasing market share in the improving commercial environment.

We have also assembled a talented team to reinforce our approach to project-based work, starting with our products being specified early in the project cycle and ending with definitive purchase orders. Our ability to build base revenue, to position ourselves for significant project work, and to continue to exhibit strength in entering new markets gives us confidence that we can experience substantial and diverse growth.

As discussed on the previous earnings call, the three 2018 performance indicators are growing our base revenue, driving year-to-date growth in both revenue and Adjusted EBITDA, and expanding capacity through the EP20 initiative.

The performance indicator, base revenue, again, defined for these purposes as revenue not comprised of subsea or the large South Asia Petrochemical Project is a good indicator of day in, day out maintenance and small scope project work, our version of a recurring revenue stream. We are targeting \$100 million in base revenue for 2018, consistent with our goal of long-term year-over-year growth in base revenue of between 10% and 15%. Base revenue in the first quarter this year was \$21.7 million, which represented

growth over last year of 8%, a little under our target range but we remain confident that we can achieve growth in base revenue for the year in the 10% to 15% range.

With respect to non-base revenue, we did win a \$4.5 million subsea project during this first quarter, an order that we expect to deliver in the first half of 2019. We anticipate winning a few additional subsea projects during Q2 for delivery later in 2018, another positive sign that the market is becoming more active.

The second performance indicator for 2018 relates to growth in year-to-date revenue and Adjusted EBITDA as measured at the end of each quarter. After delivering a 30% revenue CAGR for a seven-year period from 2008 through 2015, our goal is to return to double-digit revenue growth and to deliver significant improvement in Adjusted EBITDA. We envision a strong energy infrastructure business that generates cash to reinvest in realizing the substantial potential in our core and adjacent markets and to fund select business opportunities in new markets which can lead to break out value.

In Q1 2018, while revenue growth was marginal, Adjusted EBITDA improved by \$2.7 million, principally related to significantly lower costs associated with patent enforcement actions. While the Adjusted EBITDA improvement was not related to revenue growth, this Q1 performance will help us meet our profitability goals for the full year.

The third 2018 performance metric relates to the EP20 initiative. As described during our last earnings call, our goal for EP20 is to increase the capacity in our East Providence manufacturing facility by 20% by the end of 2020. The goal of EP20 translates to expanding our current annual revenue capacity from approximately \$150 million to \$180 million. We believe that between 40% and 50% of the increase in revenue that we generate beyond 2017 levels will drop to the Adjusted EBITDA line. At \$180 million, we project the East Providence facility would have to the potential to generate Adjusted EBITDA in the range of \$28 million to \$35 million per year. The expanded sales and marketing resources and the EP20 initiative significantly enhance the profit potential and economic profile of our existing business.

The EP20 capacity expansion to our existing manufacturing assets will be driven primarily by process technology advancements designed to improve manufacturing productivity and capital efficiency. During Q1, we prioritized our 2018 EP20 projects and allocated resources and funding to them. By the end of 2018, we expect to have begun to realize benefits from improved yields and throughput from existing assets and to have set the stage for projects currently planned for 2019.

Our 2018 capital budget for EP20 is \$3 million which we have reserved from the \$5 million prepayment from BASF. The commercial, technical and financial elements of our partnership with BASF are invaluable and BASF remains among our most important global business partners.

We will continue to report out on the three 2018 performance indicators each quarter. Again, the three indicators are growing our base revenue, driving year-to-date growth in both revenue and Adjusted EBITDA, and expanding capacity through the EP20 initiative. The achievement of these objectives and the further execution of our strategy will signal a successful 2018 and set the stage for the strong years in 2019 and 2020.

The second topic today is an update on the execution of our strategy. Our strategy is to leverage our Aerogel technology platform across our core, adjacent and new markets. There are two key elements to the strategy. The first element is to grow our core and adjacent markets to fill the East Providence manufacturing facility, including the expanded capacity from the EP20 initiative in order to create a business capable of generating annually \$180 million of revenue and between \$28 million and \$35 million of Adjusted EBITDA.

The second element of the strategy is to organize around innovation and to leverage our core competency of commercializing innovation. We have world-class and patent-protected Aerogel technology, and the premier Aerogel research scientists committed to continuing to advance the science.

We have fortified our new business development team, which is dedicated to prioritizing the best opportunities for our Aerogel technology platform and to identify world-class partners and optimal business structures to accelerate value creation.

We have allocated \$2 million of the \$5 million prepayment from BASF to technical and commercial development of our first major market outside of energy infrastructure. We believe the two elements of our strategy will maximize long-term shareholder value by generating significant free cash flow that will be dedicated to nourishing our core and adjacent markets and to leveraging business opportunities where our Aerogel technology platform has the potential to create breakout value.

Overall, we are encouraged the market is moving in our direction and we are confident that we have laid the groundwork to benefit significantly in the quarters and years ahead. Our investments in our sales and marketing teams, the EP20 capacity expansion and the leveraging of our Aerogel technology platform demonstrate our conviction that the value that we bring to our end users across multiple markets will enable us to build a large and profitable company.

Now, I will turn the call over to John for a review of the financial results.

John Fairbanks:

Thanks, Don, and good afternoon. I'd like to start by running through our reported financial results for the first quarter of 2018 at a summary level.

First quarter total revenue grew less than 1% to \$23.1 million from \$23 million in the first quarter of 2017. First quarter net loss was \$6.8 million or \$0.29 per share compared to \$9.1 million or \$0.39 per share last year.

First quarter Adjusted EBITDA was negative \$2.4 million compared to negative \$5.1 million a year ago. We define Adjusted EBITDA as net income or loss before interest, taxes, depreciation, amortization, stock-based compensation expense, and other items that we do not believe are indicative of our core operating performance.

Patent enforcement costs had a significantly lower impact on our net loss and Adjusted EBITDA during the first quarter this year than in the first quarter last year. We incurred \$90,000 of patent enforcement costs during the first quarter of 2018 versus \$2.7 million in the first quarter last year.

I'll now provide additional detail on the components of our results. First, I'll discuss revenue.

First quarter total revenue was comprised of product revenue of \$22.5 million and research services revenue of \$553,000.

During the first quarter, product revenue increased by 1% to \$22.5 million from \$22.3 million last year. Solid growth in our core and adjacent markets, particularly in North America, and modest growth in the subsea market during the quarter was offset in large part by a decline in revenue associated with the conclusion of the multiyear South Asia Petrochemical Project.

During the quarter, total shipments decreased by 6% to 7.7 million square feet of Aerogel blankets, and our average selling price increased by 8% to \$2.91 per square foot. This average selling price increase during the year reflected the impact of our 2018 annual price increase, the growth in sales of our higher priced subsea products and the decrease in revenue from the lower priced South Asia Petrochemical Project.

I'll now turn to our research services revenue. Our research services revenue is related to contract research performed principally for government agencies. Research services revenue declined to

\$553,000 during the first quarter from \$676,000 last year. This decline was due to the relative value and timing of research contracts versus last year.

At the time of our fourth quarter and full year 2017 analyst call in February of this year, we anticipated that broad-based growth across our core and adjacent markets in 2018 would offset most or all of the expected decline in product revenue, both in the subsea market and associated with the completion of the South Asia Petrochemical Project. We also expected that the average selling price of our Aerogel blankets for the full year 2018 will remain flat with 2017 at \$2.92 per square foot, plus or minus \$0.05, and we expected that research services revenue would decrease slightly from 2017 levels. Our first quarter revenue performance was right in line with this February guidance. As a result, we are reaffirming our 2018 revenue guidance today.

Next, I'll discuss gross profit. Gross profit was \$2.8 million, or 12% of revenue, during the first quarter of 2018, versus \$2.2 million, or 10% during the first quarter last year. This improvement in gross profit and gross margin was driven by the modest increase in product revenue, a 9% or \$900,000 decrease in material costs, principally due to decreased warranty expense during the quarter, offset in part by a 4% or \$400,000 increase in manufacturing expense.

As a reminder, our variable contribution is between 40% and 50%. As a result, an increase in revenue and capacity utilization will lead to a disproportionate increase in both gross profit and gross margin. Again, as we discussed in February, we expect 2018 gross margins for the full year to reach the high teens, but like we saw in 2017, quarterly gross margins could run from the low double-digits to the low 20s depending on quarterly revenue levels. This gross margin expectation includes our planned investments in manufacturing, personnel and expense to re-establish full-time three line operations in the East Providence plant, to improve manufacturing productivities and costs, and to support our EP20 initiatives.

Next, I'll discuss operating expenses. First quarter operating expenses decreased by \$1.7 million or 15% to \$9.6 million. The decrease in operating expenses was driven by a \$2.6 million decrease in IP enforcement costs offset in part by increases totaling \$900,000, principally for personnel and expense to drive growth in our energy infrastructure business and to develop breakout opportunities in new markets.

Our 2018 full year operating expense guidance has not changed. We continue to expect that operating expenses will increase by 4% to approximately \$39 million for the full year.

Next, I'll discuss our balance sheet and cash flow for 2017. Cash used in operations equivalent to our Adjusted EBITDA of negative \$2.4 million. Our investment in working capital was unchanged from the end of 2017. Capital expenditures during the first quarter totaled \$677,000, down from \$2.1 million in the first quarter last year. During the quarter, we also received the first of two prepayments of \$2.5 million each expected from BASF during 2018.

We ended the first quarter with \$9.6 million of cash, \$3.8 million on our revolving credit facility, net current assets of \$25.1 million, and shareholders' equity of \$94.7 million, and, we had access to an additional \$6.7 million under our revolving credit facility at quarter end.

We've updated a few components of our full year financial outlook for 2018. The updates reflect slight increases to our depreciation and noncash interest expense estimates for the year. Total revenue is expected to range between \$106 million and \$116 million, unchanged from prior guidance. Net loss is expected to range between \$17.6 million and \$20.6 million, revised from prior guidance of between \$16.9 million and \$20 million.

Adjusted EBITDA is expected to range between a loss of \$2 million and a loss of \$5 million, unchanged from prior guidance.

EPS is expected to range between a loss of \$0.74 and \$0.87 per share, revised from prior guidance of between \$0.71 and \$0.85 per share. This EPS guidance assumes a weighted average of 23.6 million shares outstanding for the year.

This 2018 outlook also assumes depreciating and amortization of \$10.8 million, stock-based compensation of \$4.3 million and interest expense of \$500,000. In addition, this financial outlook includes between \$1 million and \$1.3 million of costs and expenses associated with our patent enforcement actions for the year. As I noted earlier, we expect a gross margin in the high teens and an average selling price of \$2.92 per square foot plus or minus \$0.05 for the full year, once again, unchanged from our prior guidance.

Turning to cash at an aggregate level, within the context of the Adjusted EBITDA range set out in our 2018 full year outlook, we expect to exit 2018 with between \$8 million and \$11 million of net cash on hand. Included in our 2018 year-end cash guidance is the second of two prepayments of \$2.5 million from BASF which we expect to receive in July. We also continue to project the capital expenditures, including funds for our EP20 initiative, will total \$4 million for the year.

I'll now turn the call back to Rob for Q&A.

Operator:

At this time, I would like to remind everyone, in order to ask a question, press star, then the number one on your telephone keypad.

Your first question comes from the line of Eric Stine from Craig-Hallum. Your line is open.

Eric Stine:

Hi, Don. Hi, John.

Don Young:

Hi, Eric.

Eric Stine:

I just wanted to see if I could get a little more detail on your commentary in the release. You specifically pointed out great progress in the joint development agreement with BASF, and you did mention the \$2.5 million payment, some of the things that you're doing with that, but is there any detail you can share about that JVA progress that you've made?

Don Young:

This is focused, Eric, on the building materials area. Really, our first significant foray outside of energy infrastructure. What I would be able to say right now is we have continued to work very closely with BASF on a next generation product for this market that combines some of their interesting technology with our Aerogel technology, and to address some interesting characteristics of the building materials market with the principal focus, or the initial focus at least for the European market. These would be products that would have great thermal performance, as you would expect from our materials, but very importantly are non-combustible materials which are of heightened importance in that market, and of course around the world.

We continue to just make very, very good progress. We work very closely with the teams in Europe and here in the United States.

Eric Stine:

We should view this more as kind of the path that you've been on, just progressing there with the goal—I know at one time they had looked at potentially, that they've been testing, getting feedback from key customers, looking at potentially launching the Slentex® system in Europe in 2018 at some point. I mean basically this is—you're just going along that path.

Don Young:

Yes. That was the first generation product, what we refer to as Spaceloft® A2, and there's no question that we will generate revenue this year from that product.

The JVA itself is really focused on this second generation product. Really, again, nice advancements, but there is no question that we will generate revenue from Spaceloft® A2, the first generation product, here in 2018.

Eric Stine:

Okay. Maybe just turning subsea. Good to hear the award, the \$4.5 million award. You mentioned the two additional projects and maybe just talk about it sounds like you've got pretty strong visibility into that those may impact late '18. Then just any thoughts on keeping guidance unchanged in light of that. I mean is that kind of a nod to just uncertainty over project timing, or does that make you feel confident that maybe the upper end of the range is more likely?

Don Young:

On the subsea front, yeah, it was a terrific project that we worked hard for and were able to win. We do see three or four projects that are about to be awarded where we think we're in a very good position. They are smaller than the \$4.5 million project. I would put them in the category of \$1.5 million each plus or minus a million, but again, I think the revenue is great, 2018 revenue. We had anticipated some non-base revenue this year, so I would call it sort of consistent with our guidance, and so we feel good about subsea, but I think it's also a great signal for just activity levels in the market in general.

I hope you were able to sense from my comments that we are feeling better about the market. I think we were maybe guardedly optimistic in the last couple of earnings calls, but I think that has continued to move forward. We anticipate strong finish in this year and really positioning ourselves for really a terrific 2019 and 2020.

Eric Stine:

Got it. Then just on that, I know over the last, gosh, three, four, five quarters there's been some discussion of improved turnaround activity in the refinery space. Continue to hear that. Is it fair to say that the confidence, the increased confidence that you've got, whether it was last quarter or this quarter, is in part based on that? That you are starting to see that?

Don Young:

Certainly by the time we report our next quarter we will have—we'll have a crystal clear view of that. We are anticipating—it's happening, right? We are anticipating a good spring turnaround in the refineries here in the United States. As I said in my comments, when we see good activity levels in the United States, that usually foreshadows good activity levels for the market more broadly, and I think that's one of the reasons why we are conveying confidence, I think, in our year.

Eric Stine:

Got it. Okay, thanks a lot.

Don Young:

Thank you, Eric.

Operator:

Again, if you'd like to ask a question, press star, then the number one on your telephone keypad. We'll pause for just a moment to gather more questions.

Again, if you would like to ask a question, it is star, one on your telephone keypad.

There are no further questions at this time. I will turn the call over to Mr. Don Young for closing remarks.

Don Young:

Thank you, Rob. We appreciate your interest in Aspen Aerogels and we look forward to reporting to you our Q2 2018 results early August. Have a good evening. Thank you.

Operator:

This concludes today's conference call. You may now disconnect.