

Equity Research & Financial Projection Report: Innovative Solutions and Support, Inc. (NASDAQ: ISSC)

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1. Executive Summary

Company Overview

Innovative Solutions and Support, Inc. (\$7.14) EV approximately \$115 million, is a U.S.-based company specializing in the engineering, manufacturing, and supply of advanced avionic solutions. Its extensive global product reach and customer base span commercial, business aviation, and military markets, catering to both airframe manufacturers and aftermarket services for fixed-wing and rotorcraft applications. IS&S offers cutting-edge, cost-effective solutions while maintaining legacy product lines.

Recent Developments (Last Quarter & Current Quarter)

- **First Quarter 2025 Financial Results:**
 - **Net Revenue:** \$16.0 million, a 71.6% increase compared to the same period last year.
 - **Gross Profit:** \$6.6 million with a gross margin of 41.4%.
 - **Net Income:** \$0.7 million, or \$0.04 per diluted share.
 - **Adjusted EBITDA:** \$3.1 million, a 24% increase year-over-year.
 - **Military Revenue:** Increased to \$8.0 million during the first quarter of 2025, up from \$2.0 million in the prior-year period.

- **Strategic Initiatives:**
 - The company is expanding its production capacity at the Exton facility by more than three-fold by mid-2025 to support increased demand, particularly from military customers.
 - Investments have been made in infrastructure and systems to support the high-performance requirements of defense customers, leveraging IS&S's U.S. manufacturing footprint as a competitive advantage in the current policy environment.
 - The company is advancing its autonomous flight initiatives, with plans to launch the next generation Utility Management System (UMS2) in 2025, an AI-capable

system with integrated neural network capabilities designed to enhance cockpit automation.

2. Business Model & Market Position

Core Business Model

IS&S operates as a systems integrator, focusing on the design, manufacturing, sale, and service of advanced avionics systems. The company's revenue streams are derived from both product sales and services, catering to OEMs and the retrofit market. By providing integrated flight management systems, flat panel display systems, and other advanced avionics, IS&S aims to enhance flight safety, efficiency, and compliance with evolving aviation standards.

Key Business Segments

- **Commercial Air Transport Products:**
 - B737 NextGen Flight Deck Upgrade
 - B757/B767 Cockpit/IP
 - Communication & Navigation Products
 - Inertial Reference Products
 - Integrated Standby Unit
 - LPV Navigator
 - MagVar Software Updates
 - GPS Sensor Unit

- **Military Products:**
 - C-130 Engine Instrument Display System
 - C-130 Cockpit/IP
 - P-3 Cockpit/IP
 - Integrated Standby Unit
 - ThrustSense Autothrottle
 - Air Data Solutions – DADC, SSBA, Altimeters
 - GPS Sensor Unit
 - ADAHRS

- **Business Aviation Products:**
 - Pilatus PC-12 NextGen Flight Deck with Integrated Autothrottle
 - ThrustSense Autothrottle for King Air
 - ThrustSense Autothrottle for Pilatus PC-12
 - Communication & Navigation Products
 - Eclipse 500 Avio IFMS
 - Eclipse 550
 - Utilities Management System – UMS
 - ADAHRS

- Integrated Standby Unit
- GPS Sensor Unit

Industry Outlook

The aerospace and defense industry is experiencing a period of transformation, driven by technological advancements, increased defense spending, and a focus on autonomous flight capabilities. Key trends affecting the industry include:

- **Regulatory Changes:** Stricter environmental regulations are pushing for advancements in avionics that support reduced carbon emissions and enhanced flight efficiency.
- **Demand Drivers:** There is a growing demand for fleet modernization and retrofit solutions, particularly in the military sector, as governments worldwide increase defense budgets to address emerging security challenges.
- **Competitive Landscape:** The industry is characterized by intense competition, with companies striving to innovate and offer integrated solutions that enhance flight safety, efficiency, and autonomy.

3. Financial Analysis

Key Financial Metrics (FY2024 vs. FY2023)

	FY2024 (Sept 30, 2024)	FY2023 (Sept 30, 2023)	% Change
Revenue	\$47,200,000	\$34,800,000	+35.6%
Net Income	\$7,000,000	\$4,500,000	+55.6%
Total Assets	\$82,382,261	\$50,000,000	+64.8%
Total Liabilities	\$35,743,606	\$15,000,000	+138.3%
Total Equity	\$46,638,655	\$35,000,000	+33.3%

Financial Performance Breakdown

Revenue

- In FY2024, Innovative Solutions & Support, Inc. (IS&S) reported net revenue of \$47.2 million, marking a 35.6% increase compared to the previous fiscal year. This growth is attributed to momentum in new military programs and revenue synergies from acquired Honeywell product lines.

Net Income

- The company achieved a net income of \$7.0 million in FY2024, a significant increase of 55.6% from the prior year. This improvement reflects enhanced operational efficiency and successful integration of acquired platforms.

Total Assets and Equity

- As of September 30, 2024, total assets were approximately \$82.4 million, up 64.8% from the previous year. Total equity increased by 33.3% to \$46.6 million over the same period, indicating a strengthening financial position.

Total Liabilities

- Total liabilities rose by 138.3%, from an estimated \$15 million in FY2023 to \$35.7 million as of September 30, 2024. This increase is primarily due to strategic acquisitions and investments in new product development.

Financial Ratios and Liquidity

- Gross Margin: 54.9% in FY2024.
- Operating Margin: Data not available.
- Net Profit Margin: 14.8% in FY2024.
- Quick Ratio: Data not available.
- Current Ratio: Data not available.
- Total Debt to Equity: Approximately 0.77 (calculated as \$35,743,606 total liabilities divided by \$46,638,655 total equity).

Analysis

- Revenue Generation: The 35.6% increase in revenue reflects strong demand for IS&S's advanced avionics solutions, particularly in military programs and newly acquired product lines.
- Profitability: The substantial rise in net income underscores the company's ability to effectively integrate acquisitions and enhance operational efficiency.
- Liquidity: Specific liquidity ratios such as the quick and current ratios are not available, limiting a comprehensive assessment of short-term financial health.
- Leverage: The total debt to equity ratio of approximately 0.77 indicates a moderate level of debt relative to equity. While the increase in liabilities suggests higher financial obligations, the company's improved profitability may mitigate potential risks associated with this leverage.

4. Financial Projection (FY2025 - FY2027)

Revenue & Earnings Forecast

	FY2025E	FY2026E	% Change (YoY)	FY2027E	% Change (YoY)
Revenue	\$55.0M	\$70.0M	+27.3%	\$90.0M	+28.6%
Gross Profit	\$30.25M	\$42.0M	+38.8%	\$63.0M	+50.0%
Gross Margin	55.0%	60.0%	+5.0pp	70.0%	+10.0pp
Operating Expenses	\$22.0M	\$24.5M	+11.4%	\$27.0M	+10.2%

Net Income	\$8.5M	\$12.5M	+47.1%	\$18.5M	+48.0%
Total Assets	\$90.0M	\$105.0M	+16.7%	\$120.0M	+14.3%
Total Liabilities	\$38.0M	\$42.0M	+10.5%	\$46.0M	+9.5%
Total Equity	\$52.0M	\$63.0M	+21.2%	\$74.0M	+17.5%

Revenue Growth Assumptions

- **FY2025:** Revenue projected at \$55.0M, driven by increased military contracts and commercial aviation upgrades.
- **FY2026:** Revenue expected to rise to \$70.0M, as global expansion accelerates and defense sector demand strengthens.
- **FY2027:** Revenue forecasted to reach \$90.0M, reflecting full-scale adoption of next-gen avionics and increased integration of AI-driven cockpit automation.

Operating Expenses & Cost Efficiency

- **R&D Investment:** Expected to decrease as a percentage of revenue while continuing next-gen avionics and automation development.
- **Sales & Marketing:** Expansion into global defense and commercial aviation markets to drive adoption.
- **Manufacturing & Production Costs:** Anticipated efficiency gains through scaling U.S.-based production and supplier optimizations.

Net Income & Profitability Expectations

- **FY2025:** Net income of \$8.5M, reflecting early-stage efficiency gains.
- **FY2026:** Net income of \$12.5M, as cost optimizations start to take effect.
- **FY2027:** Stronger profitability of \$18.5M, supported by revenue scale and operational efficiencies.

Cash Flow & Funding Needs

- **FY2025-2026:** Additional funding may be required to support expansion in defense and AI-driven avionics.
- **FY2027:** Sustained cash flow expected, reducing dependence on external financing.

Key Risks to Financial Projections

- **Market Adoption Risks:** Slower-than-expected adoption of AI-driven avionics and automation solutions could delay revenue targets.

- **Operational Scaling Challenges:** Expanding production and distribution without efficiency losses is critical.
- **Competitive Landscape:** Larger defense and aerospace companies may introduce competing next-gen solutions.

5. Risk Matrix for Innovative Solutions & Support, Inc. (ISSC)

Risk Factor	Impact Level	Probability	Mitigation Strategy
Market Adoption Risk	High	Medium	Strengthen partnerships with major aerospace and defense contractors, expand marketing for retrofit avionics solutions.
Revenue Volatility & Demand Risk	High	Medium	Diversify customer base between commercial aviation and military sectors, secure long-term defense contracts.
Operational Scaling Challenges	Medium	Medium	Optimize supply chain logistics, invest in lean manufacturing practices, and ensure efficient component sourcing.
Funding & Liquidity Risks	High	Medium	Maintain strong cash flow management, seek government contracts, and secure credit facilities as needed.
Competitive Landscape	High	High	Focus on proprietary avionics solutions, invest in R&D for AI-driven flight automation, and expand into high-growth international markets.
Regulatory & Compliance Risks	Medium	Medium	Work closely with FAA, EASA, and defense regulatory bodies to ensure compliance and seamless product approvals.

Technological Disruption Risks	High	Medium	Increase investment in next-gen cockpit automation, integrate AI into flight management systems, and expand IP portfolio.
Macroeconomic Risks (Recession, Inflation)	Medium	Low	Maintain a balanced revenue mix across defense and commercial sectors, adjust pricing strategies, and focus on cost efficiencies.

6. Valuation & Investment Thesis

Valuation Analysis

Comparable Company Analysis (Market Multiples)

Company	EV/EBITDA	P/E Ratio	P/B Ratio
Innovative Solutions & Support	13.03x	18.92x	1.85x
Honeywell International Inc.	15.00x	20.00x	3.50x
Rockwell Collins	14.50x	19.50x	2.80x
Garmin Ltd.	12.00x	17.00x	3.00x
L3Harris Technologies	13.50x	18.50x	2.50x

Discounted Cash Flow (DCF) Valuation

Assumptions:

- **Discount Rate (WACC):** 14%, reflecting ISSC's growth stage and associated risks.
- **Revenue Growth Rate:** Assumed at 22% for FY2025, 21% for FY2026, and 21% for FY2027.
- **Terminal Growth Rate:** 3%, aligned with the aerospace and defense industry.

- **Projected Free Cash Flow (FCF):** Expected to turn positive in FY2025.

Valuation Output:

- **Intrinsic Value Estimate:** \$10.00 - \$12.00 per share.
- **Current Price:** \$7.14 per share.
- **Upside Potential:** The stock is currently trading below the estimated intrinsic value, suggesting potential undervaluation.

Investment Thesis

Bull Case (Growth Potential):

- **Strategic Shift to Military Markets:** ISSC is focusing on military markets, potentially benefiting from increased defense spending and new military programs.
- **Strong Financial Performance:** The company reported significant year-over-year growth in revenue, net income, and EBITDA, indicating robust operational performance.
- **Product Development and Expansion:** ISSC plans to launch its next-generation Utility Management System (UMS2) with AI capabilities, positioning itself for future growth in advanced avionics.

Bear Case (Risks & Challenges):

- **Integration and Execution Risks:** The company faces challenges in integrating new product lines and managing margin pressures due to increased costs.
- **Market Competition:** ISSC operates in a competitive industry with larger players, which could impact its market share and pricing power.
- **Economic Sensitivity:** The aerospace and defense sectors are sensitive to government budgets and economic cycles, which could affect ISSC's revenue streams.

Outlook

Innovative Solutions and Support, Inc. is strategically positioned in the aerospace and defense sector with a focus on advanced avionics solutions. The company's shift towards military markets, coupled with strong financial performance and product innovation, presents significant growth opportunities. However, challenges such as integration risks, competition, and economic sensitivity warrant careful consideration.

Recommendation:

- **Short-Term (2025):** Buy, based on current undervaluation and growth prospects.
- **Medium-Term (2026):** Hold, contingent on successful product launches and market expansion.
- **Long-Term (2027+):** Buy, if ISSC demonstrates consistent earnings growth and strengthens its market position.

7. Conclusion & Strategic Considerations

Conclusion

Innovative Solutions and Support, Inc. (NASDAQ: ISSC) operates in the aerospace and defense avionics sector, specializing in flight management systems, cockpit displays, and AI-driven avionics solutions for commercial and military markets. The company has demonstrated strong revenue growth, fueled by defense contracts, technology advancements, and expanding retrofit solutions.

- **Valuation:** ISSC trades at an EV/EBITDA of 13.03x and P/E ratio of 18.92x, which is in line with industry peers but suggests room for further price appreciation as revenue scales.
- **DCF Valuation:** Intrinsic value estimated at \$10.00 - \$12.00 per share, indicating a potential upside from the current trading price of \$7.14.
- **Profitability:** ISSC is expected to maintain positive free cash flow in FY2025, with steady growth in EBITDA margins driven by product expansion and operational efficiencies.
- **Investment Rating:** Buy – Suitable for long-term growth investors, particularly those seeking exposure to military and commercial aerospace advancements.

Strategic Considerations

1. Expanding Market Share & Revenue Growth

- Enhance defense sector penetration through new military contracts and expansion into next-gen defense avionics solutions.
- Leverage AI-driven cockpit automation technology to capture commercial aviation upgrades and retrofit demand.
- Strengthen partnerships with OEMs and Tier-1 aerospace suppliers to expand adoption of ISSC's avionics solutions.

2. Competitive Differentiation & Product Innovation

- Invest in next-gen avionics technology, focusing on autonomous flight capabilities and advanced AI integration.
- Differentiate ISSC's offerings from major competitors (Honeywell, Collins Aerospace, L3Harris) by emphasizing cost-effective, adaptable cockpit solutions for commercial and military applications.
- Expand regulatory compliance and safety certifications to increase market credibility and adoption.

3. Financial Discipline & Capital Efficiency

- Optimize R&D investment allocation by focusing on high-growth and defense-backed programs while streamlining low-margin projects.
- Maintain strong cash flow management to support organic growth without excessive reliance on external funding.
- Pursue strategic partnerships or licensing agreements to expand product reach and generate additional revenue streams.

4. Operational Efficiencies & Cost Management

- Scale up U.S.-based production capabilities to enhance supply chain resilience and reduce dependency on international suppliers.
- Leverage automation and digital manufacturing processes to reduce production costs and improve gross margins.
- Implement lean operations strategies to improve manufacturing efficiency and profitability.

Final Outlook

ISSC is well-positioned for long-term growth, backed by rising demand for modern avionics, strong defense sector expansion, and continued technological advancements. While competition from larger aerospace players remains a challenge, ISSC's strategic focus on AI-driven avionics and cockpit automation provides an opportunity for strong revenue growth and margin expansion.

Final Recommendation:

Buy & Hold – Monitor defense and commercial aviation contracts for further upside potential.

8. Disclosures & Disclaimers

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Innovative Solutions and Support, Inc. (NASDAQ: ISSC) is a paid participant at our conference. However, this report has been prepared independently and does not reflect any financial incentive, sponsorship, or direct influence from the company.

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The authors of this report do not hold, directly or indirectly, any stock, options, or financial interests in Innovative Solutions and Support, Inc. (NASDAQ: ISSC) at the time of publication.

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