ASTRONICS CORP
Form 10-Q
November 08, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

ý Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended October 1, 2016
or

¨ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission File Number 0-7087

ASTRONICS CORPORATION
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| New York | 16-0959303 |
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification Number) |
| 130 Commerce Way, East Aurora, New York | 14052 |
| (Address of principal executive offices) | (Zip code) |

(716) 805-1599
(Registrant's telephone number, including area code)
NOT APPLICABLE
(Former name, former address and former fiscal year, if changed since last report)
Securities registered pursuant to Section 12(g) of the Act:
$.01 par value Common Stock, $.01 par value Class B Stock
(Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “large accelerated filer”, an “accelerated filer”, a “non-accelerated filer” and a “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ý Accelerated filer ¨

Non-accelerated filer ¨ Smaller Reporting Company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý

As of October 1, 2016, 29,039,097 shares of common stock were outstanding consisting of 19,478,408 shares of common stock ($.01 par value) and 9,560,689 shares of Class B common stock ($.01 par value).

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Part I – Financial Information
Item 1. Financial Statements
ASTRONICS CORPORATION
Consolidated Condensed Balance Sheets
October 1, 2016 with Comparative Figures for December 31, 2015
(In thousands)

| | October 1, 2016 (Unaudited) | December 31, 2015 |
|---|---|---|
| Current Assets: | | |
| Cash and Cash Equivalents | $ 13,278 | $ 18,561 |
| Accounts Receivable, Net of Allowance for Doubtful Accounts | 118,888 | 95,277 |
| Inventories | 120,691 | 115,467 |
| Prepaid Expenses and Other Current Assets | 13,100 | 20,662 |
| Total Current Assets | 265,957 | 249,967 |
| Property, Plant and Equipment, Net of Accumulated Depreciation | 123,754 | 124,742 |
| Other Assets | 13,035 | 10,889 |
| Intangible Assets, Net of Accumulated Amortization | 101,037 | 108,276 |
| Goodwill | 115,645 | 115,369 |
| Total Assets | $ 619,428 | $ 609,243 |
| Current Liabilities: | | |
| Current Maturities of Long-term Debt | $ 2,686 | $ 2,579 |
| Accounts Payable | 27,493 | 27,138 |
| Accrued Expenses and Other Current Liabilities | 35,236 | 35,758 |
| Customer Advance Payments and Deferred Revenue | 27,805 | 38,757 |
| Total Current Liabilities | 93,220 | 104,232 |
| Long-term Debt | 161,305 | 167,210 |
| Other Liabilities | 35,532 | 37,576 |
| Total Liabilities | 290,057 | 309,018 |
| Shareholders' Equity: | | |
| Common Stock | 296 | 294 |
| Accumulated Other Comprehensive Loss | (13,318) | (15,064) |
| Other Shareholders' Equity | 342,393 | 314,995 |
| Total Shareholders' Equity | 329,371 | 300,225 |
| Total Liabilities and Shareholders' Equity | $ 619,428 | $ 609,243 |

See notes to consolidated condensed financial statements.

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ASTRONICS CORPORATION
Consolidated Condensed Statements of Operations
Three and Nine Months Ended October 1, 2016 With Comparative Figures for 2015
(Unaudited)
(In thousands, except per share data)

| | Nine Months Ended | | Three Months Ended | |
|---|---|---|---|---|
| | October 1, 2016 | October 3, 2015 | October 1, 2016 | October 3, 2015 |
| Sales | $479,055 | $534,939 | $155,099 | $200,145 |
| Cost of Products Sold | 356,074 | 385,898 | 116,436 | 140,718 |
| Gross Profit | 122,981 | 149,041 | 38,663 | 59,427 |
| Selling, General and Administrative Expenses | 65,246 | 66,213 | 21,138 | 22,297 |
| Income from Operations | 57,735 | 82,828 | 17,525 | 37,130 |
| Interest Expense, Net of Interest Income | 3,246 | 3,600 | 1,103 | 1,243 |
| Income Before Income Taxes | 54,489 | 79,228 | 16,422 | 35,887 |
| Provision for Income Taxes | 15,950 | 26,161 | 4,348 | 11,193 |
| Net Income | $38,539 | $53,067 | $12,074 | $24,694 |
| Earnings Per Share: | | | | |
| Basic | $1.32 | $1.82 | $0.42 | $0.84 |
| Diluted | $1.28 | $1.76 | $0.41 | $0.82 |

See notes to consolidated condensed financial statements.

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ASTRONICS CORPORATION
Consolidated Condensed Statements of Comprehensive Income
Three and Nine Months Ended October 1, 2016 With Comparative Figures for 2015
(Unaudited)
(In thousands)

| | Nine Months Ended | | Three Months Ended | |
|---|---|---|---|---|
| | October 1, 2016 | October 3, 2015 | October 1, 2016 | October 3, 2015 |
| Net Income | $38,539 | $53,067 | $12,074 | $24,694 |
| Other Comprehensive Income (Loss): | | | | |
| Foreign Currency Translation Adjustments | 1,354 | (3,410) | 49 | (196) |
| Retirement Liability Adjustment – Net of Tax | 392 | 484 | 130 | 161 |
| Other Comprehensive Income (Loss) | 1,746 | (2,926) | 179 | (35) |
| Comprehensive Income | $40,285 | $50,141 | $12,253 | $24,659 |

See notes to consolidated condensed financial statements.

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ASTRONICS CORPORATION
Consolidated Condensed Statements of Cash Flows
Nine Months Ended October 1, 2016
With Comparative Figures for 2015
(Unaudited)
(In thousands)

| | Nine Months Ended | |
|---|---|---|
| | October 1, 2016 | October 3, 2015 |
| Cash Flows From Operating Activities: | | |
| Net Income | $38,539 | $53,067 |
| Adjustments to Reconcile Net Income to Cash Provided By Operating Activities: | | |
| Depreciation and Amortization | 19,457 | 18,831 |
| Provisions for Non-Cash Losses on Inventory and Receivables | 1,554 | 1,513 |
| Stock Compensation Expense | 1,876 | 1,740 |
| Deferred Tax Benefit | (3,527) | (243) |
| Non-cash Earnout Liability Adjustment | — | (1,576) |
| Other | 401 | 21 |
| Cash Flows from Changes in Operating Assets and Liabilities: | | |
| Accounts Receivable | (23,707) | (29,796) |
| Inventories | (5,113) | (4,805) |
| Accounts Payable | 211 | (1,656) |
| Accrued Expenses | (786) | 5,662 |
| Other Current Assets and Liabilities | (460) | (498) |
| Customer Advanced Payments and Deferred Revenue | (11,281) | (5,396) |
| Income Taxes | 6,860 | 5,072 |
| Supplemental Retirement and Other Liabilities | 1,126 | 1,238 |
| Cash Provided By Operating Activities | 25,150 | 43,174 |
| Cash Flows From Investing Activities: | | |
| Acquisition of Business, Net of Cash Acquired | — | (52,606) |
| Capital Expenditures | (9,869) | (15,857) |
| Other Investing Activities | (1,585) | (2,677) |
| Cash Used For Investing Activities | (11,454) | (71,140) |
| Cash Flows From Financing Activities: | | |
| Proceeds from Long-term Debt | 20,000 | 55,000 |
| Payments for Long-term Debt | (25,909) | (29,008) |
| Purchase of Outstanding Shares for Treasury | (17,446) | — |
| Debt Acquisition Costs | (164) | — |
| Proceeds from Exercise of Stock Options | 3,902 | 3,308 |
| Acquisition Earnout Payments | — | (2) |
| Income Tax Benefit from Exercise of Stock Options | 529 | 619 |
| Cash (Used For) Provided By Financing Activities | (19,088) | 29,917 |
| Effect of Exchange Rates on Cash | 109 | (715) |
| (Decrease) Increase in Cash and Cash Equivalents | (5,283) | 1,236 |
| Cash and Cash Equivalents at Beginning of Period | 18,561 | 21,197 |
| Cash and Cash Equivalents at End of Period | $13,278 | $22,433 |

See notes to consolidated condensed financial statements.

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ASTRONICS CORPORATION
Notes to Consolidated Condensed Financial Statements
October 1, 2016
(Unaudited)

1) Basis of Presentation

The accompanying unaudited statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation have been included.

All share quantities and per share data reported have been restated to reflect the impact of the three-for-twenty Class B stock distribution to shareholders of record on October 11, 2016.

Operating Results

The results of operations for any interim period are not necessarily indicative of results for the full year. Operating results for the nine months ended October 1, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016.

The balance sheet at December 31, 2015 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements.

For further information, refer to the financial statements and footnotes thereto included in Astronics Corporation's 2015 annual report on Form 10-K.

Description of the Business

Astronics Corporation ("Astronics" or the "Company") is a leading supplier of products to the global aerospace, defense, electronics and semiconductor industries. Our products and services include advanced, high-performance electrical power generation, distribution and motion systems, lighting & safety systems, avionics products, aircraft structures, systems certification and automated test systems.

We have operations in the United States ("U.S."), Canada and France. We design and build our products through our wholly owned subsidiaries Armstrong Aerospace, Inc. ("Armstrong"); Astronics Advanced Electronic Systems Corp. ("AES"); Astronics AeroSat Corporation ("AeroSat"); Ballard Technology, Inc. ("Ballard"); Astronics DME LLC ("DME"); Luminescent Systems, Inc. ("LSI"); Luminescent Systems Canada, Inc. ("LSI Canada"); Max-Viz, Inc. ("Max-Viz"); Peco, Inc. ("Peco"); PGA Electronic s.a. ("PGA") and Astronics Test Systems, Inc. ("ATS").

Cost of Products Sold, Engineering and Development and Selling, General and Administrative Expenses

Cost of products sold includes the costs to manufacture products such as direct materials and labor and manufacturing overhead as well as all engineering and development costs. The Company is engaged in a variety of engineering and design activities as well as basic research and development activities directed to the substantial improvement or new application of the Company's existing technologies. These costs are expensed when incurred and included in cost of products sold. Research and development, design and related engineering amounted to $22.2 million and $22.5 million for the three months ended and $67.5 million and $66.1 million for the nine months ended October 1, 2016 and October 3, 2015, respectively. Selling, general and administrative expenses include costs primarily related to our sales and marketing departments and administrative departments. Interest expense is shown net of interest income. Interest income was insignificant for the three and nine months ended October 1, 2016 and October 3, 2015.

Foreign Currency Translation

The aggregate transaction gain or loss included in operations was insignificant for the three and nine months ended October 1, 2016 and October 3, 2015.

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Accounting Pronouncements Adopted in 2016

There have been no recent accounting pronouncements that have had an impact on the Company's financial statements.

2) Inventories

Inventories are as follows:

| (In thousands) | October 1, 2016 | December 31, 2015 |
|---|---|---|
| Finished Goods | $ 28,974 | $ 27,770 |
| Work in Progress | 24,493 | 23,977 |
| Raw Material | 67,224 | 63,720 |
| | $ 120,691 | $ 115,467 |

3) Property, Plant and Equipment

The following table summarizes Property, Plant and Equipment as follows:

| (In thousands) | October 1, 2016 | December 31, 2015 |
|---|---|---|
| Land | $ 11,174 | $ 11,145 |
| Buildings and Improvements | 79,532 | 78,989 |
| Machinery and Equipment | 96,573 | 89,514 |
| Construction in Progress | 4,580 | 3,282 |
| | 191,859 | 182,930 |
| Less Accumulated Depreciation | 68,105 | 58,188 |
| | $ 123,754 | $ 124,742 |

4) Intangible Assets

The following table summarizes acquired intangible assets as follows:

| (In thousands) | Weighted Average Life | October 1, 2016 Gross Carrying Amount | October 1, 2016 Accumulated Amortization | December 31, 2015 Gross Carrying Amount | December 31, 2015 Accumulated Amortization |
|---|---|---|---|---|---|
| Patents | 5 Years | $ 2,146 | $ 1,404 | $ 2,146 | $ 1,264 |
| Non-compete Agreement | 4 Years | 2,500 | 854 | 2,500 | 479 |
| Trade Names | 7 Years | 10,240 | 2,919 | 10,217 | 2,216 |
| Completed and Unpatented Technology | 6 Years | 24,213 | 8,612 | 24,056 | 6,795 |
| Backlog | Less than 1 Year | 11,226 | 11,202 | 11,202 | 10,793 |
| Customer Relationships | 12 Years | 97,253 | 21,550 | 96,472 | 16,770 |
| Total Intangible Assets | 6 Years | $ 147,578 | $ 46,541 | $ 146,593 | $ 38,317 |

All acquired intangible assets other than goodwill and one trade name are being amortized. Amortization expense for acquired intangibles is summarized as follows:

| (In thousands) | Nine Months Ended October 1, 2016 | Nine Months Ended October 3, 2015 | Three Months Ended October 1, 2016 | Three Months Ended October 3, 2015 |
|---|---|---|---|---|
| Amortization Expense | $ 8,202 | $ 8,534 | $ 2,595 | $ 2,761 |

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Amortization expense for acquired intangible assets expected for 2016 and for each of the next five years is summarized as follows:

| (In thousands) | |
|---|---|
| 2016 | $10,871 |
| 2017 | 10,454 |
| 2018 | 10,141 |
| 2019 | 9,740 |
| 2020 | 9,206 |
| 2021 | 9,160 |

5) Goodwill

The following table summarizes the changes in the carrying amount of goodwill for the nine months ended October 1, 2016:

| (In thousands) | December 31, 2015 | Acquisition | Foreign Currency Translation | October 1, 2016 |
|---|---|---|---|---|
| Aerospace | $ 115,369 | $ — | $ 276 | $ 115,645 |
| Test Systems | — | — | — | — |
| | $ 115,369 | $ — | $ 276 | $ 115,645 |

6) Long-term Debt and Notes Payable

The Company’s obligations under the Credit Agreement as amended are jointly and severally guaranteed by each domestic subsidiary of the Company other than a non-material subsidiary. The obligations are secured by a first priority lien on substantially all of the Company’s and the guarantors’ assets.

The Company's Credit Agreement consists of a $350 million revolving credit line with the option to increase the line by up to $150 million. On January 13, 2016, the Company amended the Agreement to add a new lender and extend the maturity date of the credit facility from September 26, 2019 to January 13, 2021. At October 1, 2016 there was $151.0 million outstanding on the revolving credit facility and there remains $197.9 million available, net of outstanding letters of credit. The credit facility allocates up to $20 million of the $350 million revolving credit line for the issuance of letters of credit, including certain existing letters of credit. At October 1, 2016, outstanding letters of credit totaled $1.1 million.

The maximum permitted leverage ratio of funded debt to Adjusted EBITDA (as defined in the Agreement) is 3.5 to 1, increasing to 4.0 to 1 for up to two fiscal quarters following the closing of an acquisition permitted under the Agreement. The Company will pay interest on the unpaid principal amount of the facility at a rate equal to one-, three- or six-month LIBOR plus between 137.5 basis points and 225 basis points based upon the Company’s leverage ratio. The Company will also pay a commitment fee to the lenders in an amount equal to between 17.5 basis points and 35 basis points on the undrawn portion of the credit facility, based upon the Company’s leverage ratio. The Company must also maintain a minimum interest coverage ratio (Adjusted EBITDA to interest expense) of 3.0 to 1 for the term of the Agreement. The Company’s interest coverage ratio was 29.9 to 1 at October 1, 2016. The Company’s leverage ratio was 1.52 to 1 at October 1, 2016.

In the event of voluntary or involuntary bankruptcy of the Company or any subsidiary, all unpaid principal and other amounts owing under the Agreement automatically become due and payable. Other events of default, such as failure to make payments as they become due and breach of financial and other covenants, change of control, judgments over a certain amount, and cross default under other agreements give the Agent the option to declare all such amounts immediately due and payable.

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7) Product Warranties

In the ordinary course of business, the Company warrants its products against defects in design, materials and workmanship typically over periods ranging from 12 to 60 months. The Company determines warranty reserves needed by product line based on experience and current facts and circumstances. Activity in the warranty accrual is summarized as follows:

| (In thousands) | Nine Months Ended | | Three Months Ended | |
|---|---|---|---|---|
| | October 1, 2016 | October 3, 2015 | October 1, 2016 | October 3, 2015 |
| Balance at Beginning of Period | $5,741 | $ 4,884 | $5,361 | $ 5,319 |
| Acquisitions | — | 500 | — | — |
| Warranties Issued | 1,806 | 1,553 | 600 | 414 |
| Warranties Settled | (1,906) | (2,164) | (616) | (737) |
| Reassessed Warranty Exposure | (313) | 1,130 | (17) | 907 |
| Balance at End of Period | $5,328 | $ 5,903 | $5,328 | $ 5,903 |

8) Income Taxes

The effective tax rates were approximately 29.3% and 33.0% for the nine months ended and 26.5% and 31.2% for the three months ended October 1, 2016 and October 3, 2015, respectively. The tax rates in 2016 were favorably impacted by the inclusion of the federal research and development tax credit due to its permanent reinstatement in the fourth quarter of 2015.

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9) Shareholders' Equity

The changes in shareholders' equity for the nine months ended October 1, 2016 are summarized as follows as adjusted to reflect the impact of the three-for-twenty distribution of Class B Stock as discussed in Note 10:

| (Dollars and Shares in thousands) | Amount | Number of Shares | |
|---|---|---|---|
| | | Common Stock | Convertible Class B Stock |
| Shares Authorized | | 40,000 | 15,000 |
| Share Par Value | | $0.01 | $ 0.01 |
| COMMON STOCK | | | |
| Beginning of Period | $294 | 19,349 | 10,006 |
| Conversion of Class B Shares to Common Shares | — | 509 | (509) |
| Exercise of Stock Options | 2 | 138 | 64 |
| End of Period | $296 | 19,996 | 9,561 |
| ADDITIONAL PAID IN CAPITAL | | | |
| Beginning of Period | $57,827 | | |
| Stock Compensation Expense | 1,876 | | |
| Exercise of Stock Options | 4,429 | | |
| End of Period | $64,132 | | |
| ACCUMULATED OTHER COMPREHENSIVE LOSS | | | |
| Beginning of Period | $(15,064) | | |
| Foreign Currency Translation Adjustment | 1,354 | | |
| Retirement Liability Adjustment – Net of Tax | 392 | | |
| End of Period | $(13,318) | | |
| RETAINED EARNINGS | | | |
| Beginning of Period | $257,168 | | |
| Net Income | 38,539 | | |
| End of Period | $295,707 | | |
| TREASURY STOCK | | | |
| Beginning of Period | $— | — | |
| Purchase | (17,446) | (517) | |
| End of Period | $(17,446) | (517) | |
| TOTAL SHAREHOLDERS' EQUITY | | | |
| Beginning of Period | $300,225 | | |
| End of Period | $329,371 | 19,479 | 9,561 |

On February 24, 2016, the Company's Board of Directors authorized the repurchase of up to $50 million of common stock (the "Buyback Program"). The Buyback Program allows the Company to purchase shares of its common stock in accordance with applicable securities laws on the open market or through privately negotiated transactions. The Buyback Program may be suspended or discontinued at any time. Under this program the Company has repurchased approximately 517,000 shares for $17.5 million.

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10) Earnings Per Share

Basic and diluted weighted-average shares outstanding are as follows:

| (In thousands) | Nine Months Ended | | Three Months Ended | |
|---|---|---|---|---|
| | October 1, 2016 | October 3, 2015 | October 1, 2016 | October 3, 2015 |
| Weighted Average Shares - Basic | 29,199 | 29,203 | 28,925 | 29,274 |
| Net Effect of Dilutive Stock Options | 937 | 970 | 883 | 876 |
| Weighted Average Shares - Diluted | 30,136 | 30,173 | 29,808 | 30,150 |

The above information has been adjusted to reflect the impact of the three-for-twenty Class B stock distribution to shareholders of record on October 11, 2016.

Stock options with exercise prices greater than the average market price of the underlying common shares are excluded from the computation of diluted earnings per share because they are out-of-the-money and the effect of their inclusion would be anti-dilutive. The number of common shares covered by out-of-the-money stock options at October 1, 2016 was approximately 41,000 shares.

11) Accumulated Other Comprehensive Loss and Other Comprehensive Loss

The components of accumulated other comprehensive loss are as follows:

| (In thousands) | October 1, 2016 | December 31, 2015 |
|---|---|---|
| Foreign Currency Translation Adjustments | $(6,617) | $ (7,971) |
| Retirement Liability Adjustment – Before Tax | (10,310) | (10,912) |
| Tax Benefit | 3,609 | 3,819 |
| Retirement Liability Adjustment – After Tax | (6,701) | (7,093) |
| Accumulated Other Comprehensive Loss | $(13,318) | $ (15,064) |

The components of other comprehensive income (loss) are as follows:

| (In thousands) | Nine Months Ended | | Three Months Ended | |
|---|---|---|---|---|
| | October 1, 2016 | October 3, 2015 | October 1, 2016 | October 3, 2015 |
| Foreign Currency Translation Adjustments | $1,354 | $ (3,410) | $49 | $ (196) |
| Retirement Liability Adjustments: | | | | |
| Reclassifications to General and Administrative Expense: | | | | |
| Amortization of Prior Service Cost | 329 | 390 | 110 | 130 |
| Amortization of Net Actuarial Losses | 273 | 356 | 90 | 119 |
| Tax Benefit | (210) | (262) | (70) | (88) |
| Retirement Liability Adjustment | 392 | 484 | 130 | 161 |
| Other Comprehensive Income (Loss) | $1,746 | $ (2,926) | $179 | $ (35) |

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12) Supplemental Retirement Plan and Related Post Retirement Benefits

The Company has two non-qualified supplemental retirement defined benefit plans ("SERP" and "SERP II") for certain executive officers. The following table sets forth information regarding the net periodic pension cost for the plans.

| (In thousands) | Nine Months Ended | | Three Months Ended | |
|---|---|---|---|---|
| | October 1, 2016 | October 3, 2015 | October 1, 2016 | October 3, 2015 |
| Service Cost | $130 | $ 145 | $43 | $ 49 |
| Interest Cost | 675 | 633 | 225 | 211 |
| Amortization of Prior Service Cost | 310 | 371 | 103 | 123 |
| Amortization of Net Actuarial Losses | 257 | 336 | 86 | 113 |
| Net Periodic Cost | $1,372 | $ 1,485 | $457 | $ 496 |

Participants in the SERP are entitled to paid medical, dental and long-term care insurance benefits upon retirement under the plan. The following table sets forth information regarding the net periodic cost recognized for those benefits:

| (In thousands) | Nine Months Ended | | Three Months Ended | |
|---|---|---|---|---|
| | October 1, 2016 | October 3, 2015 | October 1, 2016 | October 3, 2015 |
| Service Cost | $ 4 | $ 3 | $ 1 | $ 1 |
| Interest Cost | 30 | 30 | 10 | 10 |
| Amortization of Prior Service Cost | 19 | 19 | 7 | 7 |
| Amortization of Net Actuarial Losses | 16 | 20 | 4 | 6 |
| Net Periodic Cost | $ 69 | $ 72 | $ 22 | $ 24 |

13) Sales to Major Customers

The Company has a significant concentration of business with two major customers, each in excess of 10% of consolidated sales. The loss of either of these customers would significantly, negatively impact our sales and earnings. Sales to these two customers represented 21% and 15% of consolidated sales for the nine months ended and 21% and 15% for the three months ended October 1, 2016. Sales to these customers were in the Aerospace segment. Accounts receivable from these customers at October 1, 2016 was approximately $35.9 million. Sales to these two customers represented 21% and 13% of consolidated sales for the nine months ended October 3, 2015 and 19% and 12% for the three months ended October 3, 2015.

14) Legal Proceedings

The Company is subject to various legal proceedings, claims, and litigation arising in the ordinary course of business. While the outcome of these matters is currently not determinable, we do not expect these matters will have a material adverse effect on our business, financial position, results of operations, or cash flows. However, the results of these matters cannot be predicted with certainty. Should the Company fail to prevail in any legal matter or should several legal matters be resolved against the Company in the same reporting period, then the financial results of that particular reporting period could be materially adversely affected.

On December 29, 2010, Lufthansa Technik AG ("Lufthansa") filed a Statement of Claim in the Regional State Court of Mannheim, Germany. Lufthansa's claim asserts that our subsidiary, AES sold, marketed and brought into use in Germany a power supply system which infringes upon a German patent held by Lufthansa. The relief sought by Lufthansa includes requiring AES to stop selling and marketing the allegedly infringing power supply system, a recall of allegedly infringing products sold to commercial customers since November 26, 2003 and compensation for damages. The claim does not specify an estimate of damages and a damages claim will be made by Lufthansa only if

it receives a favorable ruling on the determination of infringement. The value of the dispute has been set by the Court to be €2 million. This is an estimate of the commercial value of the matter.

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On February 6, 2015, the Regional State Court of Mannheim, Germany rendered its decision that the patent was infringed. The judgment does not require AES to recall products which are already installed in aircraft or have been sold to other end users. On July 15, 2015, Lufthansa advised AES of their intention to enforce the accounting provisions of the decision, which required AES to provide certain financial information regarding sales of the infringing product to enable Lufthansa to make an estimate of requested damages. Additionally, if Lufthansa provides the required bank guarantee specified in the decision, the Company may be required to offer a recall of products which are in the distribution channels in Germany. No such bank guarantee has been issued to date.

The Company appealed and believes it has valid defenses to refute the decision. The appeal was heard on October 12, 2016 at the Higher Regional Court of Karlsruhe. Should that ruling be unfavorable, the Company may choose to appeal to the Federal Supreme Court. The enforcement of the accounting provision of the decision, as discussed above, has no impact on the appeals process. As a result, we do not currently have sufficient information to provide an estimate of AES's potential exposure related to this matter. As loss exposure is neither probable nor estimable at this time, the Company has not recorded any liability with respect to this litigation as of October 1, 2016. The Court is scheduled to issue its decision on November 9, 2016.

On November 26, 2014, Lufthansa filed a complaint in the United States District for the Western District of Washington. Lufthansa's complaint in this action alleges that AES manufactures, uses, sells and offers for sale a power supply system which infringes upon a U.S. patent held by Lufthansa. The patent at issue in the U.S. action is based on technology similar to that involved in the German action. On April 25, 2016, the Court issued its ruling on claim construction, holding that the sole independent claim in the patent is indefinite, rendering all claims in the patent indefinite. Based on this ruling, AES filed a motion for summary judgment on the grounds that the Court's ruling that the patent is indefinite renders the patent invalid and unenforceable. On July 20, 2016 the U.S. District Court granted the motion for summary judgment and issued an order dismissing all claims against AES with prejudice. Lufthansa has filed an appeal with the United States Court of Appeals for the Federal Circuit. The Company believes that it has valid defenses to Lufthansa's claims and will vigorously contest the appeal. As loss exposure is neither probable nor estimable at this time, the Company has not recorded any liability with respect to this litigation as of October 1, 2016.

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15) Segment Information

Below are the sales and operating profit by segment for the three and nine months ended October 1, 2016 and October 3, 2015 and a reconciliation of segment operating profit to income before income taxes. Operating profit is net sales less cost of products sold and other operating expenses excluding interest and corporate expenses. Cost of products sold and other operating expenses are directly identifiable to the respective segment.

| (Dollars in thousands) | Nine Months Ended | | Three Months Ended | |
|---|---|---|---|---|
| | October 1, 2016 | October 3, 2015 | October 1, 2016 | October 3, 2015 |
| Sales | | | | |
| Aerospace | $406,356 | $413,250 | $125,179 | $138,728 |
| Less Intersegment Sales | (367) | — | — | — |
| Total Aerospace Sales | 405,989 | 413,250 | 125,179 | 138,728 |
| | | | | |
| Test Systems | $73,066 | $121,744 | $29,920 | $61,417 |
| Less Intersegment Sales | — | (55) | — | — |
| Total Test Systems Sales | 73,066 | 121,689 | 29,920 | 61,417 |
| Total Consolidated Sales | $479,055 | $534,939 | $155,099 | $200,145 |
| Operating Profit and Margins | | | | |
| Aerospace | $61,099 | $66,728 | $17,557 | $23,055 |
| | 15.0 % | 16.1 % | 14.0 % | 16.6 % |
| Test Systems | 6,524 | 24,618 | 3,240 | 16,980 |
| | 8.9 % | 20.2 % | 10.8 % | 27.6 % |
| Total Operating Profit | 67,623 | 91,346 | 20,797 | 40,035 |
| | 14.1 % | 17.1 % | 13.4 % | 20.0 % |
| Deductions from Operating Profit | | | | |
| Interest Expense, Net of Interest Income | 3,246 | 3,600 | 1,103 | 1,243 |
| Corporate Expenses and Other | 9,888 | 8,518 | 3,272 | 2,905 |
| Income Before Income Taxes | $54,489 | $79,228 | $16,422 | $35,887 |

Total Assets:

| (In thousands) | October 1, 2016 | December 31, 2015 |
|---|---|---|
| Aerospace | $510,064 | $ 510,884 |
| Test Systems | 88,457 | 64,934 |
| Corporate | 20,907 | 33,425 |
| Total Assets | $619,428 | $ 609,243 |

16) Fair Value

A fair value measurement assumes that the transaction to sell an asset or transfer a liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. Fair value is based upon an exit price model. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and involves consideration of factors specific to the asset or liability.

The Company follows a valuation hierarchy for disclosure of the inputs to valuation used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.

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Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument.
Level 3 inputs are unobservable inputs based on our own assumptions used to measure assets and liabilities at fair value.
On a Recurring Basis:
A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement. The financial liabilities carried at fair value measured on a recurring basis consisted of contingent consideration related to certain prior acquisitions, valued at zero at October 1, 2016 and December 31, 2015, determined using Level 3 inputs.

On a Non-recurring Basis:
The Company estimates the fair value of reporting units, utilizing unobservable Level 3 inputs. Level 3 inputs require significant management judgment due to the absence of quoted market prices or observable inputs for assets of a similar nature. The Company utilizes a discounted cash flow analysis to estimate the fair value of reporting units utilizing unobservable inputs. The fair value measurement of the reporting unit under the step-one and step-two analysis of the quantitative goodwill impairment test are classified as Level 3 inputs.
Intangible assets that are amortized are evaluated for recoverability whenever adverse effects or changes in circumstances indicate that the carrying value may not be recoverable. The recoverability test consists of comparing the undiscounted projected cash flows with the carrying amount. Should the carrying amount exceed undiscounted projected cash flows, an impairment loss would be recognized to the extent the carrying amount exceeds fair value.
For the Company's indefinite-lived intangible asset, the impairment test consists of comparing the fair value, determined using the relief from royalty method, with its carrying amount. An impairment loss would be recognized for the carrying amount in excess of its fair value.
Due to their short-term nature, the carrying value of cash and equivalents, accounts receivable, accounts payable, and notes payable approximate fair value. The carrying value of the Company's variable rate long-term debt instruments also approximates fair value due to the variable rate feature of these instruments. As of October 1, 2016, the Company concluded that no indicators of impairment relating to intangible assets or goodwill existed and an interim test was not performed.

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17) Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09") which simplifies several aspects of the accounting for employee share-based payment transactions. The guidance makes several modifications to the accounting for forfeitures, employer tax withholding on share-based compensation and the financial statement presentation of excess tax benefits or deficiencies. In addition, ASU 2016-09 clarifies the statement of cash flows presentation for certain components of share-based awards. The standard is effective for interim and annual reporting periods beginning after December 15, 2016, although early adoption is permitted. The Company is currently assessing how the adoption of this standard will impact the financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases ("ASU 2016-02") which requires the lease rights and obligations arising from lease contracts, including existing and new arrangements, to be recognized as assets and liabilities on the balance sheet. The standard also requires additional disclosures by lessees and contains targeted changes to accounting by lessors. ASU 2016-02 is effective for annual periods beginning after December 15, 2018, including interim periods within those annual periods, with early adoption permitted. The guidance is required to be adopted at the earliest period presented using a modified retrospective approach. The Company is currently assessing the impact on the financial statements.

In May 2014, the FASB issued ASU 2014-9, Revenue from Contracts with Customers. This new standard is effective for reporting periods beginning after December 15, 2017, pursuant to the issuance of ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of Effective Date issued in August 2015. The comprehensive new standard will supersede existing revenue recognition guidance and require revenue to be recognized when promised goods or services are transferred to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. Adoption of the new rules could affect the timing of revenue recognition for certain transactions. The guidance permits two implementation approaches, one requiring retrospective application of the new standard with restatement of prior years and one requiring prospective application of the new standard with disclosure of results under old standards. Early adoption is not permitted. The Company is currently evaluating the impacts of adoption and the implementation approach to be used.

18) Acquisitions

Armstrong Aerospace, Inc.

On January 14, 2015, the Company purchased 100% of the equity of Armstrong for $52.6 million in cash. Armstrong, located in Itasca, Illinois, is a leading provider of engineering, design and certification solutions for commercial aircraft, specializing in connectivity, in-flight entertainment, and electrical power systems. Armstrong is included in our Aerospace segment. This transaction was not considered material to the Company's financial position or results of operations. All of the goodwill and

purchased intangible assets are expected to be deductible for tax purposes over 15 years. The purchase price allocation for this acquisition has been finalized.

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## Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(The following should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations contained in the Company's Form 10-K for the year ended December 31, 2015.)

### OVERVIEW

Astronics Corporation ("Astronics" or the "Company") is a leading supplier of products to the global aerospace, defense, electronics and semiconductor industries. Our products and services include advanced, high-performance electrical power generation, distribution and motion systems, lighting & safety systems, avionics products, aircraft structures, systems certification and automated test systems.

Our Aerospace segment designs and manufactures products for the global aerospace industry. Product lines include lighting & safety systems, electrical power generation, distribution and motion systems, aircraft structures, avionics products, systems certification and other products. Our Aerospace customers are the airframe manufacturers ("OEM") that build aircraft for the commercial, military and general aviation markets, suppliers to those OEM's, aircraft operators such as airlines and branches of the U.S. Department of Defense as well as the Federal Aviation Administration and airport operators. Our Test Systems segment designs, develops, manufactures and maintains automated test systems that support the semiconductor, aerospace, communications and weapons test systems as well as training and simulation devices for both commercial and military applications. In the Test Systems segment, Astronics' products are sold to a global customer base including OEM's and prime government contractors for both electronics and military products.

Our strategy is to increase our value by developing technologies and capabilities either internally or through acquisition, and using those capabilities to provide innovative solutions to the aerospace and defense, semiconductor and other markets where our technology can be beneficial.

Important factors affecting our growth and profitability are the rate at which new aircraft are produced, government funding of military programs, our ability to have our products designed into new aircraft and the rates at which aircraft owners, including commercial airlines, refurbish or install upgrades to their aircraft. New aircraft build rates and aircraft owners spending on upgrades and refurbishments is cyclical and dependent on the strength of the global economy. Once designed into a new aircraft, the spare parts business is frequently retained by the Company. Future growth and profitability of the Test Systems business is dependent on developing and procuring new and follow-on business in commercial electronics and semiconductor markets as well as with the military. The nature of our Test Systems business is such that it pursues large multi-year projects. There can be significant periods of time between orders in this business which may result in large fluctuations of sales and profit levels and backlog from period to period.

### ACQUISITIONS

On January 14, 2015, the Company purchased 100% of the equity of Armstrong Aerospace, Inc. ("Armstrong") for $52.6 million in cash. Specializing in connectivity, in-flight entertainment, and electrical power systems, Armstrong is a leading provider of engineering design and certification solutions for commercial aircraft, and is located in Itasca, Illinois. Armstrong is included in our Aerospace segment.

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CONSOLIDATED RESULTS OF OPERATIONS AND OUTLOOK

| (Dollars in thousands) | Nine Months Ended | | | | Three Months Ended | | | |
|---|---|---|---|---|---|---|---|---|
| | October 1, 2016 | | October 3, 2015 | | October 1, 2016 | | October 3, 2015 | |
| Sales | $479,055 | | $534,939 | | $155,099 | | $200,145 | |
| Gross Profit (sales less cost of products sold) | $122,981 | | $149,041 | | $38,663 | | $59,427 | |
| Gross Margin | 25.7 | % | 27.9 | % | 24.9 | % | 29.7 | % |
| Selling, General and Administrative Expenses | $65,246 | | $66,213 | | $21,138 | | $22,297 | |
| SG&A Expenses as a Percentage of Sales | 13.6 | % | 12.4 | % | 13.6 | % | 11.1 | % |
| Interest Expense, Net of Interest Income | $3,246 | | $3,600 | | $1,103 | | $1,243 | |
| Effective Tax Rate | 29.3 | % | 33.0 | % | 26.5 | % | 31.2 | % |
| Net Income | $38,539 | | $53,067 | | $12,074 | | $24,694 | |

A discussion by segment can be found at “Segment Results of Operations and Outlook” in this MD&A.

CONSOLIDATED THIRD QUARTER RESULTS

Consolidated sales were down $45.0 million from the same period last year. Aerospace segment sales of $125.2 million were down $13.5 million and Test Systems segment sales of $29.9 million were down $31.5 million.

Consolidated cost of products sold in the third quarter decreased $24.3 million to $116.4 million from $140.7 million for the same period last year, primarily due to lower sales volume. Engineering and development (“E&D”) costs were $22.2 million in the third quarter of 2016, down slightly from $22.5 million of E&D costs in last year’s third quarter. As a percent of sales, E&D was 14.3% and 11.3% in the third quarters of 2016 and 2015, respectively.

Selling, general and administrative (“SG&A”) expenses decreased $1.2 million compared with the 2015 third quarter, due primarily to lower commissions on lower sales volumes in the third quarter of 2016 compared with 2015.

The effective tax rate for the third quarter was 26.5%, compared with 31.2% in the third quarter of 2015. The tax rate in the third quarter of 2016 was favorably impacted by the permanent reinstatement of the federal research and development tax credit in the fourth quarter of 2015.

Net income for the 2016 third quarter was $12.1 million compared with $24.7 million in the prior-year period. Diluted earnings per share for the 2016 third quarter were $0.41 compared with $0.82 in the prior-year period.

CONSOLIDATED YEAR-TO-DATE RESULTS

Consolidated sales for the first nine months of 2016 decreased by $55.9 million, or 10.4%, to $479.1 million. Aerospace segment sales were down 1.8% year-over-year to $406.0 million, while Test Systems segment sales were down 40.0% to $73.1 million.

Consolidated costs of products sold decreased $29.8 million to $356.1 million from $385.9 million in the first nine months of 2015. The decrease was the result of lower sales volume. E&D costs were $67.5 million in the first nine months of 2016, up slightly from $66.1 million of E&D costs in the first nine months of 2015. As a percent of sales, E&D was 14.1% and 12.4% in the first nine months of 2016 and 2015, respectively.

SG&A expenses were $65.2 million, or 13.6% of sales, in the first nine months of 2016 compared with $66.2 million, or 12.4% of sales, in the same period last year. The first nine months of 2015 benefited from a $1.6 million reduction to the contingent consideration liability related to prior acquisitions. Lower SG&A expenses were due primarily to reduced commissions resulting from lower volumes.

The effective tax rate for the first nine months of 2016 was 29.3%, compared with 33.0% in the first nine months of 2015. The tax rate in the first nine months of 2016 was favorably impacted by the permanent reinstatement of the federal research and development tax credit in the fourth quarter of 2015.

Net income for the first nine months of 2016 totaled $38.5 million, or $1.28 per diluted share.

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During the third quarter, the Company repurchased approximately 157,000 shares at an aggregate cost of $5.3 million under its share repurchase program. Since the inception of the program in February 2016, the Company has repurchased approximately 517,000 shares at an aggregate cost of $17.5 million.

CONSOLIDATED OUTLOOK

Consolidated sales in 2016 are forecasted to be in the range of $635 million to $645 million. Approximately $539 million to $545 million of revenue is expected from the Aerospace segment. Expectations for Test Systems segment revenue in 2016 remains relatively unchanged at approximately $96 million to $100 million.

Consolidated backlog at October 1, 2016 was $275.2 million, of which $121.9 million is expected to ship in 2016.

The effective tax rate for 2016 is expected to be approximately 29% to 31%.

Capital equipment spending in 2016 is planned to be in the range of $15 million to $17 million. E&D costs are expected to be similar to 2015.

SEGMENT RESULTS OF OPERATIONS AND OUTLOOK

Operating profit, as presented below, is sales less cost of products sold and other operating expenses, excluding interest expense and other corporate expenses. Cost of products sold and other operating expenses are directly identifiable to the respective segment. Operating profit is reconciled to earnings before income taxes in Note 15 of the Notes to Consolidated Condensed Financial Statements included in this report.

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AEROSPACE SEGMENT

| (In thousands) | Nine Months Ended | | Three Months Ended | |
|---|---|---|---|---|
| | October 1, 2016 | October 3, 2015 | October 1, 2016 | October 3, 2015 |
| Sales | | | | |
| Aerospace | $406,356 | $413,250 | $125,179 | $138,728 |
| Less Intersegment Sales | (367) | — | — | — |
| Total Aerospace Sales | $405,989 | $413,250 | $125,179 | $138,728 |
| Operating Profit | $61,099 | $66,728 | $17,557 | $23,055 |
| Operating Margin | 15.0% | 16.1% | 14.0% | 16.6% |
| | | | | |
| Aerospace Sales by Market | | | | |
| (In thousands) | | | | |
| Commercial Transport | $331,174 | $342,839 | $101,355 | $115,016 |
| Military | 39,932 | 31,929 | 13,679 | 12,102 |
| Business Jet | 20,365 | 25,196 | 6,133 | 8,043 |
| Other | 14,518 | 13,286 | 4,012 | 3,567 |
| | $405,989 | $413,250 | $125,179 | $138,728 |
| Aerospace Sales by Product Line | | | | |
| (In thousands) | | | | |
| Electrical Power & Motion | $219,215 | $208,578 | $68,259 | $71,164 |
| Lighting & Safety | 121,520 | 119,949 | 38,975 | 39,965 |
| Avionics | 22,684 | 41,628 | 5,866 | 12,598 |
| Systems Certification | 12,577 | 16,465 | 2,580 | 6,120 |
| Structures | 15,475 | 12,418 | 5,487 | 4,388 |
| Other | 14,518 | 14,212 | 4,012 | 4,493 |
| | $405,989 | $413,250 | $125,179 | $138,728 |

| (In thousands) | October 1, 2016 | December 31, 2015 |
|---|---|---|
| Total Assets | $510,064 | $510,884 |
| Backlog | $233,443 | $212,651 |

AEROSPACE THIRD QUARTER RESULTS

Aerospace segment sales decreased by $13.5 million, or 9.8%, when compared with the prior year's third quarter to $125.2 million.

The majority of the reduction in Aerospace sales was with Avionics products. Avionics declined $6.7 million, largely due to lower sales of satellite antenna systems, which have new products in the certification process, and in-flight entertainment/cabin management systems for VVIP aircraft, which has been impacted by the decline in the global oil and gas industry, primarily in the Middle East. Additionally, Systems Certification sales declined $3.5 million on lower project activity. Electrical Power & Motion sales declined $2.9 million, as lower sales of in-seat power products were partially offset by an improvement in sales of seat motion products.

Aerospace operating profit for the third quarter of 2016 was $17.6 million, or 14.0% of sales, compared with $23.1 million, or 16.6% of sales, in the same period last year. The decrease in operating profit was the result of lower volumes. Aerospace E&D costs were $18.9 million in the quarter compared with $19.3 million in the same period last year.

Aerospace orders in the third quarter of 2016 were $122.8 million, compared with orders of $129.8 million in the 2015 third quarter. The Aerospace segment book to bill ratio for the quarter was 0.98.

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AEROSPACE YEAR-TO-DATE RESULTS

Aerospace segment sales decreased by $7.3 million, or 1.8%, when compared with the prior year's first nine months to $406.0 million.

Electrical Power & Motion sales grew $10.6 million, or 5.1%, largely driven by higher sales of in-seat power products and seat motion products, which were up $7.2 million and $4.9 million, respectively. Sales of Structures products were up $3.1 million and Lighting & Safety products were up $1.6 million. These increases were offset by an $18.9 million decline in Avionics products, which was largely due to lower sales of satellite antenna systems and lower VVIP in-flight entertainment/cabin management systems, and a $3.9 million decrease in System Certification sales.

Aerospace operating profit for the first nine months of 2016 was $61.1 million, or 15.0% of sales, compared with $66.7 million, or 16.1% of sales, in the same period last year. The decrease in operating profit was the result of lower volume, coupled with higher E&D costs and a general increase in operating costs. E&D costs for Aerospace were $58.3 million and $57.3 million in the first nine months of 2016 and 2015, respectively. Aerospace SG&A expense increased $1.1 million in the first nine months of 2016 as compared with 2015. The first nine months of 2015 included inventory step-up costs of $1.0 million that reduced normal operating margins for that period.

AEROSPACE OUTLOOK

We expect 2016 sales for our Aerospace segment to be in the range of $539 million to $545 million. The Aerospace segment's backlog at the end of the third quarter of 2016 was $233.4 million with approximately $104.3 million expected to be shipped over the remaining part of 2016 and $206.4 million is expected to ship over the next 12 months.

TEST SYSTEMS SEGMENT

| | Nine Months Ended | | Three Months Ended | |
|---|---|---|---|---|
| (In thousands) | October 1, 2016 | October 3, 2015 | October 1, 2016 | October 3, 2015 |
| Sales | $73,066 | $121,744 | $29,920 | $61,417 |
| Less Intersegment Sales | — | (55) | — | — |
| Net Sales | $73,066 | $121,689 | $29,920 | $61,417 |
| Operating profit (loss) | $6,524 | $24,618 | $3,240 | $16,980 |
| Operating Margin | 8.9% | 20.2% | 10.8% | 27.6% |

| Test Systems Sales by Market | | | | |
|---|---|---|---|---|
| (In thousands) | | | | |
| Semiconductor | $33,863 | $86,224 | $16,878 | $49,966 |
| Aerospace & Defense | 39,203 | 35,465 | 13,042 | 11,451 |
| | $73,066 | $121,689 | $29,920 | $61,417 |

| (In thousands) | October 1, 2016 | December 31, 2015 |
|---|---|---|
| Total Assets | $88,457 | $64,934 |
| Backlog | $41,784 | $61,713 |

TEST SYSTEMS THIRD QUARTER RESULTS

Sales in the third quarter of 2016 decreased approximately $31.5 million to $29.9 million compared with the same period in 2015, a decrease of 51.3%. Sales to the Semiconductor market decreased $33.1 million compared with the same period in 2015, which was partially offset by increased sales of $1.6 million to the Aerospace & Defense market.

Operating profit was $3.2 million, or 10.8% of sales, compared with $17.0 million or 27.6% of sales in last year's third quarter. E&D costs remained relatively consistent at $3.3 million and $3.2 million in the third quarters of 2016 and 2015, respectively.

Orders for the Test Systems segment in the quarter were $13.7 million, down $1.7 million, or 10.8%, over the prior year period.

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TEST SYSTEMS YEAR-TO-DATE RESULTS

Sales in the first nine months of 2016 decreased 40.0% to $73.1 million compared with sales of $121.7 million for the same period in 2015, due to lower shipments to the Semiconductor market. Sales to the Semiconductor market decreased $52.3 million compared with the same period in 2015, which was partially offset by increased sales of $3.7 million to the Aerospace & Defense market.

Operating profit was $6.5 million, or 8.9% of sales, compared with $24.6 million, or 20.2% of sales, in the first nine months of 2015. E&D costs were $9.2 million in the first nine months of 2016 compared with $8.8 million in the prior year period.

TEST SYSTEMS OUTLOOK

We expect sales for the Test Systems segment for 2016 to be in the range of $96 million to $100 million. The Test Systems segment’s backlog at the end of the third quarter of 2016 was $41.8 million with approximately $17.6 million expected to be shipped over the remaining part of 2016 and approximately $36.1 million scheduled to ship over the next 12 months.

LIQUIDITY AND CAPITAL RESOURCES

Operating Activities:

Cash provided by operating activities totaled $25.2 million for the first nine months of 2016, as compared with $43.2 million during the same period in 2015. Cash flow from operating activities increased primarily due to the impact of decreases in net income and net operating assets for the first nine months of 2016 when compared with the first nine months of 2015.

Investing Activities:

Cash used for investing activities was $11.5 million for the first nine  months of 2016 compared with $71.1 million used in the same period of 2015. Cash used for capital expenditures was $9.9 million in the first nine months of 2016 compared with $15.9 million in the prior year period. The Company expects capital spending in 2016 to be in the range of $15 million to $17 million. Cash used for the acquisition of Armstrong in January 2015 was $52.6 million.

Financing Activities:

The primary financing activities in 2016 relate to borrowings and payments on our senior credit facility to fund operations, and purchases of treasury stock as part of the buyback program announced on February 24, 2016, under which the Board of Directors authorized the repurchase of up to $50 million of common stock.

The Company’s obligations under the Credit Agreement as amended are jointly and severally guaranteed by each domestic subsidiary of the Company other than a non-material subsidiary. The obligations are secured by a first priority lien on substantially all of the Company’s and the guarantors’ assets.

The Company's Credit Agreement consists of a $350 million revolving credit line with the option to increase the line by up to $150 million. On January 13, 2016, the Company amended the Agreement to add a new lender and extend the maturity date of the credit facility from September 26, 2019 to January 13, 2021. At October 1, 2016 there was $151.0 million outstanding on the revolving credit facility and there remains $197.9 million available, net of outstanding letters of credit. The credit facility allocates up to $20 million of the $350 million revolving credit line for the issuance of letters of credit, including certain existing letters of credit. At October 1, 2016, outstanding letters of credit totaled $1.1 million.

The maximum permitted leverage ratio of funded debt to Adjusted EBITDA (as defined in the Agreement) is 3.5 to 1, increasing to 4.0 to 1 for up to two fiscal quarters following the closing of an acquisition permitted under the Agreement. The Company will pay interest on the unpaid principal amount of the facility at a rate equal to one-, three- or six-month LIBOR plus between 137.5 basis points and 225 basis points based upon the Company’s leverage ratio. The Company will also pay a commitment fee to the lenders in an amount equal to between 17.5 basis points and 35 basis points on the undrawn portion of the credit facility, based upon the Company’s leverage ratio. The Company must also maintain a minimum interest coverage ratio (Adjusted EBITDA to interest expense) of 3.0 to 1 for the term of the Agreement. The Company’s interest coverage ratio was 29.9 to 1 at October 1, 2016. The Company’s leverage ratio was 1.52 to 1 at October 1, 2016.

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In the event of voluntary or involuntary bankruptcy of the Company or any subsidiary, all unpaid principal and other amounts owing under the Agreement automatically become due and payable. Other events of default, such as failure to make payments as they become due and breach of financial and other covenants, change of control, judgments over a certain amount, and cross default under other agreements give the Agent the option to declare all such amounts immediately due and payable.

BACKLOG

The Company’s backlog at October 1, 2016 was $275.2 million compared with $274.4 million at December 31, 2015 and $297.0 million at October 3, 2015.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

The Company's contractual obligations and commercial commitments have not changed materially from those disclosed in the Company's Form 10-K for the year ended December 31, 2015.

MARKET RISK

The Company believes that there have been no material changes in the current year regarding the market risk information for its exposure to interest rate fluctuations. Although the majority of our sales, expenses and cash flows are transacted in U.S. dollars, we have exposure to changes in foreign currency exchange rates related to the Euro and the Canadian dollar. The Company believes that the impact of changes in foreign currency exchange rates in 2016 have not been significant.

CRITICAL ACCOUNTING POLICIES

Refer to the Company’s annual report on Form 10-K for the year ended December 31, 2015 for a complete discussion of the Company’s critical accounting policies.

RECENT ACCOUNTING PRONOUNCEMENTS

In March 2016, the Financial Accounting Standards Board ("FASB”) issued Accounting Standards Update (“ASU”) 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (“ASU 2016-09”) which simplifies several aspects of the accounting for employee share-based payment transactions. The guidance makes several modifications to the accounting for forfeitures, employer tax withholding on share-based compensation and the financial statement presentation of excess tax benefits or deficiencies. In addition, ASU 2016-09 clarifies the statement of cash flows presentation for certain components of share-based awards. The standard is effective for interim and annual reporting periods beginning after December 15, 2016, although early adoption is permitted. The Company is currently assessing how the adoption of this standard will impact the financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (“ASU 2016-02”) which requires the lease rights and obligations arising from lease contracts, including existing and new arrangements, to be recognized as assets and liabilities on the balance sheet. The standard also requires additional disclosures by lessees and contains targeted changes to accounting by lessors. ASU 2016-02 is effective for annual periods beginning after December 15, 2018, including interim periods within those annual periods, with early adoption permitted. The guidance is required to be adopted at the earliest period presented using a modified retrospective approach. The Company is currently assessing how the adoption of the standard will impact the financial statements.

In May 2014, the FASB issued ASU 2014-9, Revenue from Contracts with Customers. This new standard is effective for reporting periods beginning after December 15, 2017, pursuant to the issuance of ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of Effective Date issued in August 2015. The comprehensive new standard will supersede existing revenue recognition guidance and require revenue to be recognized when promised goods or services are transferred to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. Adoption of the new rules could affect the timing of revenue recognition for certain transactions. The guidance permits two implementation approaches, one requiring retrospective application of the new standard with restatement of prior years and one requiring prospective application of the new standard with disclosure of results under old standards. Early adoption is not permitted. The Company is currently

evaluating the impacts of adoption and the implementation approach to be used.

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FORWARD-LOOKING STATEMENTS

Information included in this report that does not consist of historical facts, including statements accompanied by or containing words such as “may,” “will,” “should,” “believes,” “expects,” “expected,” “intends,” “plans,” “projects,” “approxim “estimates,” “predicts,” “potential,” “outlook,” “forecast,” “anticipates,” “presume” and “assume,” are forward-looking stateme Such forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance and are subject to several factors, risks and uncertainties, the impact or occurrence of which could cause actual results to differ materially from the expected results described in the forward-looking statements. Certain of these factors, risks and uncertainties are discussed in the sections of this report entitled “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” New factors, risks and uncertainties may emerge from time to time that may affect the forward-looking statements made herein. Given these factors, risks and uncertainties, investors should not place undue reliance on forward-looking statements as predictive of future results. We disclaim any obligation to update the forward-looking statements made in this report.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

See Market Risk in Item 2, above.

Item 4. Controls and Procedures

a) The Company’s management, with the participation of the Company’s Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company’s disclosure controls and procedures as of October 1, 2016. Based on that evaluation, the Company’s Chief Executive Officer and Chief Financial Officer concluded that the Company’s disclosure controls and procedures were effective as of October 1, 2016.

b) Changes in Internal Control over Financial Reporting - There have been no changes in our internal control over financial reporting during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The Company is subject to various legal proceedings, claims, and litigation arising in the ordinary course of business. While the outcome of these matters is currently not determinable, we do not expect these matters will have a material adverse effect on our business, financial position, results of operations, or cash flows. However, the results of these matters cannot be predicted with certainty. Should the Company fail to prevail in any legal matter or should several legal matters be resolved against the Company in the same reporting period, then the financial results of that particular reporting period could be materially adversely affected.

On December 29, 2010, Lufthansa Technik AG ("Lufthansa") filed a Statement of Claim in the Regional State Court of Mannheim, Germany. Lufthansa's claim asserts that our subsidiary, AES sold, marketed and brought into use in Germany a power supply system which infringes upon a German patent held by Lufthansa. The relief sought by Lufthansa includes requiring AES to stop selling and marketing the allegedly infringing power supply system, a recall of allegedly infringing products sold to commercial customers since November 26, 2003 and compensation for damages. The claim does not specify an estimate of damages and a damages claim will be made by Lufthansa only if it receives a favorable ruling on the determination of infringement. The value of the dispute has been set by the Court to be €2 million. This is an estimate of the commercial value of the matter.

On February 6, 2015, the Regional State Court of Mannheim, Germany rendered its decision that the patent was infringed. The judgment does not require AES to recall products which are already installed in aircraft or have been sold to other end users. On July 15, 2015, Lufthansa advised AES of their intention to enforce the accounting provisions of the decision, which required AES to provide certain financial information regarding sales of the infringing product to enable Lufthansa to make an estimate of requested damages. Additionally, if Lufthansa provides the required bank guarantee specified in the decision, the Company may be required to offer a recall of products which are in the distribution channels in Germany. No such bank guarantee has been issued to date.

The Company appealed and believes it has valid defenses to refute the decision. The appeal was heard on October 12, 2016 at the Higher Regional Court of Karlsruhe. Should that ruling be unfavorable, the Company may choose to appeal to the Federal Supreme Court. The enforcement of the accounting provision of the decision, as discussed above, has no impact on the appeals process. As a result, we do not currently have sufficient information to provide an estimate of AES's potential exposure related to this matter. As loss exposure is neither probable nor estimable at this time, the Company has not recorded any liability with respect to this litigation as of October 1, 2016. The Court is scheduled to issue its decision on November 9, 2016.

On November 26, 2014, Lufthansa filed a complaint in the United States District for the Western District of Washington. Lufthansa's complaint in this action alleges that AES manufactures, uses, sells and offers for sale a power supply system which infringes upon a U.S. patent held by Lufthansa. The patent at issue in the U.S. action is based on technology similar to that involved in the German action. On April 25, 2016, the Court issued its ruling on claim construction, holding that the sole independent claim in the patent is indefinite, rendering all claims in the patent indefinite. Based on this ruling, AES filed a motion for summary judgment on the grounds that the Court's ruling that the patent is indefinite renders the patent invalid and unenforceable. On July 20, 2016 the U.S. District Court granted the motion for summary judgment and issued an order dismissing all claims against AES with prejudice. Lufthansa has filed an appeal with the United States Court of Appeals for the Federal Circuit. The Company believes that it has valid defenses to Lufthansa's claims and will vigorously contest the appeal. As loss exposure is neither probable nor estimable at this time, the Company has not recorded any liability with respect to this litigation as of October 1, 2016. Other than this proceeding, we are not party to any significant pending legal proceedings that management believes will result in material adverse effect on our financial condition or results of operations.

Item 1a Risk Factors

In addition to other information set forth in this report, you should carefully consider the factors discussed in Part 1, Item 1A. “Risk Factors,” in our Annual Report on Form 10-K for the year ended December 31, 2015, which could materially affect our business, financial condition or results of operations. The risks described in our Annual Report on Form 10-K are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or results of operations.

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Item 2. Unregistered sales of equity securities and use of proceeds
(c) The following table summarizes our purchases of our common stock for the quarter ended October 1, 2016.

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid Per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Dollar Value of Shares that may yet be Purchased Under the Program (1) |
|---|---|---|---|---|
| July 3, 2016 - October 1, 2016 | 157,287 | $33.64 | 517,401 | $32,554,000 |

(1) On February 24, 2016, the Company's Board of Directors authorized the repurchase of up to $50 million of common stock.
Item 3. Defaults Upon Senior Securities
None.
Item 4. Mine Safety Disclosures
None.
Item 5. Other Information
None.
Item 6. Exhibits

| | |
|---|---|
| Exhibit 31.1 | Section 302 Certification - Chief Executive Officer |
| Exhibit 31.2 | Section 302 Certification - Chief Financial Officer |
| Exhibit 32. | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 101.1* | Instance Document |
| Exhibit 101.2* | Schema Document |
| Exhibit 101.3* | Calculation Linkbase Document |
| Exhibit 101.4* | Labels Linkbase Document |
| Exhibit 101.5* | Presentation Linkbase Document |
| Exhibit 101.6* | Definition Linkbase Document |

*Submitted electronically herewith.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ASTRONICS CORPORATION
(Registrant)

Date: November 8, 2016 By: /s/ David C. Burney
David C. Burney
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)