Elbit Systems Ltd.
Edited Conference Call Transcript
May 30, 2023

Operator: Ladies and gentlemen, thank you for standing by. Welcome to Elbit Systems' First Quarter 2023 Results Conference Call. (Operator Instructions) As a reminder, this conference is being recorded. You should have all received by now the company's press release that is available in the news section of the company's website, www.elbitsystems.com.

I would now like to hand over the call to Rami Myerson, Elbit Systems Investor Relations Director. Rami, please go ahead.

Rami Myerson: Thank you, Yoni. Good day, everyone, and welcome to our first quarter 2023 earnings call. On the call with me today are Bezhalel Machlis, our President and CEO; Kobi Kagan, our CFO; Yossi Gaspar; Senior EVP, Business Management.

Before we begin, I would like to point out that the safe harbor statement in the company's press release issued earlier today also refers to the contents of this conference call. As we do every quarter, we will provide you with both our regular GAAP financial data as well as certain supplemental non-GAAP information. We believe that this non-GAAP information provides additional detail to help understand the performance of the ongoing business. You can find all the detailed GAAP financial data as well as the non-GAAP information and the reconciliation in today's press release.

Kobi will begin by providing a discussion of the financial results, followed by Butzi, who will talk about some of the significant events during the quarter and beyond. We will then turn the call over to a question-and-answer session.

With that, I would like now to turn the call over to Kobi.

Kobi, please?

Yaacov Kagan: Thank you, Rami. Hello, everyone, and thank you for joining us today.

The financial results of the first quarter of 2023 reflect the sustained demand for our leading technological solutions that supported the growth in the order backlog to $15.8 billion, up 15% relative to the first quarter of 2022.

I'm encouraged that our operational activities and the cost base are gradually returning to normal following the supply chain and labor challenges in 2022. We continue to invest in the operational transformation to realize the potential presented by the large funnel of opportunities around the world, and we are on track to deliver an improved performance.

We started to report segment information in 5 segments from the year ended December 31, 2022. In our press releases for the first, second and third quarter, we will provide revenues by segment, and we report revenues and operating income of each segment in our annual report. Revenues by segment in our press releases for the first, second and third quarter, replaced revenues by areas of operation that were previously provided.

The 5 reportable segment are Aerospace, C4I and Cyber, ISTAR and EW, Land and Elbit Systems of America, or ESA.

I will now discuss some of the key figures and trends in our financial results.

I would note that the sale of Ashot Ashkelon to FIMI Opportunity Funds was completed at the end of the second quarter of 2022, and our results in the first quarter of 2023 do not include a contribution from Ashot Ashkelon.

First quarter revenues were $1.393 billion compared to $1.353 billion in the first quarter of 2022.

In terms of quarterly revenue by segment, Aerospace revenues decreased by 10% in the first quarter of 2023 compared to the first quarter of 2022, mainly due to lower airborne precision-guided munition sales, partially offset by growth of training and simulation sales.

C4I and Cyber revenues increased by 19% year-over-year, mainly due to growth in command and control system sales.

ISTAR and EW revenues increased by 17%, mainly due to electronic warfare system sales.

Land revenues increased by 8%, mainly due to armored vehicle upgrade sales.

Elbit Systems of America's revenues in the first quarter were similar to the first quarter of 2022.

Our various geographic revenue base is important to the long-term sustainability of our business.

In the first quarter, Europe contributed 27%; North America, 24%; Asia Pacific, 24%; and Israel contributed 18% of revenues.

European revenues increased mainly due to the growth in UAS, munitions and training and simulation sales.

Asia Pacific revenues declined mainly due to lower precision-guided munition sales.

Latin America sales increased due to C4I sales.

The non-GAAP gross margin for the first quarter was 26.4% compared to the first quarter of 2022 at 24.6%. GAAP gross margin in the first quarter was 25.9% of revenues compared to 24.2% in the first quarter of 2022.

GAAP and non-GAAP gross margin in the first quarter of 2022 included approximately $20 million of expenses related to stock price linked compensation plan.

First quarter non-GAAP operating income was $105 million or 7.5% of revenues compared with $66 million or 4.9% of revenues last year. GAAP operating income for the first quarter was $94 million or 6.7% of revenues versus $59 million or 4.3% of revenues in the first quarter of 2022.

The operating expense breakdown in the first quarter was as follows. Net R&D expenses were 7.9% of revenues versus 7.4% in 2022. Marketing and selling expenses were 5.8% of revenues versus 6.4% last year. G&A expenses were 5.5% of revenues compared to 6.2% last year.

GAAP and non-GAAP operating profit in the first quarter of 2022 included expenses of approximately $35 million related to the stock price linked compensation plan, which, in the first quarter of 2023, were not material.

Financial expenses were $24 million in the first quarter compared to financial income of $1 million in 2022. Financial expenses in the first quarter reflect the higher interest rate environment. Financial expenses in the first quarter of 2022 included gains from changes in fair value of financial assets and exchange rate differences.

We recorded a tax expense of $9 million in the first quarter compared to tax expense of $8 million in 2022. The effective tax rate in the first quarter was 12.8% compared to 13.8% in 2022.

Our non-GAAP diluted EPS was $1.70 in the first quarter compared with

$1.22 in 2022. GAAP diluted EPS was $1.40 for the first quarter compared with $1.19 in 2022.

Our backlog of orders as of March 31, 2023, was $15.8 billion, $2.1 billion higher than the backlog at the end of the first quarter of 2022. Approximately 54% of the current backlog is scheduled to be performed during 2023 and 2024, and the rest is scheduled for 2025 and beyond. Operating cash flow for the first quarter was $73 million outflow compared to $35 million inflow in the same quarter last year.

The Board of Directors has declared a dividend of $0.50 per share.

I will now turn the call over to Mr. Bezhalel Machlis, CEO. Butzi, please go ahead.

Bezhalel Machlis: Thank you, Kobi. I'm encouraged by the financial results in the first quarter. The strong demand and large funnel opportunities and a series of significant contracts booked since the end of the first quarter. Over the last 3 years, we have experienced the challenges of COVID-19, supply chain disruptions and changes in the labor market. Elbit Systems has demonstrated its resilience through this period and the remarkable ability of our employees to deliver and support our customers during a very volatile period. There is still work to do to complete the operational transformation we presented at our Investor Day in March. I believe the first quarter results provide confidence that we are on track to deliver the transformation.

Elbit Systems is benefiting from the healthy demand for artillery solutions from countries and militaries around the world that have started to implement the lesson learned from the Russia-Ukraine conflict, including the critical importance of effective indirect prices. We also continue to receive orders from legacy customers.

Elbit Systems has developed a comprehensive portfolio of systems and solutions for artillery forces. The portfolio includes howitzers, mortars and rocket launchers, munitions, fire control and command and control systems, target designators, UAVs and training systems. We provide these to our customers as tailored solutions or as standalone systems.

A few weeks ago, on May 18, we announced a $305 million five year contract to supply 20 Precise & Universal Launching System or PULS rocket artillery systems as well as rockets and missiles of various ranges to the Royal Netherlands Army.

The PULS systems can launch both free-flying rockets and precision guided rockets and missiles with ranges of up to 300km. The PULS launcher can be mounted on a broad range of wheeled and tracked platforms, providing a significant reduction in maintenance and training costs.

The Dutch contract follows rocket artillery contracts from two European countries we received during the first quarter.

In 2022, German Defense Company KMW signed a cooperation agreement with Elbit Systems Land and Elbit Systems Deutschland to develop the Euro-PULS, the next generation European Long Range Rocket Artillery system. This agreement will enable both companies to address the growing potential in the European market for these solutions.

In April we were awarded a $102 million eight year contract to supply a battalion of ATMOS 155mm truck-mounted howitzers to an International customer. The ATMOS is a combat proven wheeled Howitzer designed for rapid deployment and operation enabling provision of fire support for a broad range of missions.

In May, the Rheinmetall Elbit team conducted a live fire demonstration of an automated 155mm wheeled self-propelled howitzer in Southern Israel. This demonstration was part of the cooperation agreement we signed with Rheinmetall in 2022 to develop, market and manufacture a European automated wheeled self-propelled howitzer. The solution combines and leverages the technological capabilities of both companies and will provide a mature and relevant solution for NATO armies that are planning to recapitalize and expand their artillery forces.

Elbit Systems provides a broad portfolio of market-leading training and simulation solutions for war fighters in all domains, in the air, on the ground, and at sea from a single soldier to larger formations and headquarters. Our simulation solutions provide more realistic training that better prepare soldiers for a wide range of scenarios at a lower cost.

In May our British subsidiary, Elbit Systems UK was awarded a $71 million contract by the UK MOD to provide, maintain and operate the Ground Maneuver Synthetic Trainer system or GMST for the UK Army's Boxer armored vehicles and Challenger 3 tanks. The contract will be delivered over three years with an additional nine year period of operation and maintenance services at UK facilities.

A few weeks ago we marked a significant milestone for our Hellenic International Flight Training Center contract with the arrival of the first two M-346 aircraft at the International Pilot Training Center in Kalamata. The M-346 aircraft are equipped with Elbit Systems' integrated virtual avionics that simulate combat and flight scenarios to enhance the pilot's training experience. The Hellenic Flight school contract is on track and delivering as planned.

At our recent investor day, we discussed the investments we are making to upgrade and expand our manufacturing footprint, as part of the transformation of the company, to enable our internal targets of revenues of $6.5 to $7 billion and operating margins around 10% in the future.

In May we opened our new manufacturing facility in North Charleston, South Carolina. The new facility will employ hundreds of people and assemble large vehicular systems for the United States military and allied nations including the Mission Command Platforms for the U.S. Army's CPI2 Program and the Sigma Howitzer system for the IDF.

Construction of our new ammunition production site in Ramat Beka is on track and should be up and running from 2024. The new, state of the art facility, should benefit from the growing demand for munitions.

Last week thousands of our Israeli employees volunteered during Elbitov, which means the "doing good at Elbit" week, to volunteer, contribute and give back to their local communities.

During this year's Elbitov week, our employees contributed more than 3000 hours volunteering on dozens of projects around the country with holocaust survivors, the elderly as well as youngsters that need a helping hand.

I am proud to see the involvement of thousands of Elbit Systems' employees around the world that volunteer to participate in activities that benefit our communities.

And with that, we will be happy to take your questions. Operator?

Operator: Thank you. Ladies and gentlemen, at this time we will begin the question-and-answer session. If you have a question, please press star-one. If you wish to cancel your request, please press star-two. If you are using speaker equipment, kindly lift the handset before pressing the numbers.

Your questions will be polled in the order they are received. Please stand by we poll for your questions.

The first question is from Sheila Kahyaoglu of Jefferies. Please go ahead.

Sheila Kahyaoglu: Hey, good morning, guys, and thank you for the time. You know, just wanted to ask a little bit deeper into the segments, if you don't mind. The Aerospace sales to start with, maybe were down 10% year-over-year, I believe. Is this the precision guided munitions headwind related to a single program? And how do we think about, sort of, that return to growth there?

Man: Hi Sheila, good afternoon, here. The answer to the question is a reduction in airborne precision-guided munition sales that we had at the first quarter of 2022. And due to program mix, we didn't have that substantial amount of airborne precision guided munition sales in the first quarter of 2023. This is the main explanation for this decline.

Butzi Machlis: Sheila, hi, it's Butzi.

Sheila Kahyaoglu: Okay.

Butzi Machlis: I want to add that, if you remember, last time we discussed the different segments, we mentioned also the importance of looking on the entire corporation. Because there are many synergies between the divisions. One quarter, one division is doing better than the other. There's also a mix of projects, which are also impacting the results. So I'd like to remind this remark again. And to make sure you see the overall thing – the overall integrated picture, I think that's reflect better the performance of the corporation.

Sheila Kahyaoglu: Okay. Now, that's helpful color. And then, maybe if you could just go to Land for a second. Your partners with BAE on OMFV, on that program. Maybe if you could just provide us an update on timing on that program, and how you're thinking about the opportunity and next steps in this, sort of, armored vehicle upgrade?

Butzi Machlis: This opportunity is, as you know, it's a tender, and we are participating in that tender, among other things, with our solution. And we are waiting for the decisions, actually. We expect decisions during this year about the first phase of the project. And that's more or less the status.

Sheila Kahyaoglu: Got it. Okay. All right. Thank you very much.

Operator: The next question is from Atinc Ozkan of WOOD & Company. Please go ahead.

Atinc Ozkan: Thank you, and good afternoon, all. I have a couple of questions. The first one is, on your previous investor call, you mentioned that following Elbit's transformation over the past couple of years, you are now in a position with infrastructure to support annual revenues of 6 to 7 billion, with improved profitability. And you also mentioned that you think you will hit 10% operating margin targets soon.

Can you elaborate or provide some more granularity of when do you expect to basically hit these levels, both on top line and operating margin levels? Is it some kind of midterm guidance? Or do you think it's going to be achievable in 2023, 2024? That's my first question.

And my second question is, given that you'll be completing most of your CapEx upcycle with the new ammunition plant in the Negev operational next year, and South Carolina plant is already behind us, and the OneERP investment is already completed, where do you see your CapEx budget, or annual CapEx or revenue trends, going forward?

Yossi Gaspar: Hi. This is Yossi. Regarding your first question, I think the best indicator to look at is our backlog of orders. We are close to 16 billion backlog of orders, growing very nice double digit year-over-year. Our revenues have grown year-over-year, probably in the mid-single digits, as you can see it, so far. And we, as we explained in the past, we are making every effort to close the gap between the growth of the backlog and the growth of the revenues, of course, by increasing the revenues.

If you look at our press release today, you see that of the 15.8 billion dollars of backlog, about 54% are planned to be transformed in revenues in the next seven quarters. That means this year and next year. Just by making a simple calculation, you will see that we probably will be in the 6-plus billion dollar next year and getting closer to the – to the 7 number maybe a year or two year – two years after that. So this is the range of the top line growth, driven by the backlog of orders that we already have. So it's no speculation. It's just simple calculation of the backlog transformation into revenues.

In parallel, as Butzi, at our investors meeting explained, we have initiated efforts to build the operational capability to do that, actually to manufacture and deliver to our customers and in the various places in the world, the various facilities, and this is underway. Some of them are completed, some of them will be completed during 2023 and 2024. So all of this would enable us to perform. And of course, by growing the top line, and by keeping the overhead rates and the G&A under control, we expect to return to the level of operating profit that we used to be several years ago.

So this is first question. I believe the second question, I will turn it over to Kobi to respond.

Kobi Kagan: Thank you, Yossi. Hi, Atinc. As Yossi explained, we are currently in the process of building our infrastructure to support the transformation of our backlog to revenues. This is involved with CapEx investments. In terms of specifics, the South Carolina facility is almost finished. We actually started working there, and most of the investment there is done. The OneERP investment is also in a process of conclusion. We hope that the last big division will go live at the 1st of July this year. And we are still in the cycle of CapEx investments in the Ramat Beka-Negev Desert, South of Israel ammunition plant to actually have all the facilities that will be relocated from the Ramat HaSharon facility to the Negev facility. So we are expecting a modest decline in CapEx investments, due to the conclusion mainly of the ERP system, but we still invest heavily in our production capacity, in order to having the backlog transformed to revenue.

Atinc Ozkan: Okay. Crystal clear. And if I may follow up just with a real short question regarding Aerospace segment. I do remember that you guys have additional capacity put into operation in your production line for drones in Israel. Is it possible to, basically, tell us what the waiting line, if a client comes and orders you? I don’t know, a dozen of drones right now. Just to give you an example, from your unlisted peer in Turkey, Baykar has now a three-year waiting line for drones. I’m just trying to have an idea whether you have the same kind of bottleneck. Thank you.

Butzi Machlis: Good afternoon, it’s Butzi. We are expanding our production capabilities for UAVs. We are building a new facility right now near the city of Modi’in, which is not far away from Jerusalem in Israel. And this is on top of the facilities we already have. And this facility should go live by the end of this year, which will enable us to meet the growing demand for UAVs that we are seeing all around the globe, and to enable us also to deliver UAVs to our customer in a relatively short period of time.

Atinc Ozkan: Thank you very much for the details.

Butzi Machlis: Thank you.

Operator: The next question is from Ella Fried of Bank Leumi. Please go ahead.

Ella Fried: Hey, good afternoon, and thank you for taking my question. I have actually a few. The first question is, what was the reason for inventories going up? I mean, it could be future growth, rising prices of raw materials, supply delays? Or it means investment in long-term projects?

Kobi Kagan: Hi, Ella, good afternoon.

Ella Fried: Good afternoon.

Kobi Kagan: This is Kobi. As we indicated back in our investor event, we are planning this year, in 2023, we are building each quarter to transform the backlog to revenues with increased sales quarter-after-quarter in 2023. That means that in order to be able to fulfill this backlog for 2023, we need, of course, to buy raw materials, to invest more in WIP and we were doing that in the first quarter.

This is according to our plan, to have those inventories ready to be transformed to revenues in 2023, and some of that in 2024. So that is just a way for us to build the additional revenues, the increased revenues that we are expecting in the coming quarters.

Ella Fried: Okay. So we should be looking at it as a positive indicator. Okay. I have a couple of more questions. In two weeks, you are going to Paris, to the Le Bourget Air Show. And you obviously will return with even more orders and with even more massive backlog. And it’s just a follow-up to all these questions that were asked. How do you plan to cope with even more massive backlog in the short, medium term? I mean, it seems that you will be really getting lots of orders and attempts to order. And I mean, will you be taking more these orders like the American leading companies, or other? Or are you implementing any other strategy with more, I don’t know if you have the possibility, with more outsourcing?

Butzi Machlis: Thank you, Ella, Butzi. You are right. We see a growing demand for our products and systems, and we see a very big funnel ahead of us. And that's exactly what we took it an account. That's exactly why we took a decision to invest to enhance our facilities in Israel, as well as abroad. Just to remind all of us, we are expanding our Yokneam facility here in the North part of Israel to support more Land Systems revenues. We expanded our radio facility in the North part of the country in order to support growth and revenues of the C4I and Cyber segment.

And we did the same in Rehovot to support more revenues coming from our ISTAR division. We already mentioned the new UAV facility we are building these days, and we are going to open it by the end of this year. And that's on top of the Ramat Beka investment, which we started to build three years back, and we'll go live next year. That's only in Israel. Abroad, a new facility in the UK, in South Carolina, a new facility in Bristol, UK, which we are going to open very soon. A new facility, which was inaugurated already, in Germany, to deliver more equipment to European customers. So we took in account the growing demand. We have mature products. We are local in our markets, via the dozens of subsidiaries we have all over Europe and all around the globe. And we will be able to take more orders from the growing demand that we see, and to convert it in relatively short period of time, to revenues and to profit. And because of that, we felt confident to mention the 6.5 to 7 billion dollar revenues that we will be able to achieve, with a level of 10% OP.

Ella Fried: Well, it sounds like lots of work. I have another follow-up question. Does it mean that we should be looking again at your pipeline? I mean, this also calls for some kind of, I don't know, M&A, or any kind of new acquisitions in the pipeline that will help all this workload?

Butzi Machlis: Yes. The answer Ella is yes. But this is not just to handle the workload. There are two main reasons for Elbit to do M&A. One is to expand our market position. And because of this, for example, we took the decision to acquire Sparton in the US, in order to build a stronger position in the US Navy. And because of that, we took another decision to acquire the night vision business in the US as well, to improve our position in the army, US Army. These are just two examples. So, one reason is to look for new markets, new market positions. The other reason is new markets, and new market positions, this is mainly in the US and in Europe.

And the other type of M&A we are looking for is new technologies. And an example for that is the acquisition of Rokar, which we acquired a few years back in Jerusalem, which brought us new technologies to the company.

So, we have proven already in the past that we know how to do M&A really in a good way. We know how to create synergies between the new companies that we are acquiring to the portfolio of Elbit, the current portfolio of Elbit, and we know how to manage it. And so we certainly look for more opportunities to expand the company in these two aspects.

At the same time, I would like to mention that we are all the time reviewing our portfolio. And we are making sure that what we have a portfolio fits the strategy of the company today. Because of that, a year ago, we took a decision to divest Ashot Ashkelon, which was a great company. But we took a decision to divest it, not because it was not a good company. The reason for that was because it was not synergetic to the Elbit portfolio. So we took a decision to divest it, and we were happy that FIMI took a decision to acquire from us, and it was a good deal for us and for them. So we continue this process as well. In parallel of looking for new M&A, we are checking our portfolio all the time making sure that the current portfolio which we have fits the current strategy of the company.

Ella Fried: So can you shed a bit more light on both directions? Or we have to wait?

Butzi Machlis: I have nothing special to report right now. But I can tell you that we are working in both directions currently.

Ella Fried: Okay. That sounds interesting. And thank you for taking so many questions. I think maybe somebody wants to follow me.

Operator: If there are any additional questions, please press star-one. If you wish to cancel your request, please press star-two. Please stand by while we poll for more questions. There are no further questions at this time. Before I ask Mr. Machlis to go ahead with his closing statement, I would like to remind participants that a replay of this call will be available two hours after the conference ends. In the US, please call 1-888-782-4291. In Israel, please call 03-925-5-900. And internationally, please call 972-3-925-5-900. A replay of this call will also be available on the company's website, www.elbitsystems.com.

Mr. Machlis, would you like to make your concluding statement?

Butzi Machlis: Thank you. I would like to thank all our employees for their continued hard work and contribution to Elbit Systems' success. To everyone on the call, thank you for joining us today and for your continued support and interest in our company. Have a good day, and goodbye.

Operator: Thank you. This concludes the Elbit Systems Ltd. first quarter 2023 results conference call. Thank you for your participation. You may go ahead and disconnect.

[End of conference call.]