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SUMMARY

Aggressive accounting, bloated balance sheet, and a culture of hitting numbers at all costs.

Ducommun sells a growth story built on contract assets, bloated inventory, and ASC 606 accounting levers rather than real demand.

Former insiders describe a top-down mandate to "find the number", leaving investors with overstated earnings power and rising risk as customers like Boeing and RTX delay shipments.

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Ducommun: Growth Story Built on Aggressive Accounting and a Culture of Hitting Numbers at All Costs

Ducommun Incorporated (DCO) is one of the oldest continuously operating aerospace and defense manufacturers in the United States, supplying structural and electronic components to military and commercial customers. In recent years, under new leadership, the company has tried to reinvent itself as a revitalized, high-growth platform, expanding through acquisitions and touting "record" backlog levels as proof of sustained demand. Management's narrative has resonated with the market, helping to push the stock higher on the perception of steady revenue expansion, improving margins, and durable end-market positioning. **Most prominently — and in one of the most overused tropes in corporate storytelling — management has begun publicly pounding the table on reaching $1 billion in revenues, *by any means necessary*.**

Beneath the surface, however, the reality is far less compelling. **Our research, reinforced by direct testimony from former employees, indicates that Ducommun's apparent growth has been driven not by robust end-market demand, but by aggressive revenue recognition, ballooning working capital, and a steady stream of acquisitions designed to mask weak organic performance.** Rising contract assets, surging receivables, and an unprecedented inventory build all point to a company booking revenue ahead of true delivery, tying up cash in warehouses, and relying on accounting levers rather than execution.

Former insiders were unequivocal: project delays and shipment push-outs from Boeing, RTX, and Airbus forced Ducommun to sit on finished goods. Rather than throttle production to reality, management doubled down, continuing to build and recognize revenue.

> *Former insiders admit the company never missed a revenue or EPS number because FP&A 'went looking for revenue' at quarter-end, exploiting ASC 606's flexibility to accelerate recognition as soon as material and labor hit the floor. While technically GAAP, this practice front-loads sales, inflates days-sales-outstanding metrics, and undermines earnings quality.*

This aggressive posture is not new to Ducommun. The company has a history of regulatory scrutiny tied to revenue recognition. Today, the same red flags are back — only now layered on top of ballooning debt, customer concentration, and slowing aerospace build rates.

Our concerns are heightened by parallels to other aerospace and defense roll-ups such as Mercury Systems, where a reliance on percentage-of-completion accounting and acquisition-driven growth masked a weakening core. **We believe Ducommun is following a similar script: management chasing headline growth while the underlying fundamentals erode.**

Our short thesis centers on the following forensic red flags:

- **Premature revenue recognition is inflating reported results.** Contract assets have grown far faster than sales, a hallmark of pulling revenue forward under percentage-of-completion accounting.

- **Inventory is spiraling.** Days-sales-of-inventory has surged from 67 days in 2018 to 121 days today — a balance sheet red flag corroborated by insiders who described warehouses with undeliverable parts as delays mount.

- **Backlog is rolling over.** What management touts as "record backlog" is in reality deteriorating demand, and when coupled with accounting gimmicks, it sets the stage for a sharp stock decline.

- **Non-GAAP games drive outsized pay.** Adjusted EBITDA runs ~4x GAAP net income, enabling the CEO to take nearly 68% of profits[1] in 2024 vs. 9.0% at peers.

- **End-market exposure is deteriorating.** Boeing and RTX, which account for a disproportionate share of revenue, are struggling with their own production, quality, and regulatory issues.

- **Governance remains weak.** A history of SEC scrutiny and recent reported material weaknesses combined with a CEO who prioritizes topline optics over fundamentals sets the stage for another reckoning.

In our view, Ducommun's earnings power is overstated, its cash flow quality is deteriorating, and its balance sheet is swelling with risk. The company's narrative of operational momentum will prove unsustainable, and the stock — currently priced for growth and stability — **is set up for a painful "big bath" period and valuation reset.**

[1] This is based on CEO total CAP in 2024. Total CEO compensation of $9.72 million for 2024 equaled 30.9% of NI.

"Finding Revenue" Plagues Ducommun at End of Every Period

Ducommun's rapid growth in receivables and ballooning days-sales-outstanding (DSO[2]) metrics indicate aggressive use of premature revenue recognition. This accounting choice is artificially pulling forward revenue from future periods, inflating current-period results, and creating a material drag on cash flows and future revenue that we believe will reverse.

In long-term contract industries such as aerospace and defense manufacturing, receivable and contract asset trends are often the most telling indicators of earnings quality. Customer programs are typically milestone-driven, payment terms are well-defined, and program schedules are largely dictated by the prime contractors or OEMs. In this environment, healthy operators show receivable growth in line with sales and DSOs that stay within a narrow range over time.

When receivables begin to meaningfully outpace revenue and DSOs expand sharply without a corresponding shift in customer mix or contract terms, it usually signals one of two scenarios:

- A deterioration in customer payment behavior, or

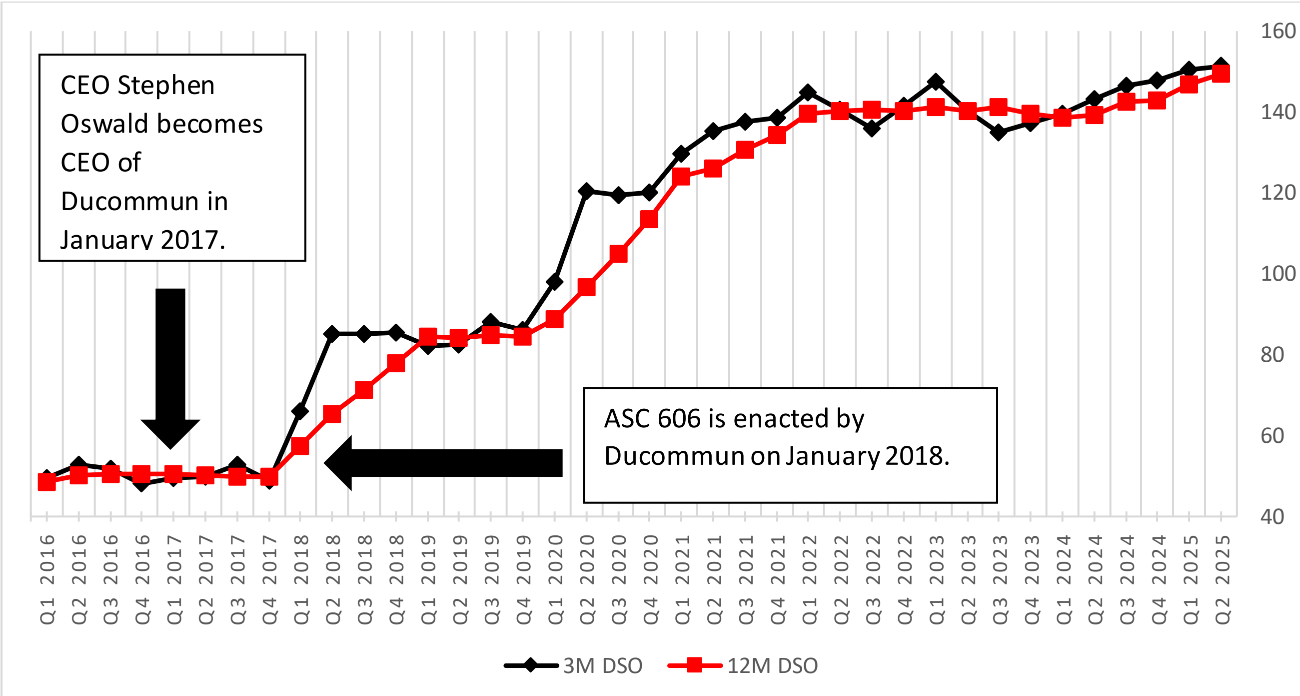
- Management is recognizing revenue ahead of actual delivery or invoicing — often via contract asset growth under percentage-of-completion methods.

Given Ducommun's customer base, payment history, interviews conducted with former high-ranking employees, and peer comparisons, we believe the second, more damaging, explanation fits. Specifically, interviews with former executives paint a picture of frantic end of periods with targets needing to be hit at all costs.

Evidence of Pull-Forward Revenue Recognition: Since CEO Stephen Oswald took the position in 2017, Ducommun's reported revenue growth has been paired with a disproportionate increase in both contract assets and total accounts receivable. Thus, causing DSOs to rise rapidly (see Chart 1, below). This has been exacerbated by the adoption of ASC606 in January 2018. Contract assets — which represent revenue recognized but not yet billed — have risen at a substantially faster pace of sales growth, swelling to a much larger proportion of total receivables than seen historically.

[2] Three-month days sales outstanding (3M DSO) = Average AR QOQ / 3M sales * 91.25. Twelve-month days sales outstanding (12M DSO) = Average AR YOY / 12M sales * 365.

Chart 1: Long-Term 3M and 12M DSO Trends

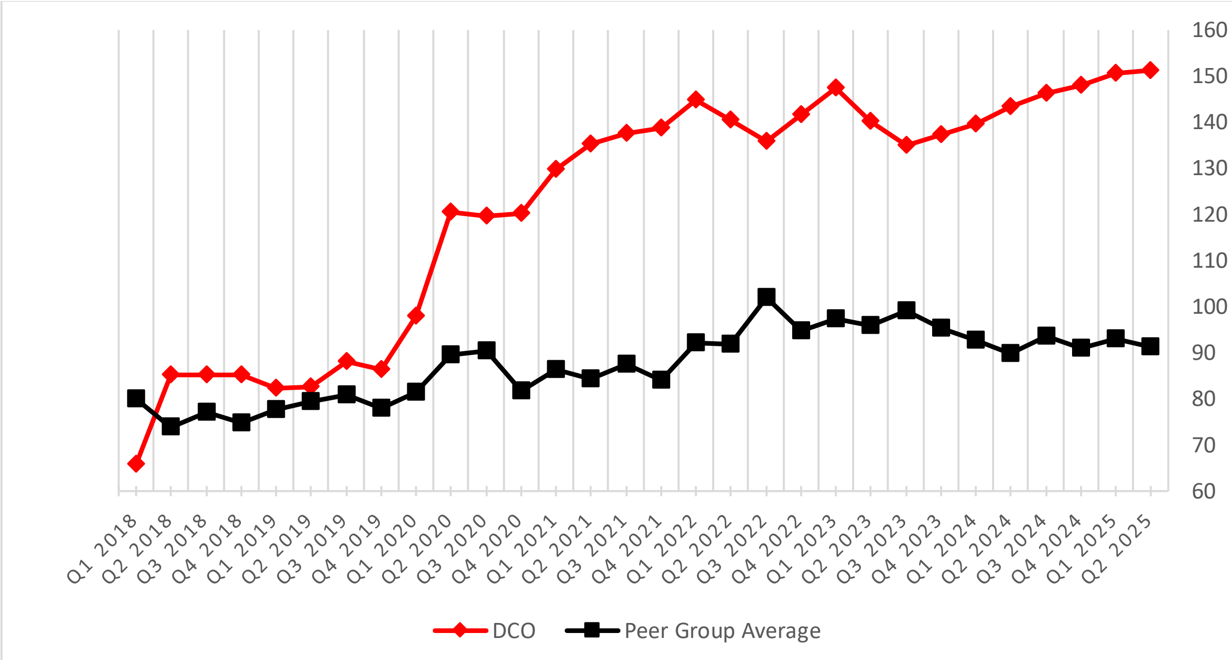


> *As you move to ASC 606... if you can get material to the floor and some labor on it, you can recognize like half the revenue — at least... It gave us a longer lever for sure... not that it's bad or wrong, it just puts stress on the company.*
> *--- Former High-Ranking Executive at Ducommun*

This pattern is not an industry-wide phenomenon. When looking at the overall peer group averages (see Chart 2, next page), we see that while there has been some DSO expansion observed by the group, it remains somewhat muted relative to Ducommun's surging metrics. Ducommun's divergence suggests an intentional shift in revenue timing, rather than a structural change in the market.

Accounting Mechanics & Risk: Ducommun recognizes revenue on certain long-term contracts using a cost-to-cost percentage-of-completion method. This method allows revenue to be recognized proportionally to the costs incurred on a project to date relative to total estimated project costs. The challenge is that these total cost estimates are inherently subjective — and Ducommun's own disclosures state that they are reviewed monthly and can be adjusted retrospectively.

Chart 2: Long-Term DSO Peer Group Analysis[3]



Excerpt 1: Revenue Recognition Estimate Policy

Contract estimates, known as "estimates at completion," are based on various assumptions to project the outcome of future events that can span multiple months or years. These assumptions include among others, actual gross profits on the same or similar products manufactured previously; labor productivity and availability; the complexity of the work to be performed; the cost and availability of materials; overhead cost rates; and the performance of subcontractors. As a significant change in one or more of these estimates could affect the progress completed (and related profitability) on our contracts, we review and update our contract-related estimates on a regular basis. We recognize such adjustments under the cumulative catch-up method. Under this method, the impact of the adjustment is recognized in the period the adjustment is identified. In any given reporting period, we have a large number of active contracts, which we have defined as a customer purchase order, and changes in estimates may occur on a significant number of these contracts. Given the significant number of contracts that we may have at any given point in time, the varied nature of products produced under such contracts, and the different assumptions, facts and circumstances associated with each individual contract, and the fact that such changes at the contract level are typically not material, we disclose cumulative catch-up adjustments on a net basis.

Net cumulative favorable and unfavorable catch-up adjustments to contracts had the following impact on our operating results:

	(Dollars in thousands) Years Ended December 31,		
	2024	2023	2022
Total net revenues	$ (2,402)	$ (7,161)	$ (4,842)
Operating income	$ (2,402)	$ (7,161)	$ (4,842)

[3] Peers used in the analysis include MRCY, ATRO, KTOS, HXL, AVAV, AIR, HEI, CR, MOG.A, RBC, NOC, as well as DCO.

This flexibility gives management the ability to accelerate or defer revenue recognition depending on internal objectives. A small downward adjustment in estimated total costs can materially increase the percentage of completion and the amount of revenue recognized in the current period — even if no physical delivery has occurred. **As we can see above, the company has reported material unfavorable adjustments to revenues and earnings in each of the last three years.**

When this discretion is used aggressively, the result is exactly what we see at Ducommun: elevated contract assets, lengthening DSOs and DSIs, and revenue growth that runs ahead of cash generation.

Earnings Volatility: The consequences of aggressive pull-forward accounting are predictable and, in our view, unsustainable. Once the projects with pulled-forward revenue conclude, the company faces a “growth gap” in subsequent periods. Without new contracts of similar size and margin, reported revenue can decelerate abruptly. Overall, we believe the recent pull-forward in revenues have cosmetically enhanced revenue and EBIT by $61.3 million in fiscal 2024.[4] With this, management was able to artificially beat analyst estimates in three of the reported four periods.

Investor Takeaway: We view Ducommun’s rising DSOs and contract asset surge as a material earnings-quality issue. The divergence from peers, the pace of growth in unbilled revenue, and the discretion inherent in the company’s revenue recognition method combine to create a high likelihood that reported results are being propped up by accounting choices rather than operational strength. Furthermore, we believe a “big bath” quarter will likely ensue causing many of the aforementioned metrics to reset back to historical standards while also decimating DCO’s stock price.

The last time we saw this pattern in the sector — most notably at Mercury Systems — it ended with a sharp slowdown in reported revenue, a working capital unwind, and a significant valuation reset as investors re-rated the stock for lower-quality earnings. **Mercury’s stock price also fell 41.1% the year after our publication on 07/26/22. We believe Ducommun is on a similar trajectory.**

This same pattern shows up even more starkly in Ducommun’s contract asset balances. If DSOs are the symptom of aggressive pull-forward accounting, then contract assets are the direct mechanism. Rising far faster than sales, they reveal how much revenue management has already recognized without billing customers — a structural imbalance that is worsening each quarter.

[4] Our calculation is detailed in the next section.

Skyrocketing Contract Assets Afflict Ducommun's Balance Sheet

Since the adoption of ASC606 in FY2018, our analysts tracked a salient rise in contract assets (AKA unbilled receivables) at Ducommun, giving us grave cause for concern. Due to DCO's customer base, this is not a credit concern, but a revenue recognition red flag, which we deem to be much worse. Thus, the focus of our research is mainly on unbilled, rather than billed, receivables. These risky types of receivables represent revenue already recognized by management; however, the client has yet to be billed or agreed on any type of pricing.

When contract assets continue to grow as contract liabilities decrease, it creates a cash flow problem. It also means:

1) The company is spending faster than they are billing on their projects
2) The project managers are behind in getting their bills out, and/or
3) The company has costs on the balance sheet that are actually losses, such as job overruns or change orders that are not or will not be approved.

Basically, contract assets represent revenue that has been recognized by management on the income statement but has not been invoiced or agreed upon by the client yet. <u>This recognized revenue is totally subjective and up to DCO management's decision making.</u> Below, we lay out the company's unfavorable contract assets trends, which will be a threat to future persistence of earnings:

- In the latest period (Q2 2025), three-month revenue was muted, growing by only 2.7% YOY to $202.3 million while contract assets increased 5.1% YOY to $221.0 million (a near all-time high). As a result, unbilleds-to-3M sales rose by 251 bps to 109.3%. This represents an all-time high mark for any Q2 period.

- Three-month unbilled DSO[5] rose to nearly five-year-high of 97 days. Longer-term trends display 12M unbilled DSO rising by 7.6% YOY to 98 days, again two days below the 100 day all-time high (see Table 1, next page). We note that since ASC606 took effect, these metrics have doubled from their 49 days balance in Q2 2019.

[5] Three-month unbilled days sales outstanding (3M unbilled DSO) = Average current contract assets QOQ / 3M Sales * 91.25. Twelve-month unbilled days sales outstanding (12M DSO) = Average current contract assets YOY / 12M Sales * 365.

- Unbilled receivables account for over 64.9% of current receivables at the end of Q2 2025, one of the highest values we have seen across DCO's peer group.

Table 1: Unbilled Receivables/Contract Assets Metrics
($ in millions)

Period Ended:	Q2 2025	Q1 2025	Q4 2024	Q3 2024	Q2 2024
Contract Assets / Unbilleds	$221.0	$210.9	$200.6	$221.4	$210.3
Contract Assets to Total AR (%)	64.9%	63.9%	64.6%	67.3%	66.4%
CA-to-3M Sales (%)	109.3%	108.6%	101.7%	109.9%	106.8%
CA-to-12M Sales (%)	27.8%	26.7%	25.5%	28.3%	27.1%
Unbilled 3M DSO (days)	97	97	98	98	94
Unbilled to 12M DSO (days)	98	96	93	93	91
YOY					
Contract Assets (%)	5.1%	7.0%	12.9%	15.8%	10.8%
Contract Assets to Total AR (bps)	-149	-145	172	263	-19
CA-to-3M Sales (bps)	251	539	924	1254	542
CA-to-12M Sales (bps)	71	100	203	295	155
Unbilled 3M DSO (%)	3.3%	8.0%	11.5%	10.4%	0.8%
Unbilled to 12M DSO (%)	7.6%	6.3%	2.6%	0.0%	-2.9%

Net Contract Assets Increase 34% in 2024; Portending a Pull-Forward of $61.3 Million of Revenue

Our analysts like to evaluate both contract asset and liability trends to get a full picture of a firm's quality of revenues. In most cases, a company with a net balance near $0 or negative would signal positive earnings quality, meaning the firm's customer advances are above unbilled AR. This is nowhere near the case for DCO, as shown by our calculations below:

- Ducommun's contract liabilities/deferred revenues have bifurcated greatly from revenue falling 26.1% YOY to $37.0 million in the latest period. While we have seen a spike in contract assets over CEO Oswald's tenure, contract liabilities growth has been somewhat muted in comparison.

- Thus, we calculate Ducommun's net contract assets (NCA) as total contract assets net of total contract liabilities. Here we see that NCAs reached its second-highest absolute value in company history surging by 14.8% YOY to $184.0 million in Q2 2025 (see Table 2, below).

- As a result, NCAs jumped by 962 bps YOY to 91.0% relative to quarterly sales in Q2 2025, representing the second-highest percentage for Q2 in any year. Net contract assets-to-12M sales also increased by 250 bps to 23.1% in the period.

- We can reverse engineer Ducommun's NCA balance using the firm's NCA relative to sales from the prior period to quantify the impact of recognizing this revenue earlier than the historical standard. We calculate that DCO recognized an astonishing $61.3 million aesthetic gain in revenue (also pure margin gains) in FY 2024.[6]

- Without this $61.3 million artificial tailwind, stated and organic revenue would have declined greatly in FY2024, missing management's outlook by a considerable amount (see Table 3, next page).

Table 2: Net Contract Assets Metrics
($ in millions)

Period Ended:	Q2 2025	Q1 2025	Q4 2024	Q3 2024	Q2 2024
Net Contract Assets (NCA)	$184.0	$173.4	$166.1	$184.6	$160.3
NCA-to-3M sales (%)	91.0%	89.3%	84.2%	91.6%	81.4%
NCA-to-12M sales (%)	23.1%	22.0%	21.1%	23.6%	20.6%
NCA 3M DSO (days)	81	80	81	78	69
NCA 12M DSO (days)	80	76	72	70	68
YOY					
Net Contract Assets (%)	14.8%	24.5%	33.8%	32.1%	1.4%
NCA-to-3M sales (bps)	962	1,636	1,960	2,046	(305)
NCA-to-12M sales (bps)	250	379	472	507	(62)
NCA 3M DSO (%)	16.2%	26.7%	29.5%	12.8%	-8.9%
NCA 12M DSO (%)	17.5%	11.7%	3.4%	-4.8%	-9.5%

[6] With a net contract asset 3M DSO value of 81 days in FY2024 (average net contract assets / 3M sales x 365), this assumes that NCA should equate to a normalized DSO value of 63 days reported in FY2023. We performed this same calculation from the prior four periods to get our FY2024 figure of $61.3 million.

Chart 3: Net Contract Assets Trends Since ASC 606
($ in millions)

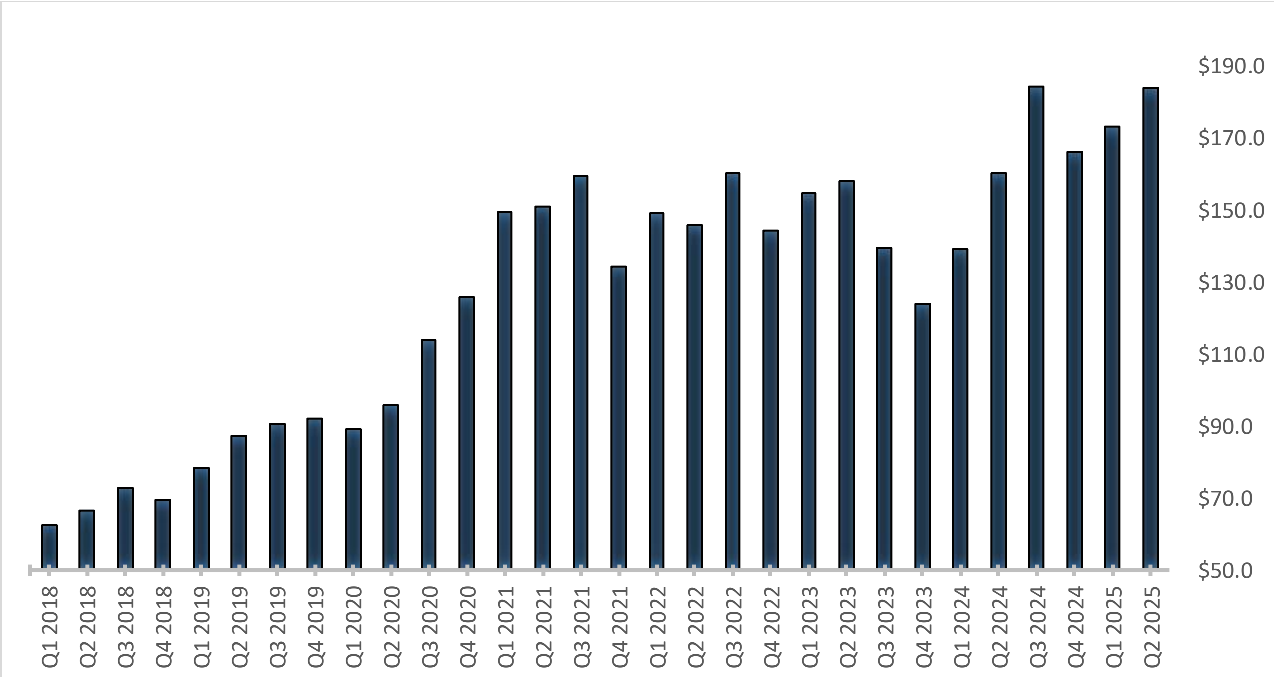


Table 3: Adjusted Revenue Metrics Vs. Estimates

($ in millions)

Period Ended:	Q4 2024	Q3 2024	Q2 2024	Q1 2024
Stated Revenue	$197.3	$201.4	$197.0	$190.8
Consensus Estimates	$195.6	$194.1	$194.9	$189.2
Beat/Miss	Beat	Beat	Beat	Beat
GlassHouse Adjusted Revenue	$200.0	$170.0	$172.7	$182.6
Difference from Actual (%)	1.4%	-15.6%	-12.3%	-4.3%
Adjusted Beat/Miss	Beat	Miss	Miss	Miss

Management Explanations for Spike in Contract Assets

If Ducommun's ballooning contract assets were a genuine reflection of demand, management wouldn't need to spend every earnings call spinning a new excuse for why cash flow is lagging so far behind revenue. Instead, investors have been fed a rotating set of justifications: seasonality, strategic inventory builds, and "temporary working capital investments" that will supposedly unwind in future periods. The story has shifted quarter to quarter, but the balance sheet keeps telling the same tale — contract assets keep climbing, while cash conversion lags badly.

In the Q1 2025 Earnings Call, when analysts pressed on surging DSOs, CFO Suman Mookerji brushed it off: ***"There isn't any structural change. It was just the seasonality, a one-time kind of thing during the quarter."*** Yet the same "temporary" headwinds have appeared year after year, always framed as anomalies that never seem to go away.

In Q2 2024, management admitted contract assets jumped another $13 million, rationalizing it as a "buffer build" tied to a facility closure and "modest build ahead" in aerospace structures to "level load production." In Q1 2024, the explanation shifted again: ***"We grew our contract assets net of contract liabilities by $15 million. We continue to look for opportunities to unwind our working capital investments to improve our cash flow."***

This theme has been a constant since at least 2023, when management began telling investors that working capital turns would "improve" and contract assets would "unwind." Yet despite repeating these assurances across multiple quarters, **no such improvement has ever materialized. Working capital has only grown more bloated, DSOs continue to expand, and cash conversion remains depressed.**

Perhaps the most damning disclosure came in the Q4 2023 earnings call, when Ducommun pre-announced a **material weakness in its internal controls over revenue recognition**. Management admitted this weakness resulted in "immaterial adjustments to net revenues and contract assets" for the quarter. While they downplayed the impact, this is the clearest evidence yet that the company's contract asset growth is not simply an issue of "timing," but tied to deficiencies in how revenue is actually being recorded.

Earlier, in 2022, then-CFO Chris Wampler had offered his own spin: contract assets and inventory growth were a sign of strength, evidence of "strategic use of cash" and improved customer relationships. *"Since I've been here, we've* *never been at a better place with our customers across the board on on-time delivery and quality,"* he claimed. But that narrative falls apart against the reality of customer push-outs, inventory swelling, and ballooning DSOs in the ensuing periods.

The pattern is clear: whenever Ducommun is pressed on working capital, management frames the contract asset spike as a short-term, intentional investment that will soon reverse. Yet after years of such assurances, balances continue to rise, free cash flow conversion remains depressed, and the company has been forced to admit material weaknesses in its revenue recognition process.

Former insiders confirm that this was not about "seasonality" or "strategic buys" at all, but a deliberate top-down mandate to hit numbers. As one senior finance executive explained:

> *If we were coming off a number, I had to go find it… literally me going to general managers saying, what can we build ahead on? What can we ship ahead on? How can we under US GAAP recognize revenue such that we can make a number?*

Under ASC 606, management leaned hard on this flexibility: *"As you move to ASC 606… if you can get material to the floor and some labor on it, you can recognize like half the revenue — at least."* The result, in his words, was that ***"We never missed a revenue or EPS number after COVID — but that was me going and finding it."***

In our view, these admissions reveal the real driver of contract asset growth: a culture of pulling every lever possible to avoid a miss, not a temporary working capital investment that will unwind. Management's repeated public assurances about improving turns ring hollow against this insider testimony.

Contract assets expose how Ducommun accelerates revenue on paper. But the other side of the same coin is sitting on the balance sheet as physical product. Instead of letting schedules slip, management kept production running and booked revenue early, leaving warehouses full of undelivered goods. The result is an unprecedented build in inventory.

Inventory Build Signals Project Delays and Customer Pushback

One of the clearest signs of Ducommun's deteriorating fundamentals is the surge in inventory relative to sales. Ducommun's days-sales-in-inventory[7] (DSI) metric has ballooned to 121 days in the latest period, nearly double the 67-day balance in Q2 2018 (when ASC 606 took effect). This is not a trivial fluctuation — it represents a structural break in working capital management that calls into question both the quality of reported earnings and the health of underlying demand.

Management's talking points pin the issue on supply chain "timing" and customer "schedules," but the real explanation is more straightforward — and far more troubling. **Former employees we spoke with were blunt: Boeing, RTX, and Airbus have all delayed programs and pushed out shipments. Instead of slowing its own production to match actual deliveries, Ducommun kept cranking out parts, stuffing them onto its balance sheet, and in many cases booking associated revenue before product ever left the dock.**

This behavior creates the illusion of steady revenue growth while silently bloating working capital. It is a form of balance sheet sleight of hand: move revenue forward, bury the cash impact in inventory, and hope nobody notices until demand "catches up." Investors applauding Ducommun's backlog narrative are missing the obvious — the backlog is not flowing cleanly into cash, it is congealing into warehouses full of unsold product.

The risks are obvious and growing:

- **Obsolescence and write-downs.** Aerospace inventory isn't generic widgets that can be shuffled between customers. It's often tied to specific programs, specifications, and production runs. When customers like Boeing (mired in FAA oversight and 737 MAX quality investigations) or RTX (dealing with multi-billion-dollar engine recalls) push schedules to the right, parts can sit on shelves indefinitely. The longer DSI stretches, the higher the likelihood that these "assets" turn into write-offs.

- **Margin compression masquerading as "investment."** Management frames inventory as a strategic investment to "support backlog growth." We see it as an exercise in margin smoothing. By overproducing today, Ducommun props up fixed cost absorption and maintains reported gross margins — but only by deferring the inevitable recognition of costs tied

[7] Three-month days sales of inventory (3M DSI) = Average inventory QOQ / 3M COGS * 91.25.

to delayed or cancelled shipments. When programs slip or customers cut orders, margins will collapse under the weight of excess stock.

- **Cash flow drain and debt reliance.** Inventory is not free. Every extra day of DSI ties up more cash that could otherwise support operations. With DSI up 80% since 2018, Ducommun has effectively locked away tens of millions of dollars in stranded working capital. The company has papered over this cash burn with debt and credit facility draws, but leverage has already crept higher. If the inventory doesn't convert, creditors — not customers — will be the real backstop.

What makes the situation worse is that Ducommun is an outlier. Yes, peers across the aerospace supply chain have seen some inventory swelling post-COVID, but nowhere near the scale of Ducommun's ballooning balance. The company's DSI trajectory is not the product of "industry trends" — it is the fingerprint of aggressive accounting and weak discipline.

Investors should be clear-eyed: Ducommun's inventory build is not a sign of "positioning for growth." It is a symptom of a company producing far more than customers are taking, recognizing revenue well ahead of cash, and hoping the cycle bails them out before the balance sheet buckles. History in aerospace roll-ups shows how this movie ends: the warehouse fills, impairments follow, and shareholders eat the loss.

DSIs Grow 80% Under ASC 606:

In the most recent period, Ducommun reported inventories of $197.3 million, representing a 2.2% decline YOY but still among the highest balances in company history. By comparison, sales for the quarter were $202.3 million, underscoring that the company is now carrying nearly a full quarter's worth of revenue in inventory.

More importantly, the diagnostics behind this balance sheet tell a very different story than management's narrative of "strategic buys" and "temporary working capital investments." **Ducommun's days sales in inventory (DSI) has nearly doubled since 2019, rising from 68 days to 121 days in the most recent quarter.** This deterioration has been steady and persistent, with Q2 DSIs of 99 (2020), 105 (2021), 106 (2022), 124 (2023), 129 (2024), and now 121 (2025). While peers saw some COVID-related dislocations, Ducommun's sustained upward trend highlights structural mismanagement rather than transitory headwinds.

Several red flags stand out:

- **Inventories have consistently outpaced sales growth since ASC 606 was enacted.** Even in the most recent quarter, with sales of $202.3 million, DSI remained at an elevated 121 days, nearly double the pre-2019 level of ~68 days.

- **Relative to forward sales expectations, inventories remain bloated.** Using consensus NTM revenue estimates of $857.5 million, inventory sits at **23% of forward sales**, well above the five-year pre-COVID average of ~15–17%.

- **Management's credibility on inventory turns has collapsed.** Since 2020, Ducommun's CFOs have repeatedly assured investors that working capital would "unwind" and that inventory turns would improve. Instead, **turnover has deteriorated five of the last six years**, leaving Ducommun's balance sheet more bloated than at any point in its modern history.

Former insiders confirm what the numbers already make obvious: the inventory build is less about "strategy" and more about customer delays. A former high-ranking executive at Ducommun said, ***"Typically it's because of a delay on the customer not wanting to take it… you're going to be sitting on some sort of finished product until those deliveries."***

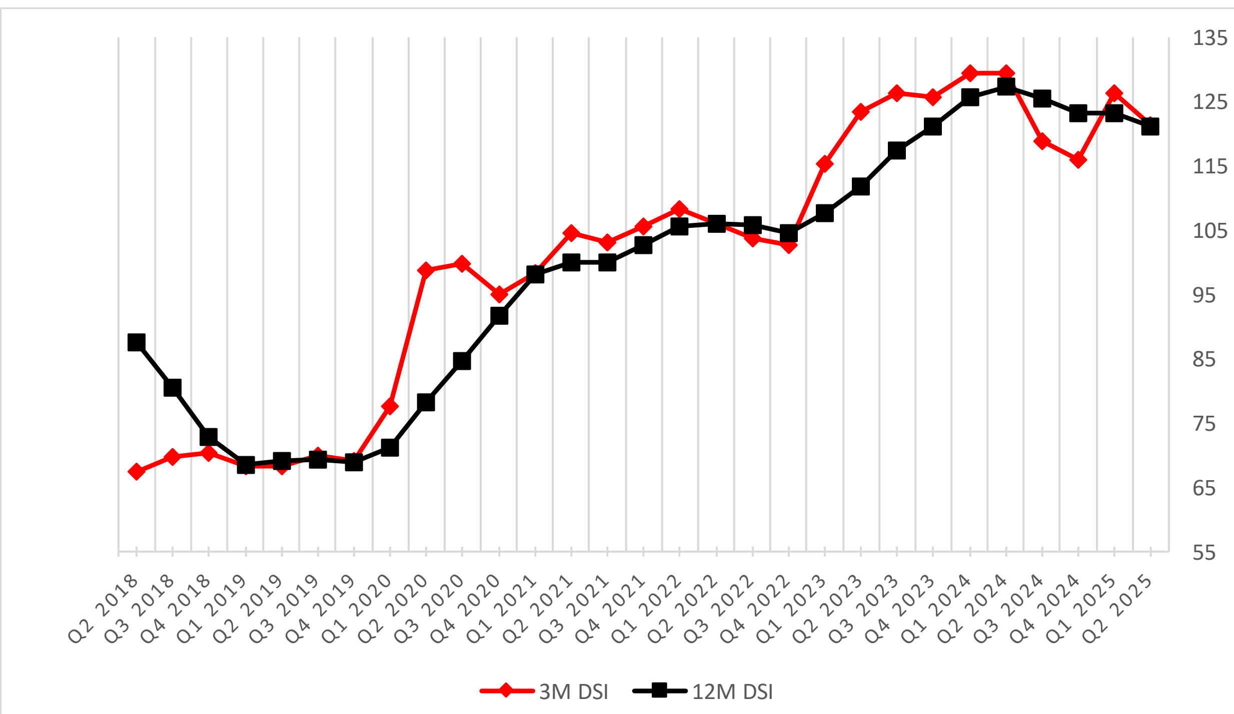
The trend is unambiguous: since the adoption of ASC 606, Ducommun has leaned heavily on contract asset recognition and overproduction, leading to an inventory build that has become embedded in its operations. With DSI stuck at 121 days despite repeated promises of improvement, the risk of write-downs, cash flow drain, and margin compression is rising.

The bloat in inventories wouldn't be quite as alarming if Ducommun's forward order book were expanding to absorb it. But the supposed cushion of 'record backlog' is itself starting to unravel, with book-to-bill ratios slipping below 1.0 and backlog rolling over.

Table 4: Inventory Metrics
($ in millions)

Period Ended:	Q2 2025	Q1 2025	Q4 2024	Q3 2024	Q2 2024
Inventory	$197.3	$197.4	$196.9	$185.8	$201.8
Inventory-to-3M sales (%)	97.5%	101.7%	99.8%	92.2%	102.5%
Inventory-to-12M sales (%)	24.8%	25.0%	25.0%	23.8%	26.0%
3M DSI (days)	121	126	116	119	129
12M DSI (days)	121	123	123	126	127
YOY					
Inventory (%)	-2.2%	-5.5%	-1.2%	-13.7%	-1.3%
Inventory-to-3M sales (bps)	(493)	(779)	(383)	(1,742)	(670)
Inventory-to-12M sales (bps)	(118)	(226)	(128)	(480)	(151)
3M DSI (%)	-6.2%	-2.5%	-7.7%	-5.9%	4.7%
12M DSI (%)	-4.8%	-2.0%	1.8%	7.0%	13.9%

Chart 4: Long-Term 3M and 12M DSI Trends



Backlog Rollover and Book-to-Bill Inflection

For years, Ducommun's management leaned on expanding backlog as a counterweight to questions about its aggressive accounting. "Record backlog" was repeatedly framed as proof that future revenues were secure and demand was strong. But the actual trajectory of backlog and bookings in 2024–2025 tells a different story — one of structural deterioration.

At year-end 2024, Ducommun reported backlog of $1.06 billion. By Q2 2025, that figure had slipped to $1.02 billion. While on the surface this decline looks modest, the underlying dynamics are troubling: both commercial aerospace and military end-markets contributed to the contraction, undermining the claim that diversification insulates Ducommun from program volatility.

The company's own booking data shows the first sustained sub-1.0 book-to-bill ratios in years: **0.70x on a three-month basis as of Q2 2025 and 0.91x in Q1 2025**. While Ducommun noted that **$714.0 million of backlog is expected to ship over the next 12 months**, that figure is down from $756 million just one quarter earlier.

The implications are significant:

1. **Future revenue visibility is deteriorating.** Backlog had previously served as the buffer against scrutiny of aggressive working capital tactics. With backlog now contracting, that narrative of order growth no longer holds.

2. **Inventory risk is rising.** "NTM Backlog" fell from **$756 million in Q1 2025 to $714 million in Q2 2025**, while inventory days remain elevated. This creates the classic setup where product is building in warehouses even as near-term shipping commitments shrink.

3. **Quality of backlog is questionable.** Remaining performance obligations (RPOs) under ASC 606 stood at **$906 million in Q2 2025**, materially below the reported backlog of $1.02 billion. The gap reflects softer agreements and underscores the risk that backlog is being presented as firmer than it truly is.

Peers have seen softer backlog dynamics post-COVID, but very few have reported simultaneous backlog contraction *and* sub-1.0 book-to-bill for multiple quarters. The pattern is uniquely concerning for Ducommun because its backlog story has been central to the bull case — and it is now unraveling just as working capital balances balloon.

Backlog growth once allowed Ducommun to deflect concerns around its reliance on cumulative catch-up adjustments and premature revenue recognition. Now, with book-to-bill ratios rolling over and the backlog itself shrinking, management faces a choice: either acknowledge slowing order intake or lean further on accounting levers to preserve the optics of growth.

As backlog momentum fades, the pressure to preserve the growth narrative only intensifies. With fewer real orders to lean on, management has turned to adjusted metrics and accounting exclusions to manufacture the appearance of steady profitability — and to justify oversized executive pay.

Table 5: Backlog and Bookings Metrics[8]
($ in millions)

Period Ended:	Q2 2025	Q1 2025	Q4 2024	Q3 2024	Q2 2024
Backlog	$1,017.9	$1,053.6	$1,060.8	$1,043.9	$1,068.0
3M Bookings (mgmt. given)	$141.0	$177.0			$205.0
3M Book-to-bill (mgmt. given)	0.70	0.91			1.04
YOY					
Backlog (%)	-4.7%	0.8%	6.8%	8.9%	5.7%
3M Bookings (%)	-31.2%	-27.5%			
3M Book-to-bill (bps)	(3,436)	(3,667)			

[8] Management has sparsely provided bookings and book-to-bill metrics within their earnings calls.

Non-GAAP Distortion & CEO Compensation

Recurring "One-Time" Exclusions

Ducommun's reconciliation from GAAP Net Income to Adjusted EBITDA demonstrates just how aggressively management massages results. In 2024, GAAP Net Income was only $31.5 million, yet Adjusted EBITDA was presented as $116.6 million — nearly a **4x uplift**. This has not been an isolated blip, but a structural feature of the company's reporting. Each year, management finds new ways to exclude recurring costs, presenting a picture of profitability that diverges sharply from economic reality.

The adjustments themselves are telling:

- **Stock-based compensation**, excluded as if it were "non-cash" and irrelevant to shareholders. Yet equity grants are very real dilution. The expense has climbed steadily: $10.7m in 2022, $15.0m in 2023, and $17.8m in 2024.
- **Restructuring charges**, supposedly "one-time," recur like clockwork. Specific charges of $7.7 million, $14.6 million, and $6.27 million in 2024, 2023, and 2022, respectively — and similar charges going back to 2017 and earlier. A charge every year is not restructuring; it is a cost of doing business.
- **Acquisition-related step-ups**, a direct function of Ducommun's roll-up strategy: $5.5m in 2023, $2.3m in 2024. Management pursues bolt-ons, then excludes the integration costs from performance measurement.
- **Opportunistic exclusions** — anything from $3.1m in "professional fees" tied to an unsolicited acquisition offer, to fire-related expenses, to a "success bonus" for a sale-leaseback.
  Depreciation conveniently ignored — yes, depreciation is technically "non-cash," but for an aerospace and defense manufacturer spending hundreds of millions in CapEx, it is very real. Pretending depreciation doesn't matter is equivalent to assuming CapEx is paid with fake money.

Peers like Triumph (TGI), Hexcel (HXL), and TransDigm (TDG) report Adjusted EBITDA, but their reconciliations are relatively narrow — stock comp and occasional restructuring. Ducommun's constant layering of charges, year after year, puts it at the extreme end of non-GAAP dependence in the aerospace sector.

Excerpt 2: GAAP to Non-GAAP Reconciliation

Reconciliation of GAAP to Non-GAAP – Adjusted Operating Income

See explanation of items added back to our operating income in "Reconciliation of GAAP to Non-GAAP Net Income to Adjusted EBITDA" above.

	2024	2023	2022	2021	2020	2019	2018	2017	2016	2015
GAAP Operating income	$52,211	$28,917	$39,788	$48,881	$45,506	$56,233	$23,918	$15,634	$29,216	$(75,309)
Adjustments to GAAP Operating Income:										
Restructuring charges	7,656	14,855	6,686	–	2,424	–	14,792	8,838	182	–
Inventory purchase accounting adjustments	2,269	5,531	1,381	106	–	511	622	1,235	–	–
Professional fees related to unsolicited non-binding acquisition offer	3,145	–	–	–	–	–	–	–	–	–
Guaymas fire related expenses	–	3,896	4,466	2,486	1,704	–	–	–	–	–
Other fire related expenses	–	477	–	–	–	–	–	–	–	–
Other income	–	222								
Other debt refinancing costs	–	–	224	–	–	77	697	–	–	–
Success bonus related to completion of sale-leaseback transaction	–	–	–	1,451	–	–	–	–	–	–
Amortization of acquisition-related intangible assets	**8,930**	**8,288**	**6,449**	**4,893**	**4,856**	**2,913**	**2,038**	**445**	**–**	**–**
Non-GAAP Adjusted Operating Income	**$74,211**	**$62,186**	**$58,994**	**$57,817**	**$54,490**	**$59,734**	**$42,067**	**$26,152**	**$29,398**	**$(75,309)**
% of net revenues	**9.4%**	**8.2%**	**8.3%**	**9.0%**	**8.7%**	**8.3%**	**6.7%**	**4.7%**	**5.3%**	**-11.3%**

Incentives Leveraged to Adjusted Metrics:

The reliance on adjusted numbers would be bad enough if it were just for investor optics. The real problem is that management's pay is explicitly tied to these inflated metrics. In 2024, the annual incentive plan was weighted:

- 70% Operating Income (as adjusted)
- 20% Adjusted Cash Flow
- 10% Net Revenues

This formula practically guaranteed a windfall. Operating Income "actual" of $74.3m — only achieved after layering in exclusions and revenue pull-forwards — narrowly cleared the "maximum" target of $71.3 million. That triggered a **300% payout** on the 70% weighting. Adjusted Cash Flow also maxed out, despite GAAP cash being far weaker once restructuring and acquisition costs are included. Net revenues, juiced by contract asset recognition, filled out the remaining 10%. The outcome: a total payout of **277% of target**.

In plain English, management was paid nearly triple their target bonus for results that would not have been possible under GAAP accounting. Shareholders saw $31.5 million of real net income, while executives enjoyed windfalls based on adjusted figures that excluded costs investors actually bore.

Contract Assets as the Hidden Lever:

The decisive lever for hitting those targets wasn't operational execution — it was accounting. Aforementioned in our contract assets section, we believe that management pulled forward **$61.3 million in 2024**, representing revenue recognized ahead of billing. Under ASC 606, if materials are on the shop floor and some labor has been applied, revenue can be recognized even if the customer hasn't accepted the product. Insiders described this flexibility as a "long lever," one management pulled aggressively.

This is not a side effect — it is the core mechanic of how bonuses were earned. Contract asset growth directly boosted both Operating Income and Net Revenues, the two metrics that together made up 80% of the annual incentive plan. Without the $61.3 million contract asset build, revenues would have been lower, operating income would have fallen short of the "maximum" hurdle, and the 277% payout would never have materialized. The incentive system encouraged management to accelerate recognition, inflate working capital, and mortgage future periods to secure immediate payouts.

Outsized Pay vs. GAAP Profits:

The end result is a company where executive pay is detached from economic performance. In 2024, CEO Steve Oswald's total compensation equated to $9.72 million, this amounts to 30.9% of net income for the year. However, when we look at Compensation Actually Paid (CAP), this was astonishingly **$21.3 million, or 67.6% of all GAAP Net Income**! That ratio is extraordinary.

Table 6: CEO CAP Vs. Net Income (Latest Fiscal Year)
($ in millions)

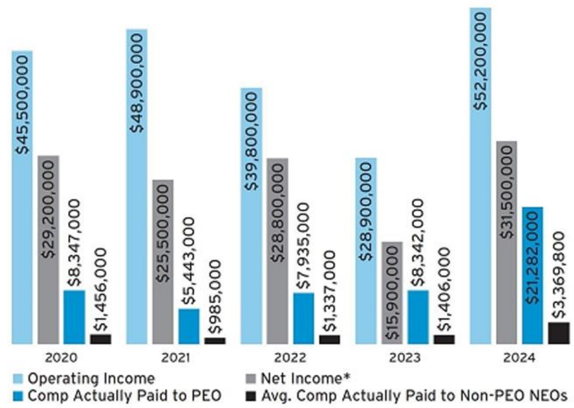
Company	CEO CAP	Net Income	CAP as % of NI
Ducommun (DCO)	$21.3	$31.5	67.6%
Peer Group Median[9]			8.9%

[9] Peer Group includes KTOS, KXL, AVAV, AIR, HEI, CR, MOG.A, RBC, and NOC. MRCY and ATRO were removed due to losses in latest fiscal year.

Excerpt 3: CEO Steven Oswald CAP vs. Earnings

The graph below illustrates the relationship between our net income, operating income and compensation actually paid to our PEO and non-PEO NEOs:

Net Income vs. Operating Income vs. Comp Actually Paid (4)



(4) *"Compensation Actually Paid" versus Net Income and Operating Income rounded to the nearest $100,000.*
* *2021 Net Income excludes $110M attributable to Ducommun's completion of a sale-leaseback transaction involving its Gardena, CA performance center.*

As illustrated in the above graph, on a year-over-year basis our net income more than doubled and our operating income increased by over 80% due to a higher percentage of revenues from engineered products, strategic pricing initiatives, footprint consolidation and lower interest expense. The compensation actually paid to our PEO and non-PEO NEOs increased in a manner reflective of the year-over-year increase in market capitalization of approximately $180M and our all-time high revenues in 2024, and which was consistent with our pay for performance compensation philosophy.

Ducommun's CEO consumed nearly **68% of GAAP profits in FY2024. Peer CEOs at similar mid-cap aerospace suppliers typically extract just 8.9%.**
The proxy statement justifies this by pointing to "adjusted operating income" growth and a higher market cap. In other words, management links its pay not to GAAP profitability or sustainable cash flow, but to metrics inflated by exclusions and accounting constructs.

Ducommun's non-GAAP practices aren't window dressing; they are the mechanism by which management justifies oversized payouts. Recurring "one-time" exclusions, opportunistic adjustments, and aggressive contract asset growth feed directly into incentive formulas. When over half of profits flow to one man while cash flow stagnates, investors should ask whose interests Ducommun is really serving.

The incentive to inflate adjusted results would be troubling enough on its own. But the underlying weakness is compounded by the fact that Ducommun's business is tethered to a handful of large primes, each facing structural challenges of their own. This concentrated exposure leaves the company hostage to customers who dictate terms, delay deliveries, and push working capital burdens downstream.

Customer/Client Base Risk: Concentrated Exposure to Struggling Primes

Ducommun's vaunted "record backlog" is only as strong as the customers standing behind it. In FY2024, its top ten customers made up nearly 60% of total revenue, with Boeing and RTX alone accounting for more than a quarter. Such reliance might be manageable if the customers themselves were growing and financially healthy. **But the reality is the opposite: every one of Ducommun's key accounts is under pressure, either from regulatory constraints, supply chain failures, program volatility, or outright restructuring. This leaves Ducommun exposed to squeezed margins, delayed collections, and finished goods piling up in warehouses.**

On build-to-print work, which makes up a large share of Ducommun's business, the company has no pricing power. The primes dictate terms — both on pricing and on cash collection. Payment cycles often stretch well beyond 60 days, directly contributing to Ducommun's ballooning DSOs. Insiders confirmed that revenue was frequently pulled forward under ASC 606 rules simply to "make the number," even when product sat undelivered because a prime had pushed out its schedule. Against this backdrop, consensus estimates across Boeing, RTX, Lockheed, Northrop, and Spirit show how fragile the foundation really is.

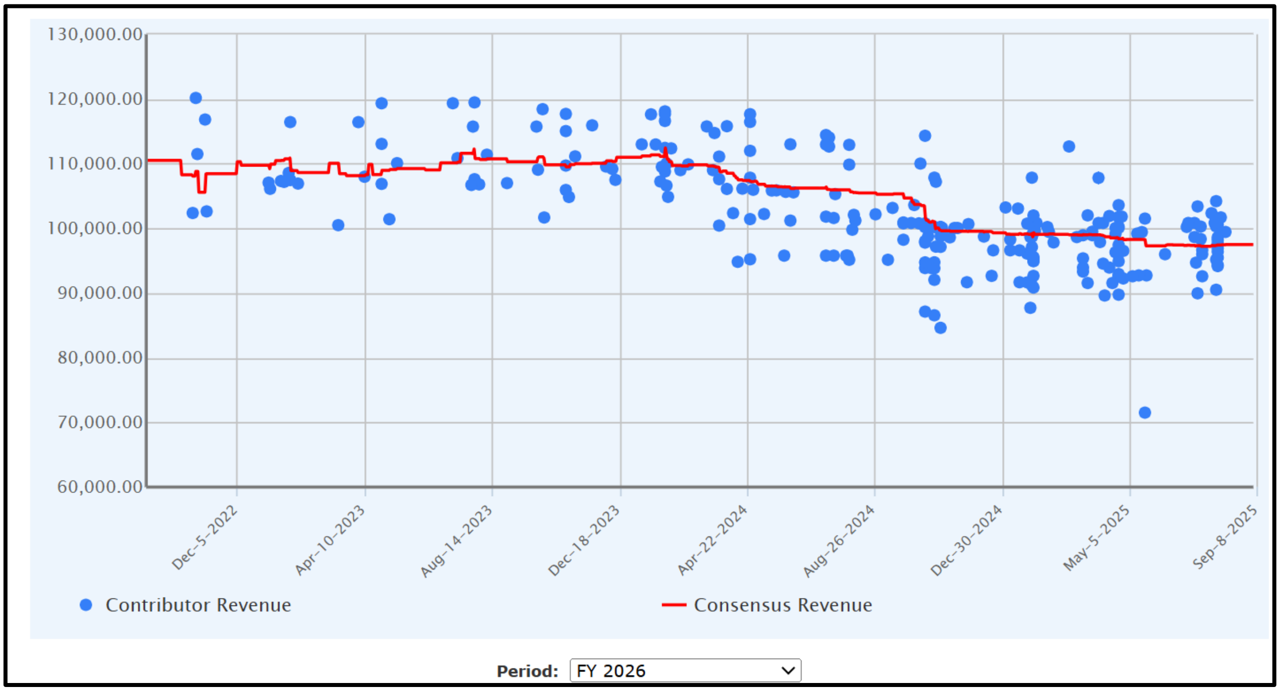
Boeing (BA)

Boeing represented 8.2% of Ducommun's revenue in 2024. Its FY2026 revenue consensus has steadily **declined from ~$110B to ~$100B** since mid-2024, reflecting persistent challenges in commercial aerospace. The FAA has capped 737 MAX production at 38 jets per month, blocking management's repeated push for higher output.[10] Quality investigations, supplier disruptions, and an uncertain regulatory path forward have left analysts steadily marking down expectations.

For Ducommun, this matters in two ways: first, shipments tied to Boeing programs are repeatedly deferred, leading to inventory swelling; and second, when revenue is recognized ahead of delivery, it gets trapped in contract assets. Boeing's weakness isn't just a headline problem — it directly inflates Ducommun's balance sheet risk.

[10] https://www.reuters.com/business/aerospace-defense/us-faa-not-currently-considering-lifting-boeing-737-max-production-cap-official-2025-06-04/

Chart 5: Boeing FY2026 Revenue Estimates (CapIQ)



RTX (Raytheon Technologies, RTX)

RTX, at 18.5% of Ducommun's 2024 sales, is its single largest customer. Consensus for FY2026 revenue has been **stable to slightly rising**, from ~$87B to ~$90B, but the headline masks multi-billion-dollar liabilities tied to Pratt & Whitney's geared turbofan engine defects. Hundreds of engines are being cycled through lengthy inspections, forcing airlines to ground aircraft and Airbus to push out deliveries.[11]

For a supplier like Ducommun, that means finished parts sit waiting, with little visibility on when they will actually be accepted. At the same time, RTX's broad portfolio allows it to offset these shocks on paper, but internally it squeezes its vendors harder on price and payment terms. This is why Ducommun's DSOs have stretched far beyond industry peers despite serving the same customers — the primes push working capital burdens downstream, and Ducommun complies in order to preserve the relationship.

[11] https://www.reuters.com/business/aerospace-defense/rtx-raises-2023-sales-outlook-boosted-by-aviation-recovery-2023-07-25/

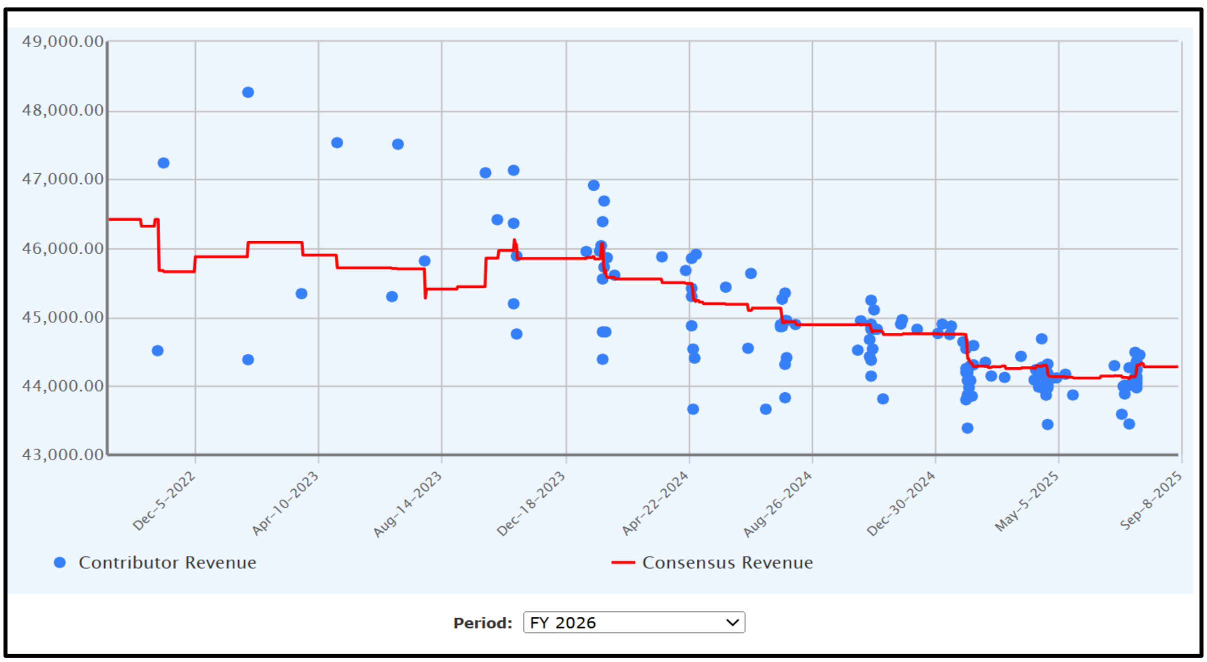
Lockheed Martin (LMT)

Lockheed accounted for mid–single-digit revenue share. Its FY2026 consensus has **inched up from ~$75B to ~$77B**, suggesting relative stability. But beneath the surface, volatility is extreme. In April 2025, Lockheed took a $1.6B charge on a classified program, triggering an 80% quarterly profit drop and a trimmed outlook.[12] Such program-driven shocks ripple straight down to suppliers: milestones are delayed, order flow is reprioritized, and cash collection is stretched. For Ducommun, already earning razor-thin margins on build-to-print work, Lockheed's volatility means unpredictable intake and more reliance on accounting levers like contract asset recognition to smooth out results.

Northrop Grumman (NOC)

Northrop has shown a more consistent deterioration. FY2026 consensus has **slipped from ~$46B to ~$44B**, reflecting cost pressures on the B-21 Raider stealth bomber program and continuing supply chain inefficiencies. [13]Management itself has cautioned that frictions dating back to the pandemic remain unresolved, and that has meant uneven order flow for suppliers. For Ducommun, this environment produces the worst possible mix: orders bunched late in quarters, acceptance criteria shifting, and cash lagging well behind reported revenue. These dynamics don't just create noise — they structurally inflate working capital and undermine cash conversion.

Chart 6: Northrop Grumman FY2026 Revenue Estimates (CapIQ)



[12] https://www.reuters.com/business/aerospace-defense/lockheed-profit-dives-80-16-billion-charge-shares-tumble-2025-07-

[13] https://finance.yahoo.com/news/northrop-grummans-profit-halves-b-112334622.html

<u>Spirit AeroSystems (SPR)</u>

Spirit AeroSystems remains one of the most precarious links in Ducommun's customer base. FY2026 consensus revenue has **fallen from ~$9.8B to ~$9.0B**, underlining concerns about its financial health. The company is in the process of being acquired by Boeing in a $4.7B all-stock deal, with Airbus slated to absorb certain Spirit operations.[14]

This restructuring may stabilize the OEMs, but for suppliers like Ducommun it introduces massive uncertainty. Contracts can be repriced, sourcing shifted to internal Boeing facilities, and payments delayed during integration. In effect, one of Ducommun's customers is shrinking into its parent, leaving even less room for outside suppliers to exert influence.

Key Takeaway: Ducommun's customer concentration ties its fortunes to a handful of primes facing production caps, program charges, supply chain disruptions, and ownership upheaval. These clients dictate pricing and payment terms, push deliveries into the future, and leave Ducommun with bloated inventory and rising contract assets. "Record backlog" is not strength—it is backlog held hostage by customers struggling with their own structural challenges.

Specifically, Ducommun lists in its "Risk Factors" section of its annual report, "***We depend upon a select base of industries and customers, which subjects us to unique risks which may adversely affect us.*"** We urge investors to read this section carefully, as we believe many of the listed factors are not hypothetical—they are currently underway.

[14] https://investors.boeing.com/investors/news/press-release-details/2024/Boeing-to-Acquire-Spirit-AeroSystems/default.aspx

The Vision 2027 Mirage

Having outlined Ducommun's deteriorating balance sheet trends and concentrated exposure to struggling primes, it is important to examine how management itself frames the company's future. In mid-2024, Ducommun unveiled its "Vision 2027" plan, projecting **$1.3–$1.5 billion in revenue** and **15%+ operating margins** by 2027. Management has positioned this initiative as the next phase of the company's evolution, branding it under the "One Ducommun" framework and emphasizing cultural transformation, supply chain efficiency, and ESG commitments.

We view Vision 2027 less as a roadmap and more as a **narrative device** to support valuation. The disconnect between management's targets and reported fundamentals is already evident. By Q2 2025, total backlog had **fallen to $1.02 billion**, down from over $1.06 billion at year-end 2024, with only **$714 million scheduled for delivery within the next 12 months**. At the same time, **Ducommun's book-to-bill ratio has slipped well below 1.00x to 0.70x**, a clear indication that new orders are failing to keep pace with revenue recognition.

Compounding this, Ducommun's revenue quality remains tethered to **cumulative catch-up adjustments** under ASC 606. The company continues to net favorable and unfavorable estimate revisions — a disclosure practice specifically criticized by the SEC in 2024 for masking contract volatility. This reliance on accounting levers directly undermines the notion of smooth, sustainable growth that Vision 2027 implies.

Ultimately, Vision 2027 functions as the **bull case centerpiece**. Without faith in this plan, investors must confront a company with shrinking backlog, sub-1.0 order intake, and revenue recognition practices that pull forward sales. In our view, the contrast between Vision 2027's lofty aspirations and Ducommun's actual contract pipeline underscores the fragility of the equity story.

The glossy Vision 2027 narrative might reassure investors on the surface, but the company's governance record tells a very different story. Far from building the foundations to deliver on its promises, Ducommun has repeatedly drawn scrutiny from regulators and auditors for its accounting and disclosure practices.

Corporate Governance & SEC Oversight Exacerbate Our Concerns

Ducommun's governance record reflects a persistent pattern of **reactive compliance under regulatory pressure**, where disclosure and accounting practices are tightened only after external intervention. Over the past decade, both the SEC and the company's independent auditor have forced Ducommun to acknowledge weaknesses that cut to the core of its financial reporting. This history strongly suggests a governance culture oriented toward **managing optics rather than ensuring durable transparency**.

A Pattern of Disclosure Gaps:

The SEC first pressed Ducommun in 2015, citing inadequate MD&A that failed to highlight material risks and insufficient granularity in explaining cost-of-sales variability. Management promised to improve by explicitly breaking out labor and material impacts, as well as providing more forward-looking commentary. While seemingly minor at the time, this early episode foreshadowed Ducommun's tendency to downplay operational and financial headwinds unless compelled to disclose them.

Fast forward to 2024, and the same theme reemerged with greater urgency. The SEC identified three separate deficiencies in Ducommun's filings:

- **Non-GAAP prominence:** Adjusted EBITDA was given greater visibility than net income, contrary to Regulation S-K.
- **Cumulative catch-up adjustments:** The company disclosed only net impacts of favorable and unfavorable estimate changes, masking the true volatility of its long-term contracts.
- **Cash flow classification errors:** Equipment insurance recoveries were incorrectly booked as operating rather than investing cash flows, artificially inflating operating cash generation.

In each case, Ducommun's instinct was to present numbers in a way that **smoothed earnings quality and downplayed risk visibility**. Only under direct SEC scrutiny did the company alter its practices.

Material Weakness and Auditor Adverse Opinion:

The most consequential governance failure surfaced in FY2023. Management disclosed a **material weakness in internal control over financial reporting**, specifically around the **accuracy of contract terms and gross margin assumptions** used in revenue recognition. PwC concurred, issuing an **adverse**

opinion on internal control effectiveness while still signing off on the financial statements. Adverse ICFR opinions are rare in aerospace and defense, underscoring the seriousness of the breakdown.

The weakness directly implicated the **percentage-of-completion and cumulative catch-up model** that drives Ducommun's revenue and earnings profile. It showed that management lacked effective review of contract modifications and margin assumptions — precisely the areas already flagged by the SEC. While Ducommun reported remediation in its FY2024 filing, skepticism is warranted. The company continues to resist gross disclosure of estimate changes, relies heavily on non-GAAP optics, and shows persistent strain in DSOs and contract assets. On this evidence, remediation appears **cosmetic rather than structural**.

Cultural Continuity Under Oswald:

Interviews with former insiders highlight that, since Stephen Oswald assumed leadership in 2017, Ducommun has operated with a **"hit the numbers at all costs"** mentality. That cultural tone explains why governance issues have repeated across cycles. Rather than embedding strong processes to anticipate risks, Ducommun has consistently minimized disclosure, only tightening controls when deficiencies become public. The combination of **SEC intervention and PwC's adverse opinion** indicates these are not isolated oversights but symptomatic of a broader governance problem.

Governance Implications:

For investors, this record has several implications:

- **Revenue quality risk is systemic.** Control failures have occurred in the very areas most dependent on management judgment, validating concerns over aggressive accounting.
- **External oversight is the only check.** Without SEC comment letters and adverse audit findings, problematic practices would likely persist.
- **Remediation should be viewed with caution.** Management's disclosure and accounting history shows a pattern of short-term compliance rather than durable reform.

The result is a governance profile that amplifies, rather than mitigates, the accounting concerns raised elsewhere in this report.

SEC Oversight Timeline

Year	SEC Concern	Ducommun's Response
2015	MD&A lacked strategic discussion; no cost-driver breakdown in cost of sales	Promised to expand MD&A and quantify cost drivers in future filings
Q1 2024	Non-GAAP prominence (Adjusted EBITDA > Net Income)	Reordered disclosures to comply with Reg S-K
Q2 2024	Cumulative catch-up adjustments disclosed only net	Refused gross disclosure; committed only to net disclosure unless single contract material
Q2 2024	Insurance recoveries misclassified in operating CF (ASC 230 violation)	Acknowledged error, pledged to reclassify as investing CF
2023	Material weakness in ICFR (contract terms & margin assumptions)	PwC issued **adverse ICFR opinion**; Ducommun claimed remediation in FY2024

Taken together — aggressive accounting, bloated working capital, customer concentration, and weak governance — Ducommun's growth story unravels. What management frames as a transformation is, in our view, a house built on accounting levers and fragile demand.

Ducommun: Strong Sell

The bull case on Ducommun rests on three flawed assumptions:

- That the company can reach $1 billion in revenue on the back of "record backlog."
- That free cash flow conversion will improve as working capital "unwinds."
- That acquisitions will create margin expansion rather than future impairments.

Our work shows the opposite. Contract assets have surged by over $100 million since 2019, far outpacing sales growth. Days-sales-outstanding have expanded more than 40% in the same period, reflecting customers stretching payments well past 60 days. Inventory has climbed to $197 million, with days-sales-in-inventory nearly doubling to 121 days since 2019. Free cash flow conversion, promised to improve for years, has instead averaged barely 40% of adjusted net income.

Backlog is not strength — it is hostage to primes like Boeing, RTX, Lockheed, and Northrop, all of whom are facing production caps, program charges, or supply chain disruptions. Spirit AeroSystems, meanwhile, is shrinking into Boeing's control with revenue estimates trending down. Ducommun has no pricing power, no leverage on payment terms, and no ability to control delivery schedules.

We believe a **"big bath" period is highly likely in the future** as years of aggressive revenue pull-forwards, bloated inventory balances, and goodwill-heavy acquisitions inevitably collide with reality. When this reset comes, Ducommun's overstated earnings power will be exposed, and downside will accelerate.

Normalizing for inflated contract assets, excess inventory, and weak cash conversion, we estimate Ducommun's true earnings power supports a valuation in the **$25–$35 per share range**, implying **40–60% downside** from current levels.

Accordingly, we assign Ducommun Incorporated (DCO) a **Strong Sell** rating.

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