



Aspen Aerogels Inc.

First Quarter 2016 Earnings Conference Call

May 5, 2016

C O R P O R A T E P A R T I C I P A N T S

Don Young, *President and Chief Executive Officer*

John Fairbanks, *Chief Financial Officer and Treasurer*

P R E S E N T A T I O N

Operator:

Good afternoon, my name is Erin and I will be your conference operator today. At this time, I would like to welcome everyone to the Aspen Aerogels Q1 2016 Earnings Conference 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.

John Fairbanks, you may begin your conference.

John Fairbanks:

Good afternoon. Thank you for joining us for the Aspen Aerogels First Quarter Conference Call. I'm John Fairbanks, Aspen's CFO. Before turning the call over to Don Young, Aspen's President and CEO, there are a couple of housekeeping items that I would like to take care of.

First, we will take questions at the end of our prepared remarks, and, as Erin indicated, an archived version of this webcast will be available in the Investors section of Aspen's website, www.aerogel.com.

The press release announcing Aspen's first quarter 2016 results and business developments, as well as a reconciliation of Management's use of non-GAAP financial measures as compared to the most applicable GAAP measures, is available on the Investors section of Aspen's website. There, you will also find a summary statement of operations, a summary balance sheet, and a summary of key financial and operating statistics for the quarter and the year.

Please note that our discussion today will include forward-looking statements, including any statements 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 the 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, www.aerogel.com.

The forward-looking statements made today represent the Company view's as of today, May 5, 2016. 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 US 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. The 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 available in today's press release, which is also available on the Aspen website.

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

Don Young:

Thank you, John. Good afternoon. Thank you for joining us for our Q1 2016 earnings call. I will provide comments about the business and our performance, and John Fairbanks, our CFO, will present financial details for the first quarter and our guidance for 2016. We will conclude the call with a Q&A session.

I'd like to start with a recap of the first quarter. The quarter played out largely as we had anticipated and was marked by strong growth in revenue, volume, gross profit and Adjusted EBITDA. Overall, revenue grew by 40%, and there were several noteworthy commercial highlights. Our revenue in Asia more than doubled to \$14.6 million. This exceptional growth reflected continued success in both hot and cold applications in multiple countries across the region and included the expanded scope of the South Asia Petrochemical Project that we have been supporting since early 2014. We also substantially completed shipments during the quarter to our first significant LNG project with PTT Thailand. On the subject of the LNG business, we anticipate receipt of a second major LNG order later in 2016. At that point in time, we will have had two major LNG project wins and participated in maintenance work in nearly two dozen LNG facilities around the world. This work will represent an excellent portfolio of case studies which we believe will lead to continued success in this important market.

First quarter revenue in our revitalized building materials market more than quadrupled to \$2.7 million. As we've discussed, we've curtailed our building materials initiative after 2013, when we were running short on production capacity, and chose instead to focus on our energy infrastructure opportunities. We have now re-engaged with our European partners and are targeting specific niches within the building materials market that we believe provide a substantial opportunity for our high-performance insulation materials. We are making great progress with these partners and the early commercial results are promising.

We also delivered \$2.8 million of subsea revenue during the quarter. However, we continue to expect that the subsidy business will tail off after record years 2014 and 2015. This upstream segment is vulnerable to oil priced below \$50 or \$60. While Latin America continues to struggle with the low oil price and country-specific challenges, our team in the region is focused on a number of high-value projects which we believe bodes well for the remainder of 2016 and for 2017.

Our first quarter revenue performance reflects growth in our core refinery and petrochemical segment, and in an increasing number of additional end markets. This continued market development has been enabled by our successful expansion in early 2015 of the East Providence manufacturing facility. We will continue our efforts to gain share in our existing markets and to diversify into other markets where our aerogel products have unique value. We believe we are successfully laying the foundation to achieve our long-term vision of being a company delivering \$500 million of revenue with 40% gross margin.

The product mix shift we predicated in late 2015 is materializing largely as expected. Subsea revenue in the first quarter was 9% of revenue, compared to 20% for the full year 2015, and 35% during the fourth quarter alone. We expect the percentage of our revenue generated in the subsea market to continue to decline through the year and ultimately constitute less than 5% of our overall 2016 revenue. Offsetting the decline is subsea, we expect increases in revenue from our downstream energy infrastructure business, as well as from the building materials, LNG and district heating markets, all areas of considerable focus for us as we strive to broaden and diversify our end market and to create additional growth engine.

I'd like to comment on the decline in average selling price and gross margin from Q4 of 2015 to Q1 of 2016. The decline in ASP and gross margin is principally due to the decrease in subsea revenue, from 35% of revenue in Q4 to 9% of revenue in Q1. We experienced an increase in building materials and LNG-related volumes in square feet, which fully offset the decline in subsea volume. However, the LNG and building materials business came with a lower average selling price and gross margin.

We have several initiatives in place to improve gross margins. First, we expect to be able to drive down the manufacturing cost of our LNG and building materials products as volumes increase and we gain additional experience manufacturing the products. Second, we have concerted technical effort ongoing, which we anticipate will result in next-generation higher-margin products optimized for the building material and LNG market. Finally, we've targeted growth in the district heating and power markets where we expect margins to be on par with our high-margin Pyrogel® product line.

Our confidence for the second half of the year has strengthened. Beginning in November 2015, we voiced concerns about headwinds related to weak upstream activity due to low oil prices, to the strong dollar and to an uncertain global economy. There's no question that these factors had an impact on our business. Having said that, we have seen strength in our core refinery and petrochemical markets, and encouraging order activity in our target markets, including LNG, district heating and building materials. We have ample room to grow in our core markets and we having success leveraging our aerogel technology platform to branch into newer segments. In addition, we are in the final stages in the development of a Pyrogel® product designed specifically to meet the requirements of the power market and we believe the optimized product will begin to contribute to revenue growth in 2017.

In short, while the macro-environment in 2016 is not ideal, we are confident that the strength of our technology and the ROI that we are bringing to our end users across multiple markets will enable solid performance for the year. We remain determined to earn the reputation as a company that can perform well even in a tough environment, and we believe 2016 will be another important step in that direction.

As we announced in today's press release, we filed a complaint with the United States International Trade Commission, the ITC, alleging that two China-based companies engaged in unfair trade practices by selling aerogel products in the United States that infringe several of our patents. This action reflects our core strategy to invest in the research, development, IP protection, commercialization and defense of our aerogel technology worldwide, and we are taking a series of pre-emptive legal actions to assert our rights against companies that infringe our intellectual property. The ITC helps to protect innovative American manufacturers from unfair trade practices, including the unauthorized importation and sale of patented technologies in the United States.

The ITC process is straightforward. Upon receipt of a complaint, such as ours, the ITC decides whether to institute an investigation within 30 days. After instituting an investigation, the ITC follows an established process to determine the merits of the case. After finding infringement of US patents, the ITC typically issues exclusion orders prohibiting the importation of infringing products into the United States.

We are committed to protect our intellectual property rights and this ITC action will play an important role in that effort. Similar to other companies that have become market leaders by creating valuable

technology and intellectual property, we must initiate legal actions to defend these strategic business assets, when required. We have hired the law firm of Fish and Richardson, one of the premier intellectual property and litigation firms in the United States, to represent us in this strategic legal action.

As we look to the remainder of 2016, we have set several milestones that we believe will be important catalysts for the long-term success of the Company. These largely fall into three categories.

First, with respect to Plant 2, we anticipate completing the engineering work and securing the required debt financing during the second and third quarters of 2016, and then proceeding to order the long lead-time equipment for the project by year's end. As our total addressable market becomes larger and more diverse, it is important that we have manufacturing capacity available to meet expected demand. We are confident that we will achieve our Plant 2 related milestone during this timeframe.

Second, with respect to market expansion, in addition to our expectation that we will receive our second major LNG order, we anticipate during 2016 a doubling or more of revenue in both district heating and building materials businesses, and the completion of a product specifically designed for the large and attractive power market. In building materials, we are becoming increasingly convinced that it would be beneficial to partner with a well-capitalized company to accelerate and strengthen our commercial expansion and the development of next-generation products. In addition, we believe we can leverage this partner model to a number of interesting opportunities beyond our core energy infrastructure market, in order to fully exploit our valuable aerogel technology platform.

Third, with respect to technology development, we will complete during the third quarter a full-scale pilot line adjacent to our third line in East Providence. This pilot capability will be dedicated to the process and product development aimed at improving yield, throughput and manufacturing costs at our East Providence and Statesboro plants, and creating next-generation products for both existing and new markets. The thrust of this effort is to increase our gross margin and to expand the number of markets that we serve.

These three catalysts, Plant 2, market expansion and technology development, are wholly consistent with our long-term goal of becoming a \$500 million revenue company with 40% gross margin. We plan to report out on our progress throughout the year.

Overall, our confidence has grown that we will perform well in 2016. We will maintain our commitment to grow profitably, to prudently scale up our operations and to remain financially strong. We are in position to execute well during this period of uncertainty in the energy market and to take advantage of the subsequent recovery. Since our last earnings call, we have seen higher oil prices and a weaker dollar, trends that are generally favorable to us. We are confident in our ability to execute our penetration strategy to gain market share and to expand into valuable new markets. It is a challenging environment, but we have the people, the technology and the products to get the job done.

Now, I'll turn the call over to John for a review of our financial results. John?

John Fairbanks:

Thanks, Don. As Don highlighted during his comments, our financial performance during the first quarter was solid. It keeps us on track to deliver 2016 results in line with our guidance. Total revenue grew 40% versus the first quarter of 2015, and contributed to strong growth in gross profit, Adjusted EBITDA and earnings per share. This performance was driven by an increasingly diverse base of demand, volume growth supported by our third production line, and improvements in manufacturing productivity.

I'd like to start by running through our reported financial results for the first quarter at a summary level.

First quarter total revenue grew 40% year-over-year to \$32.8 million. First quarter gross profit grew 45% year-over-year to \$6.5 million. First quarter GAAP net loss was \$1.8 million or \$0.08 per share, versus a net loss of \$2.8 million or 12% per share in the first quarter last year. Adjusted EBITDA for the quarter nearly tripled to \$2 million this year, versus \$734,000 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.

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 \$32.3 million and research services revenue \$535,000. During the quarter, product revenue increased 39% versus last year. This growth was due to strong demand in the petrochemical market in Asia, a significant subsea project, and resurgent demand in the building materials market in Europe. We also substantially completed deliveries on our first large-scale LNG project during the period.

During the first quarter, we shipped 11.8 million square feet of aerogel blankets, which represented growth of 35% versus the first quarter of 2015, and was supported by output from our third production line, and our first quarter average selling price increased 3% versus the first quarter of 2015, to \$2.73 per square foot, and reflected the impact of price increases over the past year, offset in part by a shift in mix to lower priced product.

I'll now turn to research services revenue. Our research services revenue is related to contract research performed principally for government agencies. Research revenue increased 85% during the first quarter to \$535,000, due to the relative value and timing of contracts, versus the first quarter of 2015. For the full year, we expect research services revenue to be approximately \$2 million, essentially flat with 2015 revenue levels. This expectation is included in our 2016 financial guidance.

Next, I'll discuss gross profit. Our gross profit grew 45% to \$6.5 million during the first quarter, and our gross margin of 20% represented an increase of one percentage point from the first quarter of 2015. The increase in gross profit was driven by strong volume growth, supported by the third production line, and improvements in manufacturing productivity. Our 2016 price increase also contributed to the gross profit increase.

Next, I'll discuss operating expenses. First quarter operating expenses grew \$1 million, or 14%, to \$8.3 million. The increase in operating expense included \$700,000 for increased investment in sales personnel and marketing programs, \$200,000 in patent enforcement related legal costs, and \$100,000 in non-cash stock-compensation expense. Our patent enforcement actions may require significant legal expenditures over the next few years. The amount and timing of these legal costs will be difficult to predict. We will report actual costs of enforcement actions incurred on a quarterly basis. Again, our patent enforcement legal costs were \$200,000 during the first quarter of 2016.

Next, I'll discuss our balance sheet and cash flow. Despite generating \$2 million in EBITDA, we used \$200,000 of cash to fund our operating activities due to a temporary increase in working capital. Capital expenditures of \$3.1 million during the quarter included engineering, design and other pre-construction costs for our planned Statesboro, Georgia plant, and betterments and additions within our East Providence, Rhode Island facility. We ended the first quarter with \$29.4 million of cash and minimal debt, net current assets of \$42.5 million, shareholders' equity of \$122 million. In addition, our \$20 million revolving credit facility remains untapped.

We are updating our financial outlook for 2016. Total revenue is expected to range between \$117 million and \$125 million, up slightly from prior guidance of \$117 million to \$122 million. GAAP EPS is expected to range between a loss of \$0.09 and a loss of \$0.16 per share, down slightly from prior guidance of a loss of \$0.06 to a loss of \$0.15 per share. This GAAP EPS guidance assumes weighted shares

outstanding of 23.2 million for the year. Adjusted EBITDA is expected to range between \$11.5 million and \$13 million, unchanged from prior guidance. This 2016 outlook assumes depreciation and amortization of between \$9.6 million and \$9.8 million, stock-based compensation expense of between \$5.2 million and \$5.4 million, and interest expense of \$200,000. This 2016 financial outlook specifically excludes the cost of patent enforcement actions we incurred in the first quarter and expect to incur during the remainder of 2016. The amount and timing of these litigation costs are difficult to predict. We will continue to report actual costs of enforcement actions incurred on a quarterly basis.

While we don't plan to provide specific quarterly guidance, we think it's important to provide our investors with a general view to our expectations during the year. We are reaffirming the following guidance we provided in our fourth quarter conference call. We expect revenue in the range of \$60 million to \$65 million in the first half of 2016, and the range of \$55 million to \$60 million during the second half of the year. Due to anticipated changes in the mix of products sold, we expect gross margin to be in the low 20s during the first half of 2016, with an increase to the mid-20s during the second half of 2016. We also expect operating expense levels to be slightly higher in the first half than in the second half of the year, excluding the impact of patent enforcement costs. In line with this anticipated product mix and the timing of operating expenses, we expect Adjusted EBITDA to be lower in the first half of the year and to trend higher during the second half of the year. As always, project work and product mix can create quarterly variability. In addition, the cost of the patent enforcement actions may be material and are excluded from our present guidance.

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

Operator:

At this time, I would like to remind everyone in order to ask a question, please press star, then the number one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Again, if you would like to ask a question, please press star, then the number one on your telephone keypad.

There are no questions at this time. I turn the call back over to Mr. Young.

Don Young:

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

Operator:

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