

April 5, 2023

ISSC: Little-Known Aviation Flight Systems Player With Catalysts; Initiating With a Buy Rating and \$11 Price Target

We initiate coverage of Innovative Solutions and Support, Inc. (ISSC) with a Buy rating and a price target of \$11, which represents 29x our 2024 adjusted EPS estimate, or possibly 21x if \$15 million of annual sales are acquired by October.

Innovative Solutions and Support is a designer, manufacturer and integrator of aviation display systems, advanced monitoring systems, primary flight guidance and autothrottle systems for new aircraft and retrofit of existing older fleets. ISSC's flight controls, computers, GPS and display systems provide the aircraft altitude, airspeed, engine data, outside temperature and vertical speed. ISSC focuses on commercial cargo transportation planes, light and medium-sized business jets and military aircraft. ISSC specializes in retrofit upgrades, new aircraft supply, maintenance, repair and service of cockpit flat panel display systems. It has a trusted reputation as a highly effective integrator of cockpit avionics. This year's growth should be driven by the Pilatus PC-24 (mid-sized business jet), the Textron King Air 260/360, the KC-46A Pegasus (Boeing military air-to-air refueling and strategic transport aircraft) and Boeing cargo transportation aircraft.

A new management team took over last year following the passing of the former CEO, who was also the company's founder. The current management team is more willing to pursue sales growth, new product development and sensible bolt-on acquisitions. Importantly, we estimate that ISSC can improve its operating utilization to trigger a significant step-up in EBITDA margin, from 27% to 31%, if it reaches \$45 million in annual sales (versus \$28 million last year). An incremental \$15 million of revenues would increase its capacity utilization from 33% to nearly 54%, which we calculate could trigger a 75% incremental gross margin. We expect ISSC to execute this strategy by seeking to acquire a target by October, which could add \$0.14 EPS (37% accretion) to our 2024 forecast.

ISSC has niches with its autothrottle system and Utilities Management System (UMS). Its autothrottle helps the pilot's workload, has a fail-safe actuator and minimizes engine damage from over-torquing or under-speed conditions. Its UMS replaces up to 22 control boxes to control and monitor an aircraft and can act as a substitute for one of the two pilots on a medium-sized business jet.

The UMS can enable a ground-based pilot to intervene in the rare event of an emergency such as pilot death, loss of consciousness or severe weather. ISSC's UMS became FAA-certified in 2018 for the Pilatus PC-24 business jet and is installed in more than two hundred of them. This semi-autonomous flight system has a 2-year payback. While there is an attractive target market for the UMS in business jets, we do not expect it to be adopted on any narrowbody commercial passenger planes, as a backup system, until after 2030. However, there could be earlier inroads made with smaller regional passenger planes (CRJ200, ERJ145, EMB120).

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MARKET DATA

Rating	Buy
Price Target	\$11.00
Price	\$7.34
Average Daily Volume	18
52-Week Range	\$5.77-\$9.90
Market Cap (\$M)	\$127.6
Enterprise Value (\$M)	\$110.6
Book Value	\$32.1
Dividend Yield	0.0%

ESTIMATES

		2022A	2023E	2024E
Revenue (\$M)	Q1	6.7	6.5	7.3
--	Q2	6.8	6.9	7.8
	Q3	6.9	7.3	8.1
	Q4	7.3	7.8	8.2
	FY	27.7	28.5	31.5
EV/Sales		4.0x	3.9x	3.5x
EBITDA Adjusted	Q1	1.6	1.2	1.9
	Q2	2.1	1.3	2.0
	Q3	1.8	1.7	2.2
	Q4	2.4	2.1	2.4
	FY	7.9	6.3	8.6
EV/EBITDA		14.0	17.6	12.9
EPS Adjusted	Q1	0.07	0.05	0.08
	Q2	0.09	0.06	0.09
	Q3	0.08	0.08	0.10
	Q4	0.09	0.09	0.10
	FY	0.33	0.28	0.37
P/E		22.2x	26.2x	19.8x

One Year Performance Chart



Please see analyst certification and important disclosures on page 21 of this report.

Under-the-Radar Stock. In our view, this stock has low investor awareness. We believe that EF Hutton (with this report) is currently the only sell-side equity research firm to publish estimates uploaded to the mainstream data providers. Furthermore, we recently toured ISSC's production facility and R&D center, which helped us gain a better appreciation of its unique innovation and retrofit market advantages. During our visit, we observed its environmental stress-testing, in-house manufacturing of sub-assemblies and quality control screening.

Aging Aircraft Fleets Provide Recurring Revenue Stream. Sales growth drivers include the upgrade mandates by the FAA, aging aircraft fleets, obsolescence, inadequate electronic equipment and demand for new aircraft. Avionics upgrades, ISSC's specialty, are the most cost-effective way to bring older aircraft up to safer flying capabilities. The average age of leading cargo planes (FedEx, DHL, UPS) is 22 years. Approximately 60% of ISSC's revenues are recurring from retrofit aftermarket installations and service. The remaining 40% comes from new aircraft OEM production orders. We estimate that ISSC has a 33% market share in retrofit upgrades for smaller business jets and mainstream cargo planes.

Capacity Utilization Increase for Margin Expansion. We forecast that ISSC can improve its EBITDA margin from 27% to 31%, along with its ROE from 17% to 21%, by improving its capacity utilization from 33% to 54%. This could be achieved through incremental revenues for better operating leverage of its fixed costs. ISSC's direct labor expense is less than 5% of sales, which helps its EBITDA margin expand as more production volumes are added. ISSC estimates that it can more than double its sales without having to incur more than \$1 million in capital expenditure.

Onsite Customer Service and Cost-Effective Integrations. ISSC visits its customer's sites and aircraft hangers to install retrofit upgrades. This makes it more convenient than the customer having to fly their planes to ISSC's facility. ISSC can achieve 33% lower costs than its two main competitors. Most of ISSC's retrofits are accomplished 10-15 days quicker than competitors, which saves the customer lost revenues from the downtime of grounding the plane. Additionally, more than 90% of ISSC's cost inflation is passed through to the customer, which helps ISSC maintain a high gross margin of 60%.

New Product Development. ISSC has a rich history of innovation including a solution for the FAA's mandate to reduce the minimum vertical separation between aircraft by 1,000 feet when flying above 29,000 feet. ISSC's NextGen flightdeck, which has its integrated ThrustSense Autothrottle for retrofits in the PC-12 and King Air dual turboprop PT6, received FAA certification. ISSC's ThrustSense Autothrottle could penetrate more than three hundred King Airs over the next several years. Last month, ISSC announced a win as a system integrator for the new Helix helicopter flight deck. We also expect an engine instruments product to be launched next year for cargo planes.

10% Organic Sales Growth Possible for 2024. The new management team has a 10% organic sales growth goal for 2024. We forecast only 3% sales growth for this year because last year's 20% growth included several large orders for cargo transportation planes that were pulled forward into 2022 and out of early 2023. We estimate that ISSC's two-year average of organic sales growth could be 11% through 2023. We like ISSC's increased R&D spending this year and its recent addition of two executives to drive future growth.

Pilot Shortage and Single Pilot Onboard Solution. There has been a severe pilot shortage in the U.S. for the past two years with an estimated 15,000 job openings (15% of the active workforce). The chronic pilot shortage was caused by a wave of early retirees in 2020 and 2021 during the COVID-19 pandemic as airlines drastically reduced flights. Additionally, fewer pilots are coming from the military and there is a bottleneck for training new pilots. Approximately 34,000 U.S. pilots are expected to retire over the next decade, which will likely worsen the pilot shortage. On peak travel days in the U.S., there are 50,000 scheduled daily flights, typically with not enough pilots to service those peak days.

ISSC's UMS has automatic and constant monitoring of the sensors and actuator controls on the plane, while improving system redundancy and wire clutter. We estimate the UMS costs \$150,000-200,000 per plane and has a two-year payback from salary and benefits savings for not needing a second onboard pilot. ISSC could generate \$7 million of UMS sales this year if Pilatus manufactures 40 of the PC-24 aircraft (same volume as in 2022).

This week, a new movie is being released on Amazon Prime Video entitled *On a Wing and a Prayer*. It is inspired by a true story of a passenger who was coached to land a King Air private plane (a customer of ISSC) after the sole pilot dies of a heart attack during a flight in 2009. We acknowledge the life-saving importance of having a remote navigation and landing system installed on planes. While ISSC has a solution for an autonomous plane without any on-board pilots, we instead envision a gradual migration to one onboard pilot, instead of two, in certain types of planes (see page 8). A few years from now, we would not be surprised to see the UMS become added, as a backup system, to assist a single pilot in emergencies on smaller passenger planes and possibly military helicopters.

Acquisition Strategy. We estimate that potential acquisitions could add 37% EPS accretion to our 2024 forecast (see page 12). By improving its capacity utilization at its owned production facility in Pennsylvania, ISSC could drive significant operating margin expansion. We expect ISSC to acquire \$15 million of annual revenues by October, which can help ISSC reach the \$45

million annual sales inflection point for a step-up in EBITDA margin in 2024. In December, ISSC created an internal development team to pursue complementary acquisitions. ISSC had \$19 million of cash last quarter and could add a revolver credit facility. In September, ISSC filed an S-3 shelf registration to sell up to \$100 million of securities.

Valuation. Our \$11 price target is based on a 29x P/E multiple of our 2024 adjusted EPS of \$0.37 compared to the peer group average of 27x P/E 2024. We believe ISSC warrants a 10% premium for its above-average EBITDA margin next year and firepower for accretive acquisitions in the near-term. If ISSC acquires \$15 million of annual sales by October, this could add \$0.14 EPS and our \$11 price target could equate to pro-forma 21x P/E 2024 and 13x EV/EBITDA 2024.

Investment Risks. Risks include liquidity of the shares (low average daily volume traded), loss of a major customer, customer concentration, a severe slowdown in sales of its UMS product to Pilatus, quality control issues, failure of a major product, bankruptcy or insolvency of a large customer and acquisition integration.

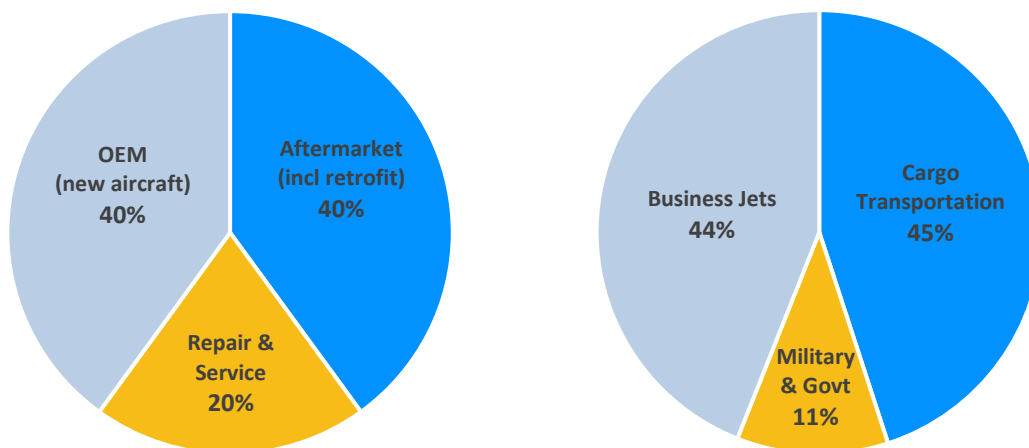
Overview

Innovative Solutions and Support (ISSC) is a systems designer, manufacturer and integrator of aviation cockpit display systems, engine display systems, primary flight guidance, advanced monitoring systems and autothrottle systems for new aircraft and retrofit of existing older fleets. ISSC's flight controls, computers, GPS and display systems can sense and provide the aircraft altitude, airspeed, engine data and vertical speed. Its primary customers are the manufacturers or operators of cargo transportation planes, private jets, business jets and military aircraft. ISSC also does retrofit upgrades, maintenance, repair and service of flight deck flat panel display systems. Nearly 40% of its sales are from new products (OEMs) and 60% are from retrofit aftermarket installations and service.

ISSC was founded in 1988 and its headquarters is located northwest of Philadelphia, PA. The stock was listed in 2000 on the Nasdaq Stock Exchange. ISSC has more than 50 global patents and several pending. It owns its expandable manufacturing facility. Most of its sales are from flat panel display systems, the autothrottle and the UMS. Its UMS for Pilatus PC-24 became an important component of sales since 2019. We estimate that prices, per aircraft, are \$90,000 for the autothrottle, \$200,000 for a cockpit display full shipset and \$175,000 for the UMS without the installation kit (\$200,000+ installed).

In 2022, 60% of its sales were from the United States and 40% were international.

Sales Mix 2022



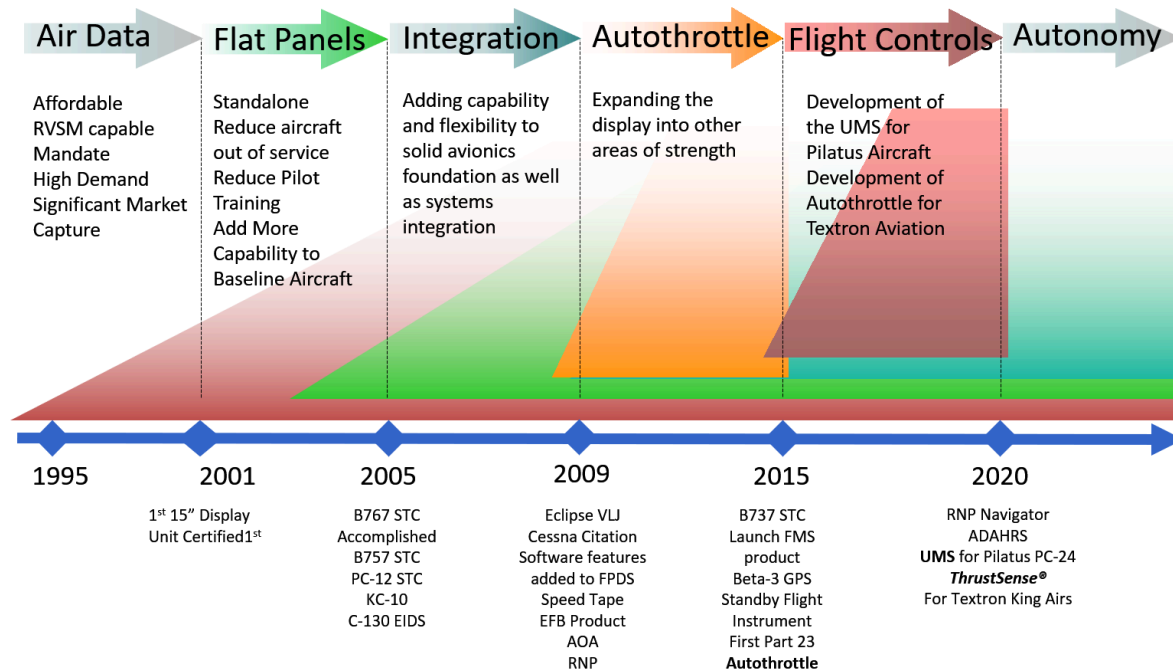
Source: Company Documents & Filings, EF Hutton estimates of mix

Blue-Chip Customers in Public and Private Sectors



Source: Company Presentation

Business Model Evolution

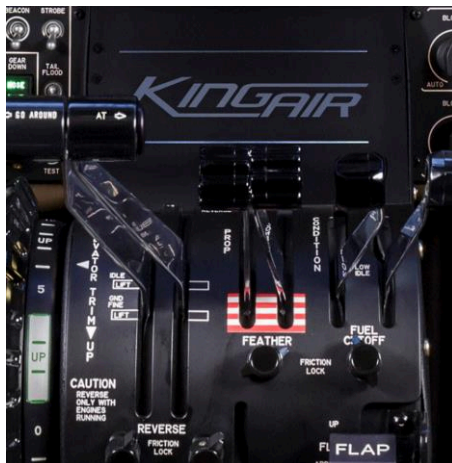


Source: Company Presentation

Autothrottle

ISSC's ThrustSense Autothrottle increases situational awareness, quickly reduces the pilot's workload and has protection modes for over-torque, over-speed, under-speed and over-heating. Its patented algorithms and engine sensors allow for power-level migration if one of the two engines fails, causing unbalanced thrust. Autothrottle recalibrates the thrust to avoid over-powering the plane's remaining engine, which can cause the plane to stall or flip over. The rare crashes on twin-engine planes tend to occur during the initial climb after takeoff. Autothrottle assists with take-off roll, take off, climb, cruise, descent, approach maneuvering and landing. It also achieves 3% fuel savings and helps reduce engine damage and maintenance costs. We estimate that the autothrottle sells for \$90,000 per plane.

It is FAA certified for the King Air 200/300, King Air 260/360, Pilatus PC-12 and NG.



Features:	IS&S ThrustSense	Autothrottle	FADEC
Over Temperature Protection	●		●
Over Torque Protection	●		●
Over Speed Protection	●	●	
Under Speed Protection	●	●	
Speed Select	●	●	
Torque Select	●		●
Hot Start Protection	● Option		●
Haptic Alert Warns of Exceedances	● Option		
Automatic Turbulence Speed Va Scheduling	●		
Approach Speeds with Wind Shear Alert	●		
Max L/D Loiter	●		
Torque Schedule as a Function of Altitude	●		

Source: Company Presentation & Company Website

Before and After Cockpit Upgrades by ISSC (737 and PC-12)



Source: Corporate Headquarters Wall (bottom left is Boeing 737 cockpit, bottom right is Pilatus PC-12 cockpit)

End Markets and Programs

Most of this year’s sales are likely to come from the Pilatus PC-24 (business jet), the Textron King Air 360/260 (business jet) and Boeing 757/767 commercial air cargo transportation aircraft. Currently, ISSC specializes in business jets and private jets that can seat 6-10 passengers.

Aircraft Platform	System Description
Business Jet	
Pilatus PC-12	Advanced avionics suite with integrated autothrottle, engine data, GPS units, flight management for approaches Utilities Management System (UMS)
Pilatus PC-24	
King Air 260/360 & 200/300 (Beechcraft)	
Eclipse 550	
Eclipse 500	
Cessna Citation	ThrustSense Autothrottle system on new aircraft and retrofit (King Air 200/300)
	Autothrottle, engine instruments, maps, integrated flight management system, electronic flight bag
	Avio IFMS is next generation digital avionics and integrated flight management system with satellite weather
	Adviz Flat Panel Display to replace and upgrade existing instruments, displays and indicators
Commercial (Cargo Transportation)	
Boeing 737	Flight deck upgrade includes cockpit IP and flat panel displays for upgrades/retrofit
Boeing 757/767	
	Flat panel display system with high-resolution and graphics. Does not require active cooling.
Military	
C-130 by Lockheed Martin	Engine Instrument Display System (EIDS) and Cockpit IP flat panel display system and navigation displays
P-3 by Lockheed Martin	
KDC-10	
KC-46A (Boeing Pegasus aerial tanker)	
	Flat panel display system retrofit upgrade including engine indicators and engine instrument displays systems
	Cockpit IP and flat panel display
	Aerial refueling operator control, display units and alert system for Boeing tanker

Source: Company Website & Filings

Investment Thesis

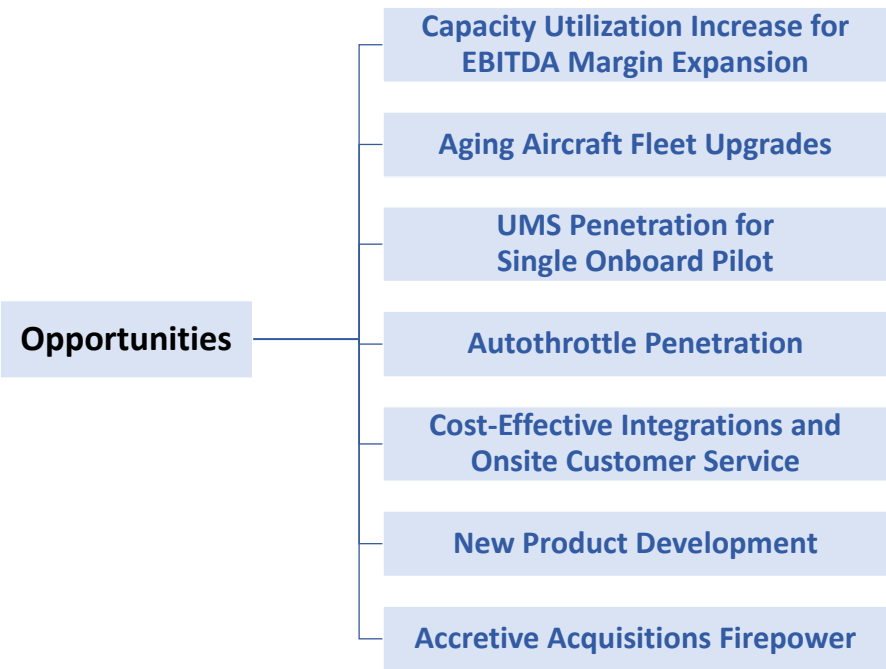
Innovative Solutions and Support is an under-followed stock, which could gain more institutional investor awareness over the next year. We recently visited ISSC’s manufacturing and quality control facility to gain a better appreciation of its niches and growth strategy for 2024.

We believe this stock deserves a premium valuation because of its UMS penetration opportunity, recurring revenues from retrofit upgrades of aging fleets, significant firepower for accretive acquisitions and an EBITDA margin next year higher than its peer group average.

In our view, investors are not fully appreciating how ISSC can utilize its cash balance and take on a reasonable debt to possibly achieve 37% EPS accretion (\$0.14) to our 2024 EPS estimate if it acquires \$15 million of sales. This important thesis component could improve ISSC’s adjusted EBITDA margin to 31% as capacity utilization climbs at its manufacturing facility to better cover its fixed costs. Furthermore, we estimate that the company would not have to spend much on labor hiring or capital expenditures to double its revenues over the next several years.

We see a path to \$0.37-0.51 adjusted EPS in 2024 versus our \$0.28 estimate for this year. We look past this year’s transitory EPS decrease caused by a catch-up of stock-based compensation for the new management team, one-off professional fees and R&D spending catch-up. For next year, we forecast 10% organic sales growth and 30% EPS growth before any potential contribution from acquisitions.

The growth catalysts include the UMS to help alleviate the ongoing pilot shortage, new product development, penetration of autothrottle, penetration of additional business jets, penetration of helicopters, expanding its onsite customer service and cost-effective timely integrations. We estimate that ISSC’s ROE can improve from 17% to 21% if it makes accretive acquisitions.



Source: EF Hutton analysis

Aviation Incidents and Crashes

We realize that some airplane passengers might not feel comfortable with having only one pilot in the cockpit instead of the typical two pilots. Our intention is to highlight the importance of having the UMS installed on aircraft to function as a “safety net” from the sky for helping to reduce the number of emergency landings or crashes. While it is exceedingly rare for a flight to have a major accident, technology exists today, from ISSC, to supplement a pilot’s abilities and act as a backup system.

During the past 21 years in U.S., fatal crashes occurred at approximately one in every 22 million departure flights on commercial airlines. This compares to one fatal car crash for every 100 million miles driven and 12 human fatalities out of every 100,000 registered vehicles. Globally, there were 12 fatal aircraft accidents in 2022, 15 in 2021 and 12 in 2020 for commercial planes with more than 19 passengers. These figures do not account for the additional crashes by civilian planes and business jets.

During the past five years in the U.S., there have been 25 near-collisions on runways or in the air for commercial passenger and cargo planes. During the first three months of this year, there were six near-collisions, four of which were deemed a “narrowly avoided” serious crash by the FAA.

Pilot error, mechanical failure, bad weather and loss of control are the top causes of plane crashes. Approximately 53% of all aviation accidents are attributed to pilot error. Occasionally, a pilot can have trouble with multitasking, which impacts situational awareness and can cause spatial disorientation. This can become more likely in congested areas near major cities or when there is bad weather with low visibility. A pilot, making a series of heading changes, along with several climbs and descents, can create a somatogravic illusion when there is not a clear horizon visible or an external visual reference like mountains or buildings. This can cause a pilot to wrongly perceive the plane is pitching up, when instead it is in a steep descent.

Semi-Autonomous Flight Potential

ISSC’s unique Utilities Management System (UMS) replaces up to 22 independent system boxes on an aircraft to monitor aircraft sensors, control systems and monitor actuators. The UMS can act as a substitute for a co-pilot on light or medium-sized business jets typically up to 10 seats.

The UMS is programmed with artificial intelligence, algorithms, video feed and communication controls of primary flight, secondary flight, surface position, landing gear, ground steering, braking, cabin pressurization, fire protection systems, oxygen systems and lighting. The UMS can improve the reliability for an emergency intervention takeover of piloting the plane from the ground in case of a pilot’s death, passing out, fatigue or disorientation. The UMS has a two-year payback for pilot salary savings, reduces wire clutter and eliminates the need for recertification.

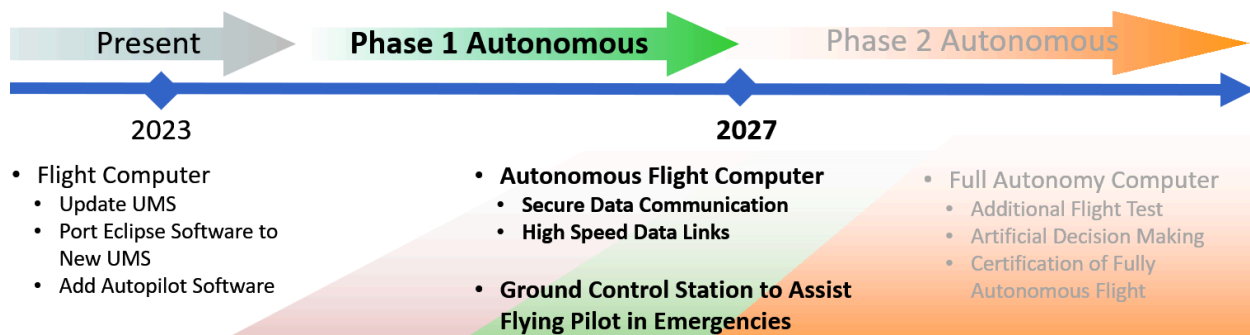
Similar to a drone operator in the military, the UMS can be guided from a ground station by a single certified pilot. One ground station pilot can monitor over fifty UMS-equipped planes simultaneously because of the rare occurrence of coincidental severe incidents. The UMS is FAA-certified for Pilatus PC-24 aircraft (installed base of 200+) and steps are underway for a possible certification and adoption by an additional business jet manufacturer. ISSC is currently developing its autonomous system for Part 135 (aircraft with 30 or fewer seats) in the medium-term and possibly for some medium-sized Part 121 (commercial passenger aircraft) in the long-term (2030 and beyond).

The autopilot landing (autoland) system has existed on planes for several years and we deem ISSC's UMS offering as a similar major step. For comparison, self-driving autonomous cars are possibly seven years away from being adopted in 2030, according to industry sources. However, automated parallel parking and adaptive cruise control features, in new vehicles, are already reliable and popular.

Phase 1

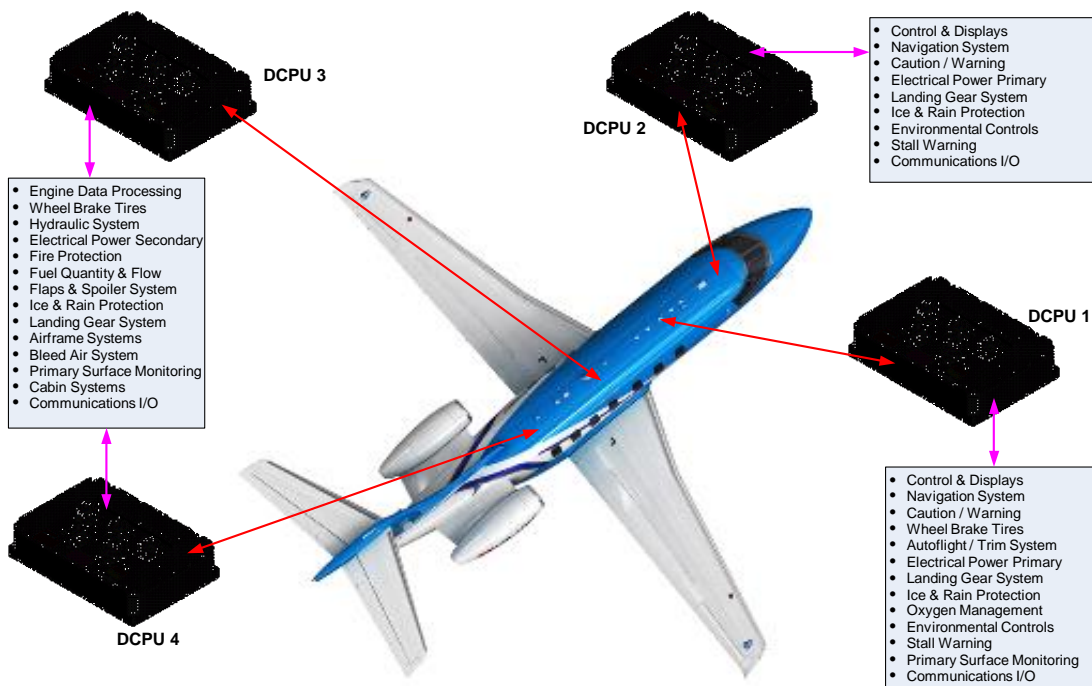
- ✓ Fully Autonomous Flight Control
- ✓ Secure Data Communication
- ✓ High Speed Datalinks
- ✓ Integrated Sensor Fusion

Controls	Pilot	Copilot
Present	Pilot	Copilot
Phase 1	Pilot	Remote Copilot
Phase 2	Computer	Remote Copilot



Source: Company Presentation

Utilities Management System (UMS)



Source: Company Presentation

Addressable Market Size for UMS

For this year, we estimate that ISSC can sell 40 of its UMS products to Pilatus at approximately \$175,000 each, which could equate to \$7 million of sales or 24% of ISSC's total revenues.

For 2024, we estimate that Pilatus might produce 50 units of the PC-24 next year, which could equate to \$9 million of sales for ISSC. It takes more than a year to earn FAA certification on a different plane type. We assume that ISSC could have a second UMS customer with revenues starting in late 2025.

In our base case scenario, we estimate UMS sales of \$19 million in 2026. We reach this by adding \$10 million from one additional business jet manufacturer win to our \$9 million estimate from the PC-24. If this occurs, along with 10% sales growth of its core business in 2024 and 2025, ISSC could achieve \$48 million of sales in 2026 before any additional sales contribution from future acquisitions.

In our bull case scenario, ISSC could generate \$63 million of total sales in 2026 if it wins another UMS customer, Pilatus makes 50 of the PC-24 with the UMS and ISSC acquires \$15 million of sales before 2026. Our \$63 million sales scenario compares to our \$28 million forecast for this year.

At this point, we are hesitant to provide any estimates for a scenario of ISSC winning UMS orders for regional or narrowbody commercial passenger planes. This might never occur. Regarding smaller passenger planes, if the FAA were to certify the UMS for either the CRJ200 or ERJ145 in 2025, this could add 150-200 planes for \$30 million of revenues over two years. While these specific 50-seater planes might be slowly heading to obsolescence, they could serve as an important middle step to semi-autonomous adoption. These regional passenger jets tend to have six to seven pilots assigned to each plane across all shifts. By adding a UMS and reducing the on-board pilot count to one, an airline could free up three pilot assignments per plane and achieve a two-year payback.

Additional Products Potential

We encourage investors not to solely focus on the UMS offering because ISSC has a long-standing history of successfully developing other products. Its engineering focus is on cockpit automation as demonstrated by its autothrottle success. ISSC's autothrottle could win more platforms over the next two years and help revenue growth at \$90,000 per plane. In January, the FAA approved ISSC's ThrustSense Autothrottle for King Airs with G1000 flight decks.

Its cockpit display systems have been installed in over 500 of the 757/767 cargo aircraft during the past few years for DHL, FedEx, Amazon and American Airlines. We expect an engine instruments product to be launched for cargo planes next year. We also expect ISSC to further penetrate helicopters and military aircraft. Last month, ISSC teamed up with Avidyne for Helix flight decks on Sikorsky S76 helicopters. This week, ISSC announced a GPS system for the Boeing T-7A Red Hawk.

During ISSC's results conference call in February, the new CEO stated that its R&D spending could increase to 13% of sales by the end of this year compared to 10% last year. This should support new product development or extensions to benefit sales growth next year and in 2025.

Additional Product Images



Eclipse 550 Business Jet Autothrottle & Display System



C-130 Military Display System and Navigation



Next Generation Flight Management System



Display Panels for Upcoming Helix for Sikorsky S-76C Helicopter



Source: Company Website for initial four images and Avidyne Corporation for Helix flight deck joint initiative

Acquisitions Catalyst

We expect that shareholders will vote in favor of a proposal at next week's annual shareholder meeting to allow ISSC's board and management team more flexibility for growth development. The CEO and CFO intend to seek out acquisition targets with product lines in its current business or sensible adjacent spaces for cockpit and aircraft cabin products. Targets are likely to have transferable production to bring that in-house to ISSC's facility in Pennsylvania to increase its capacity utilization.

The purchase prices of targets could range from \$15 million to \$35 million and have a gross margin of 60%. We model that an acquisition can be highly accretive during the first year of ownership because of two reasons. First, ISSC can use at least \$12 million of its cash to fund the acquisition and incur only a minor interest expense to fund the rest of the purchase. Second, the added volumes from an acquisition would help ISSC benefit from absorption of its overhead costs as capacity utilization improves.

We estimate ISSC can generate a 75% incremental gross margin if it reaches \$45 million of annual sales. For perspective, we forecast \$28 million of sales this year and \$32 million next year if no acquisitions occur. If ISSC acquires \$15 million of annual sales through acquisitions, then we expect the \$45 million of sales inflection point to be achieved for operating leverage benefit.

We calculate 37% EPS accretion if ISSC acquires \$15 million of sales to likely help its EBITDA margin expand from 27% to 31%. Our estimates assume a temporary increase in SG&A expense. If ISSC spends \$50 million on acquisitions, we estimate its leverage would become 2.2x Net Debt/EBITDA.

Potential Acquisitions Analysis	
Sales (millions)	\$15.0 annual
EBITDA at 25% Margin	\$3.8 annual
Pricetag if 3.0x Sales paid	\$44.6
Pricetag if 15x EV/EBITDA paid	<u>\$56.3</u>
Blended Average Pricetag	\$50.4 possible spend on acquisitions
Cash Balance Now	\$19.4 Dec '22
Cash Balance Forecast	\$20.7 June '23
If 60% of Cash Used to Co-Fund	\$12.4
Cash Remaining	<u>\$8.3</u>
Debt Raise Needed	\$38.0 estimate
Interest Expense at 6.5%	\$2.5 annual if from credit facility
EPS Accretion	\$0.14 annual
EPS % Accretion	37% versus 2024 no acquisitions

	2024E	2024E	
	Without Acquisitions	With Acquisitions	Increase Impact
Sales (millions)	\$31.5	\$46.5	\$15.0
Gross Margin	61.2%	65.6%	447 bps
SG&A % of Sales	23.6%	24.3%	69 bps
EBITDA Margin	27.2%	30.6%	345 bps
EPS Adjusted	\$0.37	\$0.51	37%
FCF (millions)	\$6.1	\$7.4	\$1.4

Source: EF Hutton analysis and estimates

Backlog and Orders

Its recent backlog of \$8.5 million equates to four months of forward sales and ISSC has visibility with Pilatus into 2024. Most of the backlog is comprised of UMS orders for the Pilatus PC-24, autothrottle systems for King Air 360/260 (multi-year supply agreement with Textron) and systems for the KC-46A Pegasus (a Boeing military air-to-air refueling and strategic transport aircraft). These three programs are expected to exist over the next decade.

Importantly, ISSC has averaged a book-to-bill ratio of 1.08x over the past four years.

(In Millions USD, September Year)	2020	2021	2022	1Q	2QE	3QE	4QE	2023E	1QE	2QE	3QE	4QE	2024E
Revenues	21.6	23.0	27.7	6.5	6.9	7.3	7.8	28.5	7.3	7.8	8.1	8.2	31.5
% change (yoy)	22.9%	6.7%	20.4%	-2.7%	1.5%	5.4%	6.8%	2.9%	12.7%	12.3%	10.5%	6.2%	10.3%
Backlog	3.6	9.1	11.8	8.5	9.5	10.0	11.0	11.0	11.5	12.0	12.5	12.5	12.5
% change (yoy)	-38%	151%	29%	37%	26%	-20%	-6%	-6%	35%	26%	25%	14%	14%
% change (sequential qoq)	-38%	151%	29%	-28%	12%	5%	10%	-6%	5%	4%	4%	0%	14%
Orders	19.3	31.5	28.8	3.3	7.9	7.8	8.8	27.8	7.8	8.3	8.6	8.2	33.0
% change (yoy)	10%	63%	-9%	-14%	51%	-41%	36%	-4%	141%	4%	10%	-6%	19%
% change (sequential qoq)	10%	63%	-9%	-50%	144%	-2%	12%	-4%	-72%	6%	3%	-4%	19%
Book/Bill	0.90x	1.37x	1.04x	0.50x	1.14x	1.07x	1.13x	0.97x	1.07x	1.06x	1.06x	1.00x	1.05x

Source: EF Hutton estimates & Company Filings

Customers

ISSC's three largest customers for the September 2022 fiscal year were Pilatus (business jets) at 22% of sales, Air Transport Services (cargo transportation) at 11% of sales and Textron (King Air) at 11% of sales. Other customers included DHL, FedEx, Amazon, the U.S. Department of Defense, the US. Department of the Interior, Boeing, Lockheed Martin and American Airlines.

Competition

Innovative Solutions and Support most often competes with Collins Aerospace (part of Rockwell Collins, now a unit of Raytheon Technologies), Honeywell International, Thales Defense and Security. Occasionally, it competes with Garmin and GE Aviation Systems.

Reliable Robotics designed an unmanned system for a four-seat Cessna plane to take off, fly briefly and land at the same airport. Reliable Robotics has made some progress towards FAA certification as an upgrade kit for a Cessna 208 Caravan aircraft, but is not fully certified. We are unsure whether or not it will receive FAA full supplemental certification in 2025.

Valuation

Our \$11 price target represents a 29x multiple of our 2024 adjusted EPS of \$0.37 compared to the peer group average of 27x P/E on 2024 earnings. We believe ISSC warrants a 10% premium for its above-average EBITDA margin next year and acquisitions firepower.

If ISSC acquires \$15 million of annual sales by October, this could add \$0.14 EPS and our \$11 price target could equate to pro-forma 21x P/E 2024 and 13x EV/EBITDA 2024.

See Page 20 for risks to our investment thesis and price target.

Peer Group

Company	Ticker Symbol	Stock Price	Market Cap (\$ million)	Enterprise Value (\$ million)	P/E 2023E	P/E 2024E	EV/EBITDA 2023E	EV/EBITDA 2024E	EBITDA Margin 23E	EBITDA Margin 24E
Honeywell Intl.	HON	\$193.28	129,138	140,194	21.4x	19.3x	15.0x	13.9x	25.5%	26.1%
TransDigm Group	TDG	\$745.76	40,717	57,213	33.3x	28.0x	18.2x	16.7x	50.8%	51.0%
Curtiss-Wright	CW	\$178.30	6,830	7,999	20.3x	18.5x	13.8x	12.9x	21.6%	21.9%
HEICO Corp.	HEI	\$172.25	20,629	21,655	56.7x	49.4x	30.1x	27.4x	26.4%	27.0%
Woodward	WWD	\$98.49	5,883	6,644	30.7x	23.8x	16.6x	14.3x	15.1%	16.3%
Aerojet Rocketdyne	AJRD	\$56.27	4,529	4,555	27.6x	25.5x	15.2x	14.2x	12.9%	13.2%
AeroVironment	AVAV	\$91.95	2,307	2,424	54.6x	37.7x	23.5x	17.9x	18.7%	22.1%
RBC Bearings	RBC	\$230.54	6,638	8,069	31.0x	27.9x	18.5x	17.5x	29.1%	29.2%
Safran SA	ENXTPA:SAF	€ 136.86	€ 57,519	€ 58,262	27.3x	21.7x	13.2x	11.2x	19.1%	20.4%
Howmet Aerospace	HWM	\$42.97	17,695	21,236	26.4x	21.3x	15.1x	13.2x	22.8%	24.3%
Hexcel	HXL	\$69.36	5,846	6,507	37.5x	28.1x	17.8x	15.0x	20.6%	22.0%
Mercury Systems	MRCY	\$50.79	2,951	3,475	26.0x	21.4x	17.0x	14.5x	19.7%	21.6%
Collins Aerospace	part of Rockwell Collins/United Technologies/Raytheon Technologies									
Esterline Technologies	part of TransDigm									
Peer Average					32.7x	26.9x	17.8x	15.7x	23.5%	24.6%
Peer Median					29.1x	24.6x	16.8x	14.4x	21.1%	22.0%
Innovative Solutions & Support	ISSC	\$7.48	130	136	26.4x	20.3x	21.5x	15.9x	22.1%	27.2%

Source: S&P Capital IQ & EF Hutton estimates as of 4/3/23. Past performance is not indicative of future results or performance.

Outlook and Recent Results

The company does not provide annual guidance, but reports a quarterly backlog amount. ISSC has stated that SG&A expense will increase by an abnormal amount this year due to catch-up of higher stock-based compensation for the new management team and one-time professional fees.

In FY2022, ISSC grew sales by 20% driven by strength in commercial air cargo transportation, the C-130 military program, the UMS product for the PC-24 and autothrottle for King Air. Adjusted EBITDA margin expanded by an impressive 830 bps to 28.6% due to a favorable product mix and a temporary decrease in SG&A expense as a percentage of revenues. Adjusted EPS grew by only 8% because of the lapping of a negative tax rate in the year-ago period. Pre-tax income grew significantly and free cash flow was \$6 million for the year.

For the March Quarter, we forecast:

- Sales of \$6.9 million for 2% growth
- Gross Margin of 58.6%
- Adjusted EBITDA Margin of 18.5%
- Adjusted EPS \$0.06 for a 32% decrease due to one-off higher SG&A expense and professional fees

For fiscal year 2023 (ending September 2023), we forecast:

- Sales of \$28.5 million for 3% growth
- Gross Margin of 59.2% for a slight decline from 2022 due to product mix (less cargo orders)
- Adjusted EBITDA Margin of 22.1%
- Adjusted EPS \$0.28 for a 15% decrease due to one-off higher SG&A expense and professional fees
- Free cash flow of \$5 million

We forecast only 3% sales growth for this year because last year's 20% growth included several orders for cargo transportation planes that were pulled forward into 2022 and out of early 2023. We note that ISSC's two-year average organic sales growth through 2023 could be 11%.

For fiscal year 2024 (ending September 2024), we forecast:

- Sales of \$31.5 million for 10% growth
- Gross Margin of 61.2% if higher capacity utilization triggers better operating leverage
- Adjusted EBITDA Margin of 27.2% for a 510 bps improvement if it benefits from operating leverage and a more normal SG&A expense than in 2023
- Adjusted EPS \$0.37 for 30% growth
- Free cash flow of \$6 million

Our forecasts do not include the benefit of future acquisitions.

Management Team

Shahram Askarpour, PhD., Chief Executive Officer

Dr. Askarpour was promoted to CEO of the company in January 2022. He joined the company in 2003 as Vice President of Engineering and was promoted to President in 2012. He has been heavily involved as a key contributor to the company's leadership, strategy and technology. Dr. Askarpour has more than 40 years of aerospace industry experience in increasingly responsible technical and managerial positions. Prior to joining the company, he was employed by Smiths Aerospace (a division of Smiths Group Plc), Instrumentation Technology and Marconi Avionics. He holds key patents in the aviation field. Dr. Askarpour earned an undergraduate degree in Electrical Engineering from Middlesex University in the United Kingdom. He earned a postgraduate Certificate in Systems Engineering and a PhD in Automatic Control from Brunel University London.

Michael Linacre, Chief Financial Officer

Mr. Linacre became CFO of the company in July 2022. Prior to joining the company, he worked as a public accountant at KPMG LLP. He also held finance leadership positions at Genpak, LLC, a food service packaging company, and SI Group, Inc., a chemical manufacturing company, before serving as the Chief Financial Officer of Sysco Albany, LLC, a subsidiary of Sysco Corporation, a multinational seller, marketer, and distributor of food products, and of Crisafulli Bros. Plumbing & Heating Contractors, Inc., a provider of plumbing, sewer and drain, heating and cooling design, installation and maintenance services. Mr. Linacre is a licensed CPA and a member of the American Institute of CPAs and the New York State Society of CPAs. He attended the State University of New York at Albany.

Brian Urbanski, Vice President of Quality

Mr. Urbanski joined the company in 1999 as Director of Quality and was promoted to Vice President of Quality in 2002. His current responsibilities include ISO9001/AS9100D Management Representative, FAA Certification Liaison to the Boston Aircraft Certification Office, Accountable Manager to the FAA/EASA Repair Station, CASE-1A Management Representative, DO-178B/C Software Quality Assurance Manager, DO-254 Hardware Quality Assurance Manager, Type 2 LOA Aeronautical Database Manager, and Reliability and Maintainability Manager. Mr. Urbanski is the main focal point for coordinating all FAA STC, TSO and PMA projects. Prior to joining the company, he held Six Sigma Master Black Belt positions at Raytheon and Allied Signal. He has over 30 years of experience in aerospace continuous improvement and quality management systems. Mr. Urbanski holds a BS in Materials Engineering from Drexel University and is a certified Six Sigma Master Black Belt.

Markus Knopf, Vice President of Product Development

Mr. Knopf joined the company in 2000 as a member of the Engineering department in various capacities. Prior to joining the company, he worked as a Design Engineer on ultrasonic fastener equipment covering the automotive and aerospace markets. Mr. Knopf holds a BS/MS in Electrical Engineering from the University of Applied Sciences in Ulm-Germany and an MS in Information Science from the Pennsylvania State University.

Top Shareholders

Top Shareholders	Common Stock Shares	% of Shares Outstanding
Estate Of Geoffrey S. M. Hedrick (founder and former CEO)	3,531,765	20.3%
Harborne, Christopher	2,603,263	15.0%
Central Square Management LLC	875,417	5.0%
Pessin, Norman H. (private investor of small caps)	861,825	5.0%
WealthTrust Axiom, LLC	770,906	4.4%
The Vanguard Group, Inc.	611,043	3.5%
Dimensional Fund Advisors LP	416,372	2.4%
Renaissance Technologies LLC	407,710	2.3%
BlackRock, Inc. (NYSE:BLK)	371,569	2.1%
Askarpour, Shahram (President, CEO & Director)	217,458	1.3%
Joh. Berenberg, Gossler & Co. KG, Asset Management Arm	195,823	1.1%
GAMCO Investors, Inc. (OTCPK:GAMI)	151,500	0.9%
Geode Capital Management, LLC	132,891	0.8%
Teton Advisors, LLC (OTCPK:TETAA)	106,000	0.6%
Morgan Stanley, Investment Banking and Brokerage	97,329	0.6%
Bridgeway Capital Management, LLC	92,200	0.5%
Royce & Associates, LP	78,828	0.5%
Bressner, Glen R. (Independent Vice-Chairman & Director)	68,332	0.4%
HighTower Advisors, LLC	46,887	0.3%
Carolin, Roger A. (Independent Director)	44,180	0.3%
State Street Global Advisors, Inc.	42,093	0.2%
Northern Trust Global Investments	24,976	0.1%
Susquehanna International Group, LLP, Asset Management	23,299	0.1%
Wharton Business Group, LLC	19,395	0.1%
O'Shaughnessy Asset Management, LLC	16,415	0.1%
UBS Asset Management	14,983	0.1%
Citadel Advisors LLC	14,938	0.1%
Overbrook Management Corporation	14,575	0.1%
Churchill Jr., Winston J. (Independent Chairman of the Board)	14,130	0.1%
Millennium Management LLC	12,745	0.1%

Source: S&P Capital IQ (as of 12/31/22 13F filing, 3/24/23 Form 4 and 2/13/23 Proxy)

As seen in the chart above, there are two major shareholders. The Hendrick Estate, with 20% ownership, is the family of the deceased founder. We do not expect many of those shares to be sold anytime soon.

The second largest shareholder is Christopher Harborne, who owns 15% of the shares, including a recent addition to his stake. He is the CEO of Sherriff Global Group, which trades private planes and is an owner of AML Global, which sells aviation fuel. He is also a pilot.

Financial Model & Forecasts

(In Millions USD, September Year-End)

	DecMarJuneSept						DecMarJuneSept				DecMarJuneSept						
(In Millions USD, September Year-End)	2020	2021	1Q	2Q	3Q	4Q	2022	1Q	2QE	3QE	4QE	2023E	1QE	2QE	3QE	4QE	2024E
Revenues:																	
Products & Systems	20.8	22.8	6.7	6.6	6.9	7.0	27.3	6.1	6.8	7.2	7.7	27.9	7.2	7.6	7.9	8.0	30.8
% change (yoy)	29%		39%	30%	16%	2%	20%	-8%	3%	4%	9%	2%	17%	11%	10%	5%	10%
Engineering Development Contracts	0.8	0.3	-	0.2	-	0.3	0.5	0.4	0.1	0.1	0.1	0.7	0.2	0.2	0.2	0.2	0.7
% change (yoy)	-44%		-100%	934%	-100%	NM	62%	NM	-50%	NM	-62%	45%	-59%	100%	50%	100%	5%
Total Revenues	21.6	23.0	6.7	6.8	6.9	7.3	27.7	6.5	6.9	7.3	7.8	28.5	7.3	7.8	8.1	8.2	31.5
% change (yoy)	22.9%	6.7%	37.5%	33.7%	12.2%	5.7%	20.4%	-2.7%	1.5%	5.4%	6.8%	2.9%	12.7%	12.3%	10.5%	6.2%	10.3%
Organic Sales Growth (excl Acquisitions)	22.9%	6.7%	37.5%	33.7%	12.2%	5.7%	20.4%	-2.7%	1.5%	5.4%	6.8%	2.9%	12.7%	12.3%	10.5%	6.2%	10.3%
Backlog	3.6	9.1	6.2	7.5	12.6	11.8	11.8	8.5	9.5	10.0	11.0	11.0	11.5	12.0	12.5	12.5	12.5
% change (yoy)	-38%	151%	48%	13%	33%	29%	29%	37%	26%	-20%	-6%	-6%	35%	26%	25%	14%	14%
% change (sequential qoq)	-38%	151%	-32%	21%	67%	-6%	29%	-28%	12%	5%	10%	-6%	5%	4%	4%	0%	14%
Orders	19.3	31.5	3.8	5.3	13.3	6.5	28.8	3.3	7.9	7.8	8.8	27.8	7.8	8.3	8.6	8.2	33.0
% change (yoy)	10%	63%	-30%	-35%	16%	-1%	-9%	-14%	51%	-41%	36%	-4%	141%	4%	10%	-6%	19%
% change (sequential qoq)	10%	63%	-42%	39%	153%	-52%	-9%	-50%	144%	-2%	12%	-4%	-72%	6%	3%	-4%	19%
Book/Bill	0.90x	1.37x	0.57x	0.77x	1.92x	0.89x	1.04x	0.50x	1.14x	1.07x	1.13x	0.97x	1.07x	1.06x	1.06x	1.00x	1.05x
Cost of Sales	9.8	10.3	2.7	2.7	2.9	2.8	11.1	2.8	2.9	3.0	3.0	11.7	2.8	3.0	3.1	3.2	12.2
Gross Profit	11.8	12.8	4.0	4.2	4.1	4.5	16.7	3.7	4.1	4.4	4.7	16.9	4.5	4.8	4.9	5.0	19.2
Gross Profit Margin	54.7%	55.5%	59.3%	61.1%	58.5%	61.5%	60.1%	57.1%	58.6%	59.6%	61.0%	59.2%	61.4%	61.0%	61.1%	61.1%	61.2%
Gross Margin Change (yoy)	(167 bps)	81 bps	657 bps	442 bps	421 bps	392 bps	464 bps	(211 bps)	(252 bps)	107 bps	(47 bps)	(94 bps)	426 bps	238 bps	156 bps	11 bps	198 bps
Gross Profit Margin (Products)	54.0%	55.2%	59.3%	60.2%	58.5%	62.1%	60.0%	55.5%	58.5%	59.5%	61.0%	58.8%	61.3%	60.8%	61.0%	61.0%	61.0%
Gross Profit Margin (Engineering Dvlp)	71.5%	72.7%	NM	91.6%	NM	45.3%	65.2%	84.4%	62.0%	62.0%	62.0%	74.3%	66.0%	66.0%	66.0%	66.0%	66.0%
Operating Expenses:																	
Selling, General and Administrative	6.1	6.3	1.8	1.7	1.7	1.5	6.8	2.3	2.2	1.8	1.7	7.9	1.8	1.9	1.9	1.8	7.4
% change (yoy)	4%	3%	4%	8%	12%	8%	8%	25%	25%	6%	12%	17%	-19%	-13%	6%	6%	-6%
Research & Development	3.0	2.6	0.7	0.7	0.7	0.6	2.7	0.7	0.8	1.0	1.0	3.5	1.0	1.0	1.0	1.0	4.0
% change (yoy)	19%	-11%	23%	-6%	5%	-6%	3%	-9%	26%	41%	62%	29%	45%	22%	6%	-3%	14%
Total Operating Expenses	9.1	8.9	2.5	2.4	2.4	2.2	9.5	2.9	3.0	2.7	2.7	11.4	2.8	2.9	2.9	2.8	11.4
% change (yoy)	8%	-2%	9%	4%	10%	4%	7%	15%	25%	16%	27%	21%	-4%	-3%	6%	3%	0%
Operating Income (Loss)	2.7	3.9	1.4	1.8	1.7	2.3	7.2	0.8	1.1	1.6	2.0	5.5	1.7	1.9	2.0	2.2	7.8
% change (yoy)	80%	NM	513%	196%	41%	23%	85%	-44.4%	-39.4%	-4.8%	-13.4%	-24%	115%	72%	27%	11.6%	43%
Interest Income or Expense	0.2	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.0	0.4	-	-	-	-	-
Other Income or Expense	0.1	0.1	0.0	0.0	0.0	0.0	0.1	0.0	-	-	-	0.0	-	-	-	-	-
Income before Taxes	3.0	4.0	1.4	1.8	1.7	2.4	7.3	0.9	1.2	1.7	2.0	5.9	1.7	1.9	2.0	2.2	7.8
Income Taxes	(0.3)	(1.1)	0.3	0.4	0.4	0.8	1.8	0.2	0.3	0.4	0.5	1.4	0.4	0.5	0.5	0.5	1.9
Tax Rate	-10.4%	-27.4%	21.3%	21.4%	20.9%	32.2%	24.8%	24.5%	24.7%	24.7%	24.7%	24.7%	24.7%	24.7%	24.7%	24.7%	24.7%
Net Income (GAAP)	3.3	5.1	1.1	1.4	1.4	1.6	5.5	0.7	0.9	1.3	1.5	4.4	1.3	1.4	1.5	1.7	5.9
Add-back: Stock-based Compensation	0.2	0.3	0.1	0.2	0.1	0.0	0.3	0.3	0.2	0.1	0.1	0.7	0.2	0.2	0.2	0.2	0.7
Net Income Adjusted (excl stock comp)	3.4	5.3	1.2	1.6	1.4	1.6	5.8	0.9	1.1	1.4	1.6	4.9	1.4	1.5	1.7	1.8	6.6
EPS (GAAP, diluted)	\$0.19	\$0.29	\$0.07	\$0.08	\$0.08	\$0.09	\$0.32	\$0.04	\$0.05	\$0.07	\$0.09	\$0.25	\$0.07	\$0.08	\$0.09	\$0.10	\$0.34
EPS Adjusted (excl stock-based comp)	\$0.20	\$0.31	\$0.07	\$0.09	\$0.08	\$0.09	\$0.33	\$0.05	\$0.06	\$0.08	\$0.09	\$0.28	\$0.08	\$0.09	\$0.10	\$0.10	\$0.37
% change (yoy)	70%	55%	336%	103%	-49%	4%	8%	-24%	-32%	-3%	-4%	-15%	52%	43%	22%	15%	30%
EBITDA	3.2	4.3	1.5	1.9	1.8	2.4	7.6	0.9	1.2	1.7	2.1	5.8	1.8	2.0	2.1	2.3	8.2
% change (yoy)	61%	36%	338%	164%	36%	22%	75%	-42%	-38%	-5%	-13%	-23%	105%	67%	26%	11%	41%
EBITDA Adjusted (excl stock-based comp)	3.4	4.7	1.6	2.1	1.8	2.4	7.9	1.2	1.3	1.7	2.1	6.3	1.9	2.0	2.2	2.4	8.6
% change (yoy)	56%	39%	309%	123%	36%	21%	70%	-28%	-38%	-5%	-12%	-20%	68%	60%	28%	13%	36%
Shares Outstanding (diluted)	17.1	17.2	17.2	17.3	17.3	17.3	17.3	17.3	17.3	17.4	17.4	17.4	17.4	17.4	17.4	17.5	17.5
Margins:																	
Gross Margin	54.7%	55.5%	59.3%	61.1%	58.5%	61.5%	60.1%	59.3%	58.6%	59.6%	61.0%	59.2%	61.4%	61.0%	61.1%	61.1%	61.2%
EBITDA Margin	14.7%	18.8%	22.6%	27.8%	25.6%	32.9%	27.3%	13.5%	17.0%	23.1%	26.7%	20.4%	24.4%	25.3%	26.3%	28.0%	26.1%
EBITDA Adjusted (excl stock-based comp)	15.5%	20.3%	23.9%	30.2%	26.4%	33.3%	28.6%	17.8%	18.5%	23.8%	27.4%	22.1%	26.5%	26.3%	27.5%	29.2%	27.2%
Operating Margin	12.7%	16.9%	21.3%	26.4%	24.3%	31.6%	26.0%	12.1%	15.8%	22.0%	25.6%	19.2%	23.2%	24.2%	25.2%	26.9%	24.9%
Operating Margin Adjusted (excl stock comp)	13.5%	18.4%	22.5%	28.8%	25.1%	32.1%	27.2%	16.5%	17.2%	22.6%	26.3%	20.9%	25.2%	25.1%	26.4%	28.2%	26.0%
Net Margin	15.1%	22.0%	16.9%	20.9%	19.6%	22.1%	19.9%	10.7%	13.2%	17.8%	19.4%	15.5%	17.5%	18.2%	18.9%	20.3%	18.8%
Net Margin Adjusted (excl stock comp)	15.8%	23.1%	17.9%	22.7%	20.2%	22.4%	20.8%	14.0%	15.3%	18.8%	20.3%	17.3%	19.0%	19.6%	20.8%	22.1%	21.0%
Operating Expenses as % of Sales	41.9%	38.5%	38.0%	34.7%	34.2%	29.9%	34.1%	45.0%	42.8%	37.6%	35.4%	40.0%	38.2%	36.8%	36.0%	34.2%	36.2%
SG&A as % of Sales	28.2%	27.2%	27.0%	25.2%	24.4%	21.0%	24.3%	34.7%	31.0%	24.6%	22.0%	27.8%	25.0%	24.0%	23.5%	22.0%	23.6%
R&D as % of Sales	13.7%	11.4%	11.0%	9.5%	9.8%	8.8%	9.8%	10.3%	11.8%	13.0%	13.4%	12.2%	13.2%	12.8%	12.5%	12.2%	12.6%

Adjusted EPS & Adjusted EBITDA are non-GAAP figures. We exclude stock-based compensation & restructuring expense to match the company's methodology and many peers.

Backlog is mostly comprised of Pilatus PC-24, Textron King Air and KC-46A programs. Other customers have included DHL, FedEx, Amazon, Air Transport Services, American Airlines, Boeing, Lockheed Martin, L3 Harris, U.S. Dept of Defense

Source: EF Hutton estimates, Company Reports & Filings

Free Cash Flow

				Dec	Mar	June	Sept		Dec	Mar	June	Sept	
	2020	2021	2022	1Q	2QE	3QE	4QE	2023E	1QE	2QE	3QE	4QE	2024E
Debt (excl operating leases)	0	0	0	0	0	0	0	0	0	0	0	0	0
Cash & Equivalents (excl restricted cash)	13	8	17	19	20	21	22	22	25	26	28	28	22
Net Debt (incl operating leases)	33	35	11	6	4	2	0	0	-2	-4	-5	-7	-1
Net Cash (excl operating leases)	-13	-8	-17	-19	-20	-21	-22	-22	-25	-26	-28	-28	-22
Debt/EBITDA LTM (excl op leases)	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x
Net Debt/Adj EBITDA LTM (excl one-offs)	-3.8x	-1.8x	-2.2x	-2.6x	-3.0x	-3.1x	-3.5x	-3.5x	-3.5x	-3.3x	-3.3x	-3.3x	-2.6x
Free Cash Flow:													
Net Income (reported)	3	5	6	1	1	1	2	4	1	1	2	2	6
Depreciation & Amortization	0	0	0	0	0	0	0	0	0	0	0	0	0
Working Capital/Other Non-Cash Items	-2	-1	0	1	0	-1	0	0	1	0	0	-1	0
Operating Cash Flow	2	5	6	2	1	0	2	5	2	2	2	1	6
Capital Expenditures (gross, not net)	0	0	0	0	0	0	0	0	0	0	0	0	0
Free Cash Flow	2	4	6	2	1	0	2	5	2	1	2	1	6
Dividends*	20	0	0	0	0	0	0	0	0	0	0	0	0
Acquisitions (gross, not net of divestitures)	0	0	0	0	0	0	0	0	0	0	0	0	0
FCF Conversion of Adjusted EBITDA	62%	91%	75%					73%					71%

*Special Dividend paid out in 2020

Source: EF Hutton estimates, Company Reports & Filings

Balance Sheet & Liquidity

(US Dollars in Millions)

Assets	12/31/22	Liabilities	12/31/22
Current Assets		Current Liabilities	
Cash & Cash Equivalents	19.4	Accounts Payable	0.8
Accounts Receivables	3.3	Accrued Expenses	2.5
Contract Assets	0.2	Contract Liability	0.1
Inventories	5.3	Contract Liability (related party)	0.0
Prepaid Expenses & Other Current Assets	1.0		
		Non-Current Liabilities	
Non-Current Assets		Other Liabilities	0.4
Property & Equipment (net)	6.2	Commitments & Contingencies (see Note 6)	
Deferred Income Taxes	0.3	Total Liabilities	3.9
Other Assets	0.2		
Total Assets	36.0	Shareholder's Equity	
		Total Shareholder's Equity	32.1
		Total Liabilities & Shareholder's Equity	36.0

Source: Company Reports & Filings

- Cash of \$19 million could partially fund an acquisition. ISSC did not have a revolving credit facility as of February 2023, but we expect that one could be established soon to use for an acquisition.

Risks to Our Buy Rating & Price Target

In addition to the risks mentioned below, we strongly encourage investors to review the regulatory filings for additional risk factors.

- Economic recession or a macro slowdown
- Loss of a large customer and customer concentration risk from Pilatus and Textron Aviation
- Bankruptcy or insolvency of a key customer
- Cancellation of an aircraft program
- Supply chain disruptions
- Increased competition or substitutes
- Failure to achieve adequate sales volumes on its UMS product or autothrottle product
- Quality control issues or failures
- FAA regulation changes that negatively impact revenues
- Intellectual property infringement by competitors
- Inventory write-down
- Cybersecurity incident or hacking of ISSC systems or products
- Liquidity of the stock shares (low average daily volume traded)
- Dilution to shareholders from an equity raise or private placement to fund an acquisition
- Integration of acquisitions
- Overpaying for acquisition targets

Important Disclosures

Analyst Certification

I, Tim Moore, CFA, certify that all of the views expressed in this research report accurately reflect my personal views about the subject security(ies) and subject company(ies). I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

Company-Specific Disclosures

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EF Hutton rating definitions are expressed as the total return relative to the expected performance of S&P 500 over a 12-month period.

BUY (B) - Total return expected to exceed S&P 500 by at least 10%

HOLD (H) - Total return expected to be in-line with S&P 500

SELL (S) - Total return expected to underperform S&P 500 by at least 10%

Distribution of Ratings/IB Services

EF Hutton

Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY	153	97.45	22	14.38
HOLD	4	2.55	0	0.00
SELL	0	0.00	0	0.00

Innovative Solutions and Support, Inc. Rating History as of 04/03/2023

