KAL Capital - Aerospace & Defense

Quarter In Review

Introduction

Quarter in Review Q3 2017

Dear Friends,

Though it means that summer is over, we are pleased to share our Q3 Aerospace & Defense Industry Review. In this newsletter, we cover both the resurgence in defense-related M&A as well as the dynamic Chinese market for commercial aerospace.

In the most recent quarter, we were pleased to advise on the purchase of Triumph Group's Embee-division by All Metals Processing, a portfolio company of Watson Family Investments. This was an important transaction for KAL Capital and represents a continuation of our track-record in the aerospace metal finishing market.

The third quarter had multiple headline-grabbing M&A transactions, most notably the announced acquisition of Rockwell Collins by UTC. The $20bn+ transaction is illustrative of the unprecedented depth of M&A appetitive and capital availability within the strategic buyer community. Publicly-traded aerospace/defense companies are experiencing share price gains that are stretching valuations to levels that are reminiscent of 2007. Notable increases in Q3 include market bellwethers Boeing (+29%), Spirit (+34%) and Embraer (+24%). For our client-base within the Tier II and III of the supply-chain, we continue to see valuation trends that mirror those of their larger customer base.

Many of our clients have asked us our thoughts on the Trump Administration's tax reform efforts and their potential effects on the M&A market. Without offending anyone (a tight needle to thread in today's environment!), we are cautiously optimistic that the proposed tax cuts will serve to further buoy market multiples. Though always about more than a mathematical exercise, transaction values should theoretically be based on the present value of expected future cash-flows; therefore, reduced tax rates would be a net positive. That said, the potential elimination of critical tax deductions, most notably interest expense and key transaction structure tools (338(h)10 election) could potentially cause tax reform to have a chilling effect on valuations and activity levels. As with all potential legislative changes, the devil is in the details and all potential changes must be probability weighted to take into account the deeply partisan and unpredictable political environment.

We always welcome your thoughts or questions, and would be happy to reach out to discuss these topics or any others that may interest you.

Sincerely,

Trevor Bohn
Partner

Ryan Murphy
Partner

HIGHLIGHTS

- *AMP acquires Embee, Triumph Group's metal finishing division*

- *The AMP/Embee platform will be a unique asset within the A&D supply-chain with the broadest, most complex service offering*

KAL Capital Advises All Metals Processing

Embee Acquired by All Metals Processing of Orange County

Transaction Summary

KAL Capital is pleased to announce the acquisition of Embee, Triumph Group's metal processing division, by All Metals Processing of Orange Country (AMP), a portfolio company of Watson Family Investments.

Acquired by Triumph in 2012, Embee is a leading provider of metal finishing services offering A&D customers over 70 different services including anodize, plating, NDT, IVD, HVOF, shot peen, and complete grind & hone capabilities.

KAL Capital served as the exclusive investment banking advisor to All Metals Processing.

AMP Overview

Headquartered in Stanton, CA, AMP serves a diverse customer base of primarily blue-chip OEMs and Tier I aerospace suppliers providing a variety of plating, anodizing, non-destructive testing, and coatings services focused primarily on complex, mission critical components.

Transaction Description

Watson Family Investments acquired AMP in November 2015 in a partnership with the owner Kevin Fairfax. Immediately following the investment, Michael Coburn a former executive at Cadence Aerospace joined the AMP team.

Triumph had acquired Embee from the Dahlberg family in 2012 with the goal of creating a vertically-integrated offering to compliment their broad machining portfolio of businesses. The transaction with AMP will return Embee to its former focus of being an independent service provider to the Tier I and II community. With the close of the transaction, the combined entity will boast a broad-range of highly-unique processes and approvals with unmatched size and capacity in the Southern California region.

Unmatched Portfolio of Approvals

- With Embee's unmatched portfolio of approvals, the combined entity will provide its customers with an unmatched "One-Stop-Shop" value proposition.

Largest Metal Finisher in SoCal

- The combined entity will be one of only two full-service independent aerospace finishers in the U.S. and roughly 3x the size of the next largest competitor in SoCal.

HIGHLIGHTS

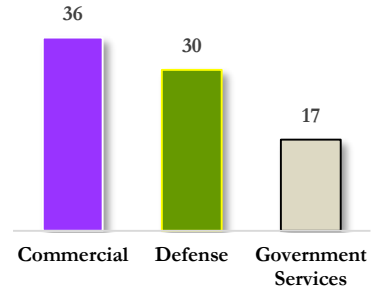
- *A&D M&A activity remains strong in the third quarter of 2017*
- *Notable A&D acquisitions demonstrate heightened interest in defense and airport services*

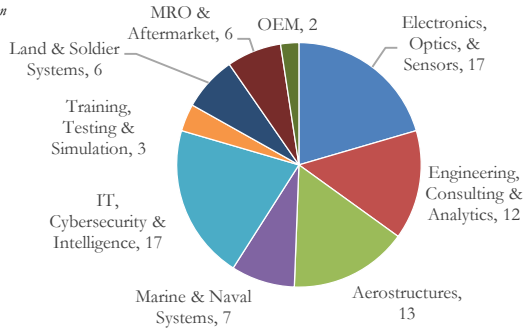
Market Snapshot

Select Aerospace & Defense M&A Activity

Q3 Deal Volume by End-Market and Product Category

Source: DACIS, KAL Capital estimates, and other publicly available information





Q3 Notable M&A Transactions

Target	Buyer	Price ($mm)	EV / EBITDA
Rockwell Collins	UTC	$22,750	**16.0x**
Orbital ATK	Northrop Grumman	9,200	**15.2x**
Royal Adhesives & Sealants	H.B. Fuller Company	1,575	**11.4x**
GCA Services Group	ABM Industries Inc.	1,250	**NP**
AeroAntenna Corp.	HEICO Corp.	317	**NP**
NCI, Inc.	H.I.G. Capital	283	**NP**

H.B. Fuller Company Acquires Royal Adhesives & Sealants

H.B. Fuller has acquired Royal Adhesives & Sealants, a leading global provider of proprietary, high-performance adhesives and sealants for the aerospace and industrial market. The acquisition will allow H.B. Fuller to increase its exposure to aerospace and other high-value segments.

ABM Acquires GCA Services Group

ABM has acquired GCA Services, one of its leading competitors in the facility services sector, for $1.25 billion. GCA specializes in facility maintenance including airports, janitorial services, grounds management, and outsourced workforce solutions. ABM acquired Air Serv in 2012.

H.I.G. Capital Acquires NCI Inc.

H.I.G. Capital has acquired NCI, Inc. a leading provider of information technology (IT) and professional services and solutions primarily to the U.S. Department of Defense, Intelligence Community, and federal health and civilian agencies.

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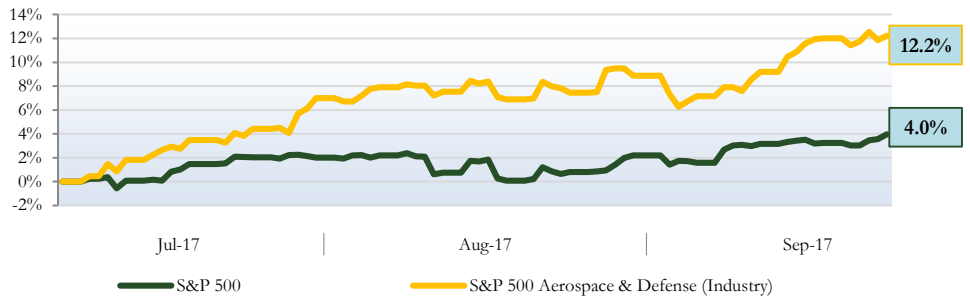
HIGHLIGHTS

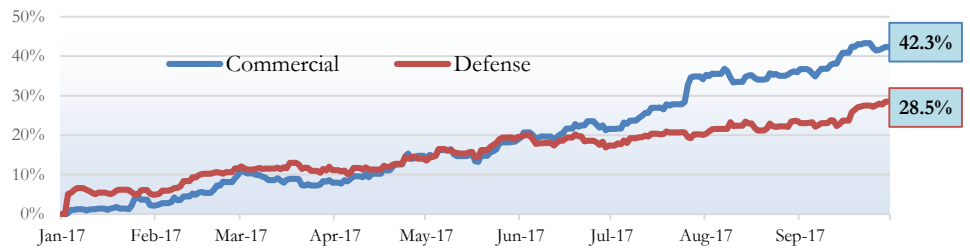
- *Aerospace and defense equity significantly outperformed the market in Q3 of 2017*
- *Commercial and defense performance based on select industry constituents*

Market Snapshot

Select Aerospace & Defense Public Markets Activity

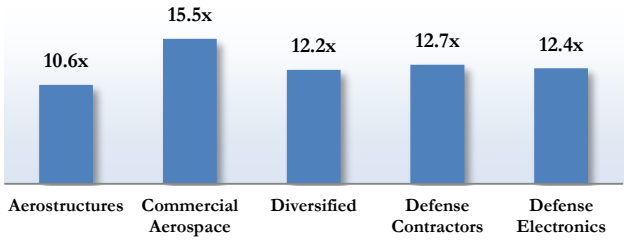
Q3 Relative Performance





Source: Capital IQ, analyst estimates, and other publicly available information

Enterprise Value/EBITDA by Subsector



Q3 Share Price Performance

Boeing	28.6%
Bombardier	-4.2%
Crane	0.8%
Embraer	24.0%
General Dynamics	3.8%
L-3 Technologies	12.8%
Lockheed Martin	11.8%
Moog	16.3%
Northrop Grumman	12.1%
Raytheon	15.5%
Rockwell Collins	24.4%
Spirit Aerosystems	34.1%
Textron	14.4%
Triumph Group	-5.9%
United Technologies	-4.9%

Aerospace and defense stocks experienced substantial gains across the board with Boeing, Spirit AeroSystems, and Embraer among the best performers.

L-3 Technologies and Northrop Grumman showed impressive gains following announcements of their acquisitions of Doss Aviation and Orbital ATK, respectively.

Triumph and United Technologies experienced slight declines after an eventful quarter. After a positive Q2, Triumph was back in the red after divesting its non-core processing division, Embee. UTC, on the other hand, was down over the quarter despite a positive bump following announcement of its Rockwell Collins acquisition and news that Pratt & Whitney was awarded a $2.7 billion contract from the Pentagon for C-17 engine sustainment.

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HIGHLIGHTS

- *Northrop Grumman acquires Orbital ATK for $9.2 billion*
- *Recent trend of large defense acquisitions in 2017 continues*

Defense Focus: Resurgence in Defense M&A

Northrop Grumman Acquires Orbital ATK

On September 18th, Northrop Grumman announced its acquisition of Orbital ATK in a $9.2 billion deal which many defense analysts believe could be a catalyst for a wave of consolidation in the defense sector.

Orbital ATK's core competencies are highly complementary to Northrop's. They include designing and building small-to-mid-sized space launch and propulsion systems, missile systems, defense subsystems and electronics, precision weapons and armaments, as well as other space and defense components.

With this acquisition, Northrop Grumman is signaling a shift in its capital deployment strategy more towards growth and innovation through M&A after having delivered 14 straight years of dividend increases. Additionally, Orbital ATK fills key niches in Northrop's portfolio in space and missile defense; two areas that have become of increased priority for the Department of Defense given recent geopolitical events.

The overall defense market reacted favorably towards the acquisition with the majority of defense contractors experiencing a spike in their stock price; a positive development which could prompt similar bolt-on style acquisitions with OEMs acquiring key Tier I defense suppliers.

Recent Resurgence in Defense M&A

The NG-Orbital acquisition is yet another indication that after years of sequestration and tightening defense budgets, defense M&A may be finally experiencing a resurgence with several large acquisitions over the past 6 months.

Buyer	Target	Price ($mm)	Description
United Technologies	Rockwell Collins	$22,750	▪ Rockwell specializes in comm. equipment, displays, and avionics for both defense & commercial platforms.
MDA	DigitalGlobe	$2,400mm	▪ Company will rebrand as Maxar Technologies post-merger creating space hardware, imaging, and geospatial giant.
HEICO	AeroAntenna Technology, Inc.	$317mm	▪ AeroAntenna of high-performance antennas for defense applications, precision guided munitions, and commercial aircrafts.
L3 Technologies	DOSS Aviation	NP	▪ Doss provides the U.S. gov't and commercial customers with a range of flight training and airfield operations services.

Source:, KAL Capital estimates, and other publicly available information

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Commercial Focus: China Supply Chain Evolution

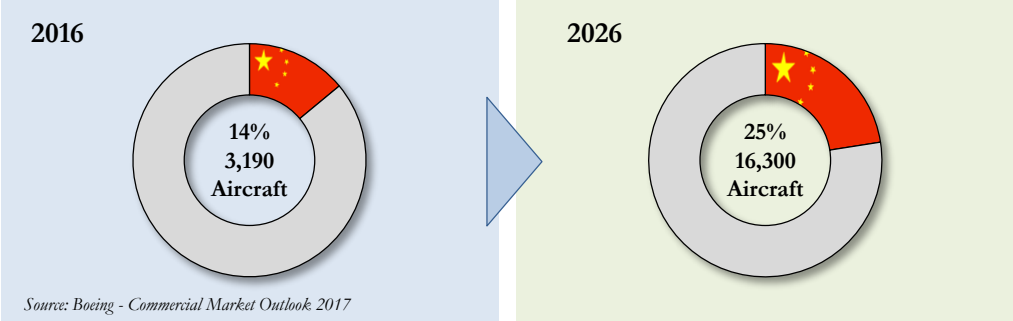
HIGHLIGHTS

- *As China's cements its place as the largest single market in commercial aerospace, it looks towards fortifying its production supply chain*

China Aerospace Industry Continues to Fulfill its Promise

China has long-been touted to become the largest single market in commercial aerospace with a growing middle-class leading to an unmatched boom air traffic demand. That trend is well underway with nearly a third of Boeing's and Airbus' backlog coming from Chinese customers.

China Share of World Fleet



Source: Boeing - Commercial Market Outlook 2017

Production Supply Chain in China

While its imminent status as the single largest market secure, China has shifted its efforts over the past few years towards moving up the manufacturing value chain into complex aircraft production. China has made it clear that Boeing and Airbus must help build China's aerospace industry if they want to win future orders. Boeing and Airbus now have to navigate the dilemma where their biggest customer might now become their competitor.

- *China is developing its domestic production supply chain both through its own aircraft manufacturer, COMAC, and through Boeing and Airbus establishing facilities to produce narrow-bodies in mainland China.*

COMAC

COMAC is leading China's efforts to become a key player in the global commercial aviation market.

On September 28th, the domestically developed C919 successfully completed its second test flight. The narrow-body aircraft is set to compete with the 737 and A320.

The program has had its fair share of delays since its inception in 2008 and is currently 3 years behind schedule but after two successful test flights, the C919 is set to enter service in 2020 with an order book of 730 aircrafts from 27 customers.

Boeing and Airbus Production in China

In order to secure orders from China, both Boeing and Airbus have built assembly facilities and increasingly sourced parts from China.

Airbus: Airbus opened its first final assembly facility outside of Europe in Tianjin, China to assemble A320s. It plans to open another facility in Tianjin to assemble A330 before the end of 2017.

Boeing: Boeing began construction of its first overseas facility in March of this year in the port city of Zhousan. The facility is set to be completed in 2018 and will have the capacity to deliver 8-10 737s per month.






Public Market A&D Valuations

Select Company Trading Levels as of September 30, 2017

Company	Market Cap.	EV	Revenue	EBITDA	EV/ Revenue	EV/ EBITDA	Debt/ EBITDA
Arconic Inc.	$10,973	$16,103	$12,558	$1,349	1.28x	11.9x	4.8x
BAE Systems plc	$26,959	$29,267	$24,058	$2,487	1.22x	11.8x	2.5x
The Boeing Company	$150,259	$150,767	$90,899	$10,735	1.66x	14.0x	1.1x
Bombardier Inc.	$3,978	$12,808	$15,784	$404	0.81x	n/a	19.1x
CAE Inc.	$4,698	$5,390	$2,117	$389	2.55x	13.9x	2.5x
Chemring Group plc	$674	$824	$707	$106	1.16x	7.8x	2.3x
Cobham plc	$4,646	$5,266	$2,637	($709)	2.00x	n/a	n/a
Dassault Systèmes SE	$25,785	$23,640	$3,624	$914	6.52x	n/a	1.2x
Embraer S.A.	$4,163	$5,774	$6,206	$444	0.93x	13.0x	8.0x
Esterline Technologies Corporation	$2,702	$3,214	$2,014	$312	1.60x	10.3x	3.1x
General Dynamics Corporation	$61,563	$63,685	$31,219	$4,892	2.04x	13.0x	0.8x
GKN plc	$7,958	$8,693	$12,291	$1,351	0.71x	6.4x	1.2x
Hexcel Corporation	$5,155	$5,931	$1,954	$442	3.04x	13.4x	1.5x
Honeywell International Inc.	$107,803	$114,620	$39,359	$7,845	2.91x	14.6x	2.1x
ITT Inc.	$3,896	$3,746	$2,427	$360	1.54x	10.4x	0.6x
L3 Technologies, Inc.	$14,739	$17,767	$10,895	$1,322	1.63x	13.4x	2.7x
Lockheed Martin Corporation	$89,361	$101,276	$49,045	$6,231	2.06x	16.3x	2.3x
Meggitt PLC	$5,409	$6,914	$2,698	$704	2.56x	9.8x	3.3x
MTU Aero Engines AG	$8,214	$9,380	$5,683	$726	1.65x	12.9x	2.6x
Northrop Grumman Corporation	$50,107	$55,805	$25,194	$3,802	2.21x	14.7x	1.9x
Orbital ATK, Inc.	$7,671	$9,102	$4,515	$607	2.02x	15.0x	2.3x
Raytheon Company	$54,155	$56,974	$24,519	$3,708	2.32x	15.4x	1.4x
Rheinmetall AG	$4,830	$5,192	$6,630	$663	0.78x	7.8x	1.4x
Rockwell Collins, Inc.	$21,279	$28,486	$6,074	$1,346	4.69x	21.2x	1.8x
Rolls-Royce Holdings plc	$21,868	$23,569	$20,856	$1,077	1.13x	21.9x	5.1x
Saab AB (publ)	$5,404	$5,574	$3,569	$311	1.56x	17.9x	2.6x
Safran SA	$42,472	$41,571	$18,891	$4,130	2.20x	10.1x	1.1x
Smiths Group plc	$8,365	$9,682	$4,323	$843	2.24x	11.5x	2.7x
Spirit AeroSystems Holdings, Inc.	$9,196	$9,587	$6,802	$739	1.41x	13.0x	1.2x
Textron Inc.	$14,263	$17,329	$13,699	$1,492	1.26x	11.6x	2.3x
Thales S.A.	$23,972	$21,567	$17,434	$1,865	1.24x	11.6x	1.0x
TransDigm Group Incorporated	$13,271	$23,429	$3,470	$1,621	6.75x	14.4x	7.1x
Triumph Group, Inc.	$1,476	$2,721	$3,421	$401	0.80x	6.8x	2.7x
Ultra Electronics Holdings plc	$1,868	$2,217	$1,020	$166	2.17x	13.4x	2.4x
United Technologies Corporation	$92,722	$112,122	$58,108	$10,145	1.93x	11.1x	2.4x
Zodiac Aerospace	$8,088	$9,656	$5,484	$265	1.76x	n/a	3.7x
				Average	**2.1x**	**12.8x**	**2.9x**
				Median	**1.8x**	**13.0x**	**2.3x**

Market data as of September 30th, 2017; financial data per most recent filing available as of September 30th, 2017
$US in mm; conversion rate, if applicable, based on historical exchange rate as of most recent filing date
Source: Capital IQ, analyst estimates, and other publicly available information



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Triumph Processing Embee Division HAS BEEN ACQUIRED BY AMP ACQUISITION ADVISORY	DAS Dallas Aeronautical Services HAS BEEN ACQUIRED BY WEST STAR AVIATION SALE OF COMPANY	MAYDAY MANUFACTURING HI-TECH METAL FINISHING HAVE BEEN ACQUIRED BY ESCO TECHNOLOGIES SALE OF COMPANY	STARCO Industries Inc. HAS BEEN ACQUIRED BY senior SALE OF COMPANY	CAPCO HAS BEEN ACQUIRED BY KACHI PARTNERS SALE OF COMPANY
AMP HAS BEEN RECAPITALIZED BY WATSON Family Investments RECAPITALIZATION	PRYER HAS BEEN RECAPITALIZED BY TCP TULSA CAPITAL PARTNERS RECAPITALIZATION	PFI PROCESS FAB INC. A PORTFOLIO COMPANY OF Vance Street Capital HAS BEEN ACQUIRED BY BURTEK A PORTFOLIO COMPANY OF WYNNCHURCH CAPITAL SALE OF COMPANY	IMPRESA AEROSPACE A PORTFOLIO COMPANY OF GRAYCLIFF PARTNERS HAS BEEN ACQUIRED BY TWIN HAVEN SALE OF COMPANY	Merlin RAMCo, Inc. Wizards at Work HAS BEEN ACQUIRED BY TRIVE CAPITAL SALE OF COMPANY
DYNAMIC PAINT SOLUTIONS HAS BEEN ACQUIRED BY VALENCE SURFACE TECHNOLOGIES SALE OF COMPANY	Chrome Plus International, Inc. HAS BEEN ACQUIRED BY VALENCE SURFACE TECHNOLOGIES SALE OF COMPANY	CSI HAS BEEN ACQUIRED BY TRIVE CAPITAL SALE OF COMPANY	COAST PLATING, INC. "Premier Metal Finishing" HAS BEEN RECAPITALIZED BY TRIVE CAPITAL RECAPITALIZATION	Ascent A PORTFOLIO COMPANY OF VPC Victory Park Capital HAS BEEN ACQUIRED BY LVC LONGUEVUE CAPITAL SALE OF COMPANY
SHEFFIELD MANUFACTURING HAS BEEN RECAPITALIZED BY HANCOCK PARK ASSOCIATES AND next point CAPITAL RECAPITALIZATION	SOUTHWEST UNITED INDUSTRIES A PORTFOLIO COMPANY OF ARGONAUT PRIVATE EQUITY HAS BEEN ACQUIRED BY PCC ACQUISITION ADVISORY	TJC THE JORDAN COMPANY HAS ACQUIRED VT Group ACQUISITION ADVISORY	NAAS HAS BEEN RECAPITALIZED BY MANGROVE EQUITY PARTNERS RECAPITALIZATION	KAZAK HAS BEEN ACQUIRED BY PLASAN SALE OF COMPANY

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