Moog Inc. NYSE:MOG.A

FQ1 2024 Earnings Call Transcripts

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Call Participants

EXECUTIVES

Aaron Astrachan
Director of Investor Relations

Jennifer Walter
VP & CFO

Patrick J. Roche
CEO & Director

ANALYSTS

Cai von Rumohr
TD Cowen, Research Division

Kristine Liwag
Morgan Stanley, Research Division

Michael Frank Ciarmoli
Truist Securities, Inc., Research Division

Presentation

Operator

Good morning, and welcome to the Moog First Quarter Fiscal Year 2024 Earnings Conference Call. Today's conference is being recorded.

At this time, I'd like to turn the conference over to Mr. Aaron Astrachan. Please go ahead, sir.

Aaron Astrachan
Director of Investor Relations

Good morning, and thank you for joining Moog's First Quarter 2024 Earnings Release Conference Call. I am Aaron Astrachan, Director of Investor Relations. With me today is Pat Roche, our Chief Executive Officer; and Jennifer Walter, our Chief Financial Officer.

Earlier this morning, we released our results and our supplemental slides, both of which are available on our website. Our earnings press release, our supplemental slides and remarks made during our call today contain adjusted non-GAAP results. Reconciliations for these adjusted results to GAAP results are contained within the provided materials. Lastly, our comments today may include statements related to expected future results and other forward-looking statements which are not guarantees. Our actual results may differ materially from those described in our forward-looking statements and are subject to a variety of risks and uncertainties that are described in our earnings press release and in our other SEC filings.

Now I'm happy to turn the call over to Pat.

Patrick J. Roche
CEO & Director

Good morning, and welcome all. Today, we report on an excellent start to fiscal '24. We have positive feedback that we are delivering for our customers and that our employees are highly engaged and invested in our success. This feeds through to stronger financial performance.

Sales were strong, delivering double-digit growth relative to prior year. Adjusted operating margin increased 90 basis points relative to prior year, which is in line with our margin enhancement. Together, these factors resulted in EPS performance at the upper end of our guidance range.

Given the great start to the fiscal year, we are confident that we will deliver 110 basis points of incremental adjusted operating margin for the full year as previously guided. We have also increased both revenue and EPS guidance relative to 90 days ago.

Now I'd like to provide some highlights on our operational performance, starting with customer focus. We were pleased to receive customer recognition from United Launch Alliance as the most innovative supplier of the year 2023. Moog supplies thrust vector actuators for ULA's Vulcan Rocket. It was great to see the successful Vulcan Certification 1 flight on January 8, and we look forward to many more successful launches.

We've secured major contract awards in both Defense and Space that indicate that our product offerings are meeting real customer needs. We received a significant order for our reconfigurable integrated weapons platform, taking cumulative bookings from $270 million to $350 million, which extends full production through to the end of fiscal '25. In addition, we secured further space vehicle business, bringing cumulative bookings to $280 million. We are delighted with the success in building these businesses.

Finally, in a highly regulated medical market, we are pleased to have completed a full independent audit of our medical device operations with zero non-conformances. This is a credit to the team's focus on quality and continuous improvement.

Speaking of teams and moving to people, community and planet, our unique culture is core to defining who we are as a company. It is the reason that talented people come to our organization and stay with us. I'm immensely proud to share that Moog was recently recognized by Glassdoor as one of the best places to work. We were ranked 21st of the top 100 large U.S. companies, ranked first in New York State, and we're the top manufacturing company and top aerospace and defense company in this ranking.

In addition to this recognition externally, our own recent global employee survey indicated increased levels of engagement relative to our last survey taken prior to the pandemic. Our highly engaged workforce is what enables us to deliver for our customers and drive improved company performance.

Turning next to Planet. We continue to increase our focus on environmental issues. During our last earnings call, we committed to reducing Scope 1 and Scope 2 greenhouse gas emissions by 40% by 2030. We are also intent on reducing both water consumption and hazardous waste byproducts and we'll commit to specific goals by the end of calendar year '24. We recently published our fiscal '23 Sustainability Accounting Standards Board disclosure which provides insights into our environmental performance for our stakeholders.

And finally, financial strength. We continue to drive margin enhancement through pricing and simplification. We've already secured important price adjustments that reflect the value that we deliver for our customers. This made an important contribution to our margin improvements in this quarter. Our business leaders continue to pursue fair pricing on an ongoing basis.

We're continuing to systematically reduce unnecessary complexity in our business. 80/20 is the methodology that drives much of this activity, and we are gaining traction across all businesses. In the quarter, we rolled out 80/20 to a further 2 manufacturing sites bringing total deployment to 12 sites. We're using data and analytics on customers, products and profitability to make key business decisions.

At 2 of our more recently deployed sites, we uncovered the opportunity to end-of-life, significant numbers of low-margin, high overhead items to reduce complexity. For example, we've discontinued more than 40% of part numbers that were previously available for sale at one site and 20% at the other. This is all part of our product simplification efforts. We're making good progress in strengthening our 80/20 talent. We trained 120 more leaders on our 80/20 approach this quarter, bringing total trains to close to 1/4 of our global leadership.

In addition, we're selectively hiring key expertise to supplement our internal talent. We see significant opportunities to deliver financial improvements beyond profitability.

We're building a framework to better structure our 80/20 activities. This will guide how we apply 80/20 at each site, and we will also be able to assess our ability to deliver against our own capability maturity model. Finally, we will use consistent measures across the business to inform our operational reviews and decision-making.

The buy-in for 80/20 from all levels of the organization has been outstanding. This widespread acceptance and support of 80/20 activities is a positive sign that we are on the right track. It shows that our team understands the benefit of this approach and is committed to implementing it in their respective areas.

Our work on portfolio rationalization, footprint and focused factories continue to pace, and we will have more to report on this in the next earnings call.

Macroeconomic and end market conditions. The geopolitical environment has remained volatile over the past months. The situation is defining defense priorities for the U.S. and global partner nations. This is driving investment in industrial capacity to meet current and future demand. In addition, the need for a strategic shift is pushing the development of new capabilities, we are active in supporting both near-term production requirements and the development of those future capabilities.

Consequently, we are seeing a broad-based increase in demand across our defense applications. Notably, missile components, space components and space vehicles.

Commercial Aviation continues to recover strongly. Increased fleet utilization is driving higher aftermarket activity, and the wide-body production ramps at Boeing and Airbus are driving a significant pickup in our OEM business. Industrial output in Europe continues to soften with German manufacturing contracting in the last quarter. We continue to adjust our business in response to demand, and we will move to a reduced work week for our largest German site in February. On the other hand, our flight simulation business is experiencing strong demand due to increasing fleet utilization and flight hours, leading to increased flight training. We are getting indications of strong future demand from our customers.

Guidance for '24. Considering our quarter 1 performance and the current end market conditions, we're increasing our full year guidance for revenue by $50 million and EPS by $0.10 per share and holding firm on our adjusted operating margin guidance of 12%, an increase of 110 basis points relative to the prior year.

Now let me hand over to Jennifer for a more detailed breakdown of the quarter and our guidance.

Jennifer Walter
VP & CFO

Thank you, Pat. Since the start of FY '24, we split our aircraft business into 2 segments: military aircraft and commercial aircraft. So we'll now be reporting 4 segments. We provided indicative numbers for the military and commercial split of quarter results for comparative purposes. We've now updated those prior year amounts to reflect the current organization. I'll begin with our first quarter financial performance. I'll then provide an update on our guidance for all of FY '24.

It was a great start to the year with sales coming in strong at $857 million. Adjusted operating margin of 11.3% was just above plan and adjusted earnings per share of $1.53 was at the high end of our guidance range. Sales in the first quarter of $857 million were 13% higher than last year's first quarter with each of our segments contributing to that growth. The largest increase in segment sales was in commercial aircraft. Sales of $194 million increased nearly 50% over the same quarter a year ago.

Commercial OE sales in the quarter were strong, driven by continued market recovery in wide-body platforms. This is in addition to strength across the broader commercial book of business and robust aftermarket sales due to airlines wanting to have more spares on hand.

Space & Defense sales of $230 million increased 6% over the first quarter last year. Their strong defense demand across our portfolio with new defense work ramping up and increased activity in defense-related space applications.

Military aircraft sales of $186 million were up 5% over the first quarter of last year. Activity on the V-280 program has continued to ramp up over the past 3 quarters driving OE sales higher.

Industrial sales of $246 million increased 6% over last year's first quarter. Demand for flight simulation systems is strengthening and is associated with recovery in commercial aircraft flight hours and related demand for pilot training. Industrial automation sales also grew over the same quarter a year ago, though we've seen a slowdown in orders in recent quarters and the sales decrease from our most recent quarter.

We'll now shift to operating margins. Adjusted operating margin of 11.3% in the first quarter increased 90 basis points from the first quarter last year. Adjustments this quarter were $2 million of restructuring charges. Adjustments for last year's first quarter consisted of a $10 million gain on the sale of 2 buildings and $2 million of restructuring and other charges. Adjusted operating margins increased over the first quarter of last year in each of our segments other than commercial aircraft.

In Space and Defense, operating margin increased 160 basis points to 11.0%, this increase is associated with production efficiencies, along with the benefit from additional pricing activities. The operating margin for military aircraft was 10.5%, up 200 basis points. The higher margin resulted from increased activity on the V-280 program as we near the expected full staffing level and a favorable mix. Commercial aircraft operating margin was 10.6%, down slightly from the first quarter last year. The benefits associated with pricing and higher volume across our entire book of business was offset by the lack of retrofit activity on the 787 program that we had in last year's first quarter. Industrial operating margin was 12.6% in the first quarter, up 30 basis points. We continue to realize benefits from our pricing activities, though this improvement is mostly masked by a favorable mix we experienced in last year's first quarter.

Nonoperating expenses are also impacting our financial results this quarter. The most significant element of that is interest expense, which was $17 million, up $4 million over the first quarter of last year. Putting it all together, adjusted earnings per share came in at $1.53 near the high end of the range we provided a quarter ago. EPS was up 22% from the same quarter a year ago driven by the increase in operating profit, and partially offset by the increased levels of interest and other nonoperating expenses.

Let's now shift over to cash flow. Free cash flow for the first quarter was $23 million, which included a $25 million benefit associated with the expansion of our securitization facility. Due to this facility structure, the associated receivables are not recognized on the balance sheet, so any growth in the outstanding balance of this facility results in an improvement in free cash flow. We amended our securitization facility in the first quarter, extending the maturity to 2026 and increasing the capacity from $100 million to $125 million. We took advantage of the additional capacity this quarter.

In my following comments, I'll reference our free cash flow performance and working capital changes, excluding the benefit associated with the increase in our securitization facility balance. We had an expected slow start for adjusted free cash flow in the quarter. Net earnings were solid, and capital expenditures are under the run rate expected for the year. However, we consumed cash with working capital growth. During the quarter, we were negatively impacted by the timing of compensation payments. There were other offsetting changes in working capital with growth in physical inventories being fully offset by cash collected from customers.

We grew inventories in anticipation of production increases. In addition, we purchased materials to mitigate exposure from supply chain constraints.

On the other hand, we have strong cash collections. We converted [indiscernible] cash and generated cash from customer advances on defense programs. Capital expenditures were $37 million in the first quarter and include investments in our facilities to support our growth. Our leverage ratio calculated on a net debt basis at the end of the first quarter was 2.2x, around the low end of our target range at 2.25x to 2.75x.

Our capital deployment priorities, both long term and near term, are unchanged. Our current priority continues to be investing in organic growth. On the acquisition front, we did acquire a technology company that enhances our digital airfield solutions capabilities for $6 million this quarter.

We'll now shift over to our updated guidance for this year. We're raising our sales and earnings per share guidance based on our first quarter performance, and we're holding our operating margin at 12.0%. Fiscal year 2024 will be another positive step on our journey towards our long term financial targets. Our sales will grow by 5%, operating margin will expand by 110 basis points and earnings per share will increase by 12%. We're projecting sales of $3.5 billion in FY '24, with sales growth in commercial aircraft, Space and Defense and military aircraft and a decline in sales in industrial.

We're increasing our guidance for FY '24 sales by $50 million from 90 days ago. We're increasing our sales guidance for commercial aftermarket by $30 million to reflect the strong first quarter activity and the strength we're seeing. We're increasing our military aircraft sales guidance by $10 million, which reflects our first quarter run rate. We're also increasing our industrial sales guidance by $10 million, reflecting a stronger first quarter than expected.

Let's shift over to operating margins. We're projecting our adjusted operating margin in FY '24 to be 12.0%, a 110 basis point increase over FY '23. Operating margins will be 13.5% in Space and Defense, 11.6% in Military Aircraft, 10.2% in Commercial Aircraft and 12.3% in Industrial, all the same as our previous guidance. For FY '24, we're projecting adjusted earnings per share of $6.90, plus or minus $0.20, which is up 12% over FY '23, reflecting strong operational performance. We've increased this guidance by $0.10 from a quarter ago based on our first quarter performance. For the second quarter, we're forecasting earnings per share to be $1.70, plus or minus $0.10.

Finally, turning to cash. We're projecting free cash flow for FY '24 to be modest, as previously guided. Relative to FY '23, we'll see stronger cash from net earnings and working capital while capital expenditures remain around the same level. We'll use less cash for working capital needs this year as fiscal inventories grow at a slower rate. Overall, we had a great start to the year, and our outlook for the year continues to look strong.

And now I'll turn it over to Pat.

Patrick J. Roche
CEO & Director

Thank you, Jennifer. I'm really pleased with our performance in this quarter and look forward to another exceptional year.
Now let's open it up for questions.

Question and Answer

Operator

[Operator Instructions] We'll take our first question from Cai von Rumohr with TD Cowen.

Cai von Rumohr
TD Cowen, Research Division

Good quarter. So your Space and Defense profit margin, given the price hike and the productivity looks a little light we'd estimated. Were there any additional charges on the satellite program?

Jennifer Walter
VP & CFO

There is nothing of significance to call out from space vehicles.

Cai von Rumohr
TD Cowen, Research Division

Got it. And so you talked -- I guess, can you give us some color on your customers like LHX is on the tranche 2 tracking satellites but which satellites of there? Are you providing the bus? And have you expanded to additional customers yet?

Patrick J. Roche
CEO & Director

It's Pat here. Yes, we're actively pursuing the development of that business and broadening out the customer base that is still underway. We are continuing to work with our lead customer, L3Harris, and we're not really able to talk about the individual programs, which they're performing on. So that's makes it a little bit more difficult for me to describe the detail behind it. But what I would say is positive about the business is that it continues to expand. We have a lot of proposal activity. And as I mentioned, we've increased orders during the course of the last quarter, bringing our total book of business there to a quite significant number. We're over $0.25 billion of business there in that new endeavor to get into the space vehicles.

So I think it's a really positive story for us. It's growing. And -- we hope to see flight hardware in space in the coming 6 months.

Cai von Rumohr
TD Cowen, Research Division

Great. And is it in the black yet?

Patrick J. Roche
CEO & Director

The business is challenged because of the issues we uncovered last year and the charges we took. We are taking all of those learnings into account on any of the new contracts that we are in negotiation on. So we expect that, that picture improves over the course of the coming year.

Cai von Rumohr
TD Cowen, Research Division

Great. And then on the RIwP, where would those -- are those basically more domestic orders? And what's the prospect for foreign sales?

Patrick J. Roche
CEO & Director

So yes, they are basically domestic orders. They are supporting the needs on 2 programs. One is M-SHORAD, which is the bigger of those programs and the other one is M-LIDS. So that program is -- as you can see, very successful for us. We're really pleased with those orders because they allow us to continue full rate production without interruption through to the end of fiscal year '25. So on M-SHORAD, we are working on the Stryker vehicle. On M-LIDS, the third is mounted on a Oshkosh all-terrain vehicle. And during the quarter, we also had a press release from BAE systems that indicated that they had our card installed on their armored multipurpose vehicle, and they had done live-fire tests at one of the Army firing ranges with great success. So we are working to build out that business beyond those 2 existing programs. And that would be, for us, building the business beyond fiscal '25, maybe even expanding the run rate that we're currently doing. But we're really active there, Cai.

Operator

Our next question will come from Kristine Liwag with Morgan Stanley.

Kristine Liwag
Morgan Stanley, Research Division

Pat, I was just thinking about this, like Moog's performance regarding margin growth, margin expansion and revenue had kind of been stagnant for about a decade or so. But since taking all of CEO at Moog, you've clearly injected energy on revenue growth and margin expansion, and you're starting to show results. You discussed this at the Investor Day, but now that you are showing some of this traction. Can you give more color on how different your leadership approach is? How you're thinking about strategy? And what are immediate more low-hanging fruit that you can accomplish this year to show more of the traction from your multiyear outlook?

Patrick J. Roche
CEO & Director

Thanks for the question, Kristine. I think we're making great success as a business and a team overall. It's not all down to me and this role. I think the contribution that I can make is increasing the level of focus and prioritization around these activities. We are single-minded in our intent to improve operating margin. And that's what we committed to as an entire leadership team when we went to the Investor Day in June. And what you're seeing are the fruits of that coming through now. That wasn't an overnight switch that was thrown. It was planning that had gone on prior to that building out, what we believed were realizable plans. And I think what we're seeing now in our results is, yes, they were indeed realizable. We're getting the value that we thought we would from those activities.

And as we see the results coming through, it actually builds belief and commitment and momentum within the organization as well because you can see the fruits of your labor coming through in those improvements, and that's actually reinforcing the activity.

We talk a lot in the call about 80/20. It's one of the techniques that we've started to use, but you know that there's a lot more activities going on in the background on portfolio shaping, on the footprint activities and during the next quarter call, I'll have more to report on progress made in those areas. So the activities and effort continues at pace in all of the areas and the results are coming through in our financials. So I'm really pleased where we are with in this journey.

Kristine Liwag
Morgan Stanley, Research Division

And a few off-program questions. You've clearly been seeing success with this turret, which I saw at AUSA last October. I mean it's really more of an integrated system versus individual components. You're running the strategy of providing for integrated solutions in space. Does that mean that you want to do more of that also in defense?

Patrick J. Roche
CEO & Director

I think that's a journey we've been on for probably 2 decades, Kristine because as you think about our aircraft business, we were a component supplier. And over the 2-decade period, we became system engineering experts and able to build a primary flight control system that now flies on 787, A350, Embraer E2 jet. That capability, those skills we've now applied in different areas. You see it -- as you rightly point out, in the reconfigurable integrated weapons platform. That's a pretty complex system where we brought those systems capabilities, so there's user interfaces, there's software, there's aiming and fire control systems in there. There's the motors and actuation, there's sensing and vision systems. Very complicated systems. And I think we know how to do those now. And yes, you see then the extension of that into the space side. That will continue. We're using those capabilities and exploiting them in different end market applications.

Kristine Liwag
Morgan Stanley, Research Division

That's great to hear. And as you climb up the value chain, how do you think about margin profile? Historically, sometimes being a component manufacturer is higher margin, but more of an integrator or taking on more risk. How do you balance the opportunity versus managing a broader supply chain with an integrated approach and making sure that you're getting margin?

Patrick J. Roche
CEO & Director

Yes, that's a great question. I mean when you're building these complex systems, there is a lot more engineering activity invested up front. We got to be really clear that we're going to generate a return from those. And so that's down to each of the business leaders looking at the value proposition that they're developing and making sure that it's going to be a profitable business. So those investment decisions are something we, as a leadership team, pay a lot of attention to, to see where we can spend our next investment dollar. And in what piece of the business, we're likely to generate the greatest return. So we actively do that portfolio review type work as well, which I think helps ensure that we have the right level of profitability.

We continue to want to explore in new areas. And so we have a funnel of opportunities, new ideas that we continue to develop, but we do that in a fairly prudent manner to test out new capabilities and new developments.

Operator

[Operator Instructions] We'll take our next question from Michael Ciarmoli with Truist Securities.

Michael Frank Ciarmoli
Truist Securities, Inc., Research Division

Nice results here. Maybe, Pat, just to quick close the loop maybe a bit here on Cai's question on the Space margins. I mean you put up the 11% in the quarter. What gives you the confidence are you seeing to drive that expansion to get the full year target? I mean, I guess you've got a bit of volume growth. It sounds like you're still battling some pressures on some programs. But I guess I'm just asking maybe risk parameters around that margin target this year.

Jennifer Walter
VP & CFO

Yes. I would just wanted to comment, maybe share a little bit more color. Yes. What we're seeing in the first quarter is we've got the production efficiencies that I've mentioned, it's a nice growing business with strong health overall, and we're seeing the benefits from the pricing. And certainly, when we look at the full year, the benefits that we're going to see year-over-year '23 to '24 is going to be the absence of space vehicle charges that we were saddled with last year. It's a little bit muted when we're looking at our first quarter results because we did have some higher investments in R&D expenses. So that's kind of the other thing that [indiscernible] the factor here.

But really, it's a nice, solid business. We're getting some improvement in the pricing there. But when you look at '23 to '24 overall, it's really the absence of the charges that stands out most significantly because that was our learning. But we've gotten through a lot of risk on these programs. As Pat mentioned, we've learned a lot, and we're happy to be taking on new work and new business and having this business grow.

Patrick J. Roche
CEO & Director

Thanks very much, Jennifer. And we're seeing pricing coming through generally on the work in the Space and Defense group.

Michael Frank Ciarmoli
Truist Securities, Inc., Research Division

And then, Jennifer, just on inventory, up I think 9% sequentially. How should we think about inventory levels going forward here as it relates to cash flow?

Jennifer Walter
VP & CFO

Yes. So physical inventory definitely grew larger than we had anticipated. I think last quarter, I shared that over the few quarters in last year, we made improvements every quarter of using less and less inventory each quarter. This quarter, we used more than that average that we were projecting to be throughout the full year.

A few things happened to us. First of all, we had some supply chain challenges more than we had anticipated. It doesn't mean that supply chain is necessarily getting any worse or challenged, but that was a factor for us. There's obviously the growth in the business, the commercial ramp certainly has an impact on that. And then there's also timing. Some of that timing things that has caused us to have an increase this quarter are already pushing through and are going to help us out in the next quarter or 2.

So that's where we're at on that. So definitely a little bit more challenged. It's probably going to have more growth than what we had previously anticipated for the year. However, our collections from our customers, in particular on customer advances that we [received] this first quarter are also higher than we had anticipated. So that's really offsetting it. So we feel like we're in the same shape that we were coming into this quarter as we do right now, just a little bit different on the mix as we've gotten a little bit stronger on the customer advances but that's offset by a little bit of growth in the physical inventories that we've got.

Michael Frank Ciarmoli
Truist Securities, Inc., Research Division

And then I'll just ask one last one here, I'll jump in the queue. Pat, something that just stuck out to me. The medical device audit, what, sort of, drove that? And what was the I guess, the rationale to call that out, anything we should read into there?

Patrick J. Roche
CEO & Director

Just for me, it demonstrates the level of focus and commitment on quality of work within our organization. The audit itself was to certify ourselves to an ISO standard, which is the international standard for medical device production that makes sure that we have access to European markets, other areas as well. It was a plan for event, we invited in a German certification company to do that audit at our 3 manufacturing sites. And I think the remarkable thing is we came up with zero non-conformances. These are talking about production sites where we have 100s of people. Costa Rica, 600 people, Salt Lake City, 100 people and Lithuania. They were the 3 manufacturing sites that were reviewed. So overall, a really good result and a very strong endorsement of the work of the team in that business.

Operator

[Operator Instructions] And it appears there are no further telephone questions. I'd like to turn the conference back to our presenters for any additional or closing comments.

Patrick J. Roche
CEO & Director

So thank you very much, everyone, for joining our call. I think we had a great start to the year, looking forward to continuing to drive all of the initiatives we have to improve margins in the business, and we are expecting a really good year for fiscal '24.

So thank you very much for your time today.

Operator
And once again, that does conclude today's conference. We thank you all for your participation. You may now disconnect.