

KAL Capital - Aerospace & Defense

Quarter In Review

Introduction

Quarter in Review Q3 2018

Dear Friends,

Between the news of back-and-forth trade debate, Q3 has built a more positive narrative for the greater aerospace and defense market. The sector witnessed an uptick in M&A from both the strategic and private equity community while suppliers have begun to feel the lift of commercial aero optimism and defense funding increases.

Much market noise has been heard in the commercial aero market around Boeing's 737MAX program. The grandeur of production and associated growing pains need not raise concern to those who watch the numbers. With over 4,700 orders and counting, and over 200 delivered, the 737MAX program will keep the commercial aerospace supply chain lined up with work for many years to come. The MAX program is a long-term source of growth for suppliers while also implying an upcoming aftermarket services boom.

Strategic buyers and private equity stalwarts have been keen to the expected aftermarket surge and continue to invest heavily in the space. This quarter we saw buyers expressing a continued favoritism of the profitability found within the proprietary aftermarket and specialized MRO services. Notable Q3 aftermarket strategic buyers include K LX and BBA Aviation (Ontic), while the private equity side was represented by Vance Street and GenNX360 Capital Partners.

The government services and defense sector has quietly moved forward beneath the headliner news of the commercial side. The federal IT and niche C4ISR service providers continue to buoy EV/EBITDA multiples in the government services market with IT/Cybersecurity being the most popular by deal count in Q3. We conclude our newsletter with a spotlight into the DoD funding effects on key Naval Submarine programs and the implications for drastic growth through the naval supply chain.

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





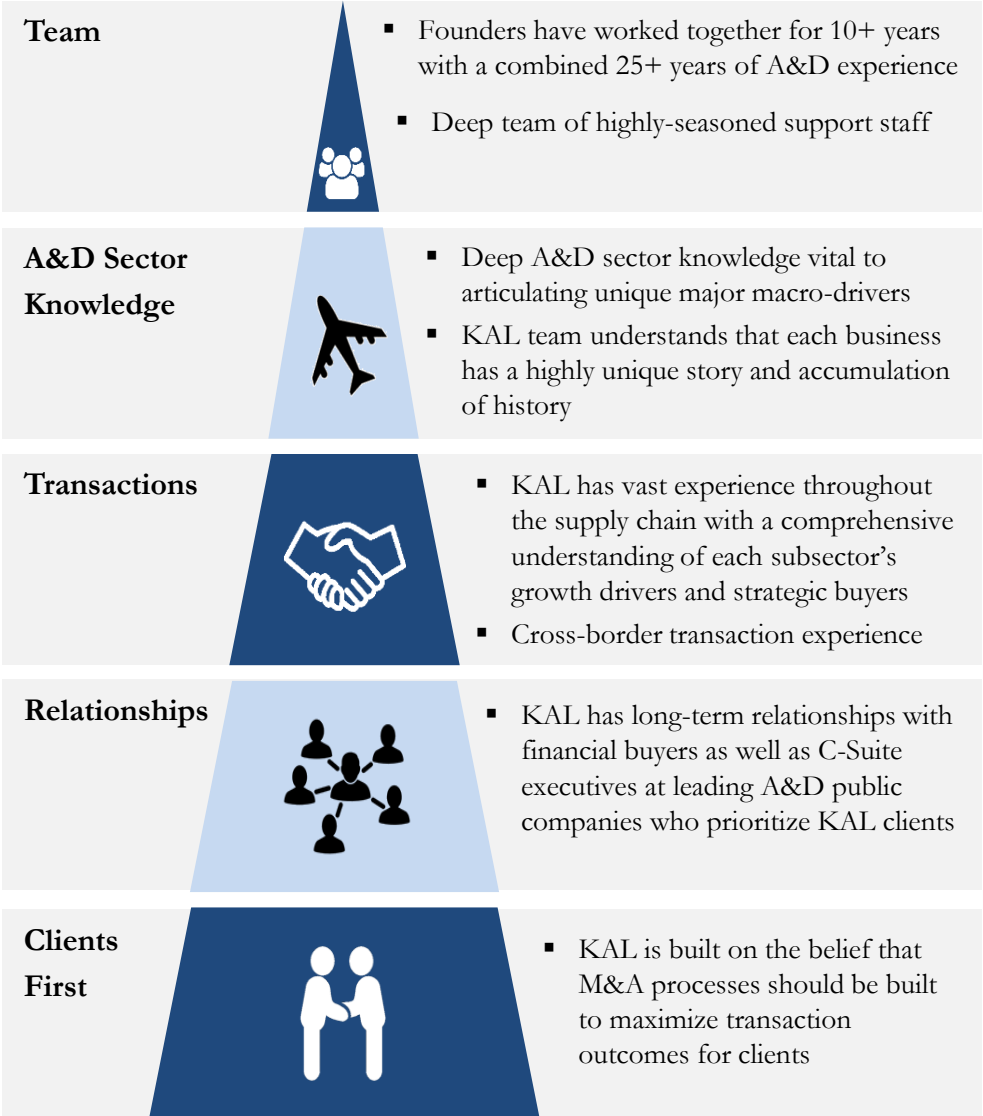
KAL Capital Overview

KAL Capital is a boutique investment bank focused on providing advisory services to owners of businesses throughout the greater aerospace supply-chains.

Our services consist primarily of M&A advisory and liquidity event planning. Our clientele are generally family or partnerships that own successful, growing businesses within the aerospace/defense sector. Today's M&A environment offers business owners a wide-range of transaction alternatives, often at compelling valuations. Our role is to assist in the navigation of this process and to ensure that valuation is maximized.

Services Provided

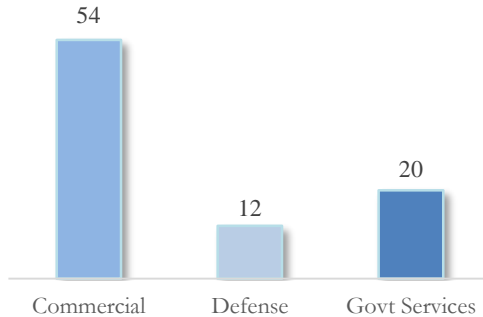
- Sell-Side Advisory
- Buy-Side Advisory
- General Strategic Advisory
- Debt Capital Raising
- Equity Capital Raising
- Merchant Banking



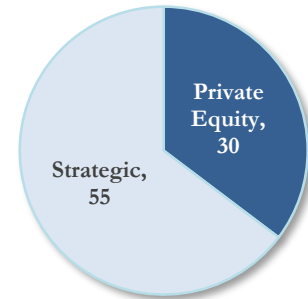
Q3 2018 A&D M&A Deal Activity

Select Aerospace & Defense M&A

Deals by End-Market



Deals by Buyer Type

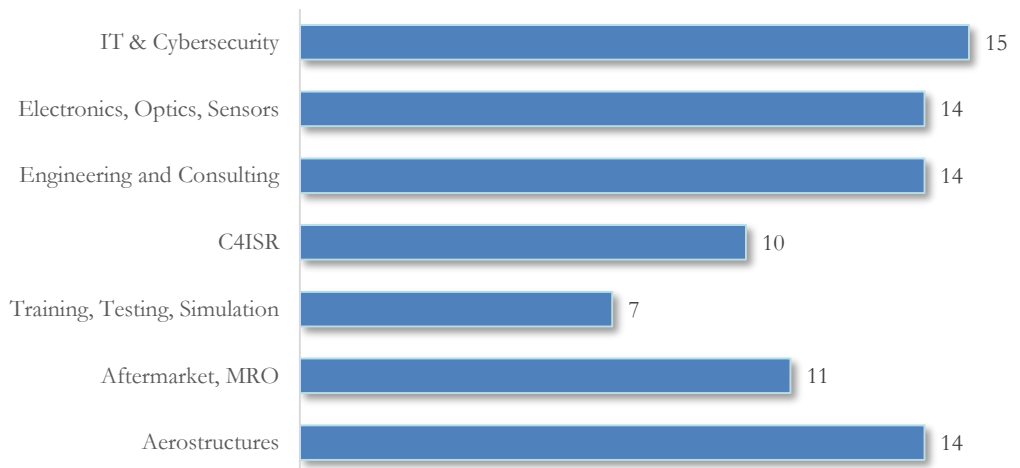


❖ Commercial markets grow quickly with several aerostructures-related and aftermarket deals

❖ IT and Cybersecurity services firms nudge past the recent M&A favorite of electronics manufacturers

❖ Acquisition interest shows a greater product category balance than preceding quarters of 2018

Deals by Product Category



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

Analysis

Q3 experienced a rather strong balance across the A&D product categories with a slight uptick from Q2 in deal count.

After its acquisition of Beaver Aerospace, where KAL Capital acted as exclusive financial adviser to Beaver, Heroux-Devtek continued momentum in the mechanical and electromechanical systems space, completing the acquisition of Airbus subsidiary CESA for \$161mm.

Government services sector saw a spike this quarter, attributed to the increased interest in federal IT and cybersecurity service providers. Notable deals include L3 Technologies purchase of Azimuth Security and Linchpin Labs to form L3 Trenchant for \$200mm, and on the Private Equity side Arlington Capital acquiring the Gov. IT business of Black Box Corp at a purchase price of \$75mm.

More formal defense-related deals include Commercial-Off-The-Shelf (COTS) rugged computer systems providers Germane Systems, acquired by Mercury Systems for \$45MM, and Airtech Rugged Group acquired at \$30mm by FIMI Opportunity Funds.

HIGHLIGHTS

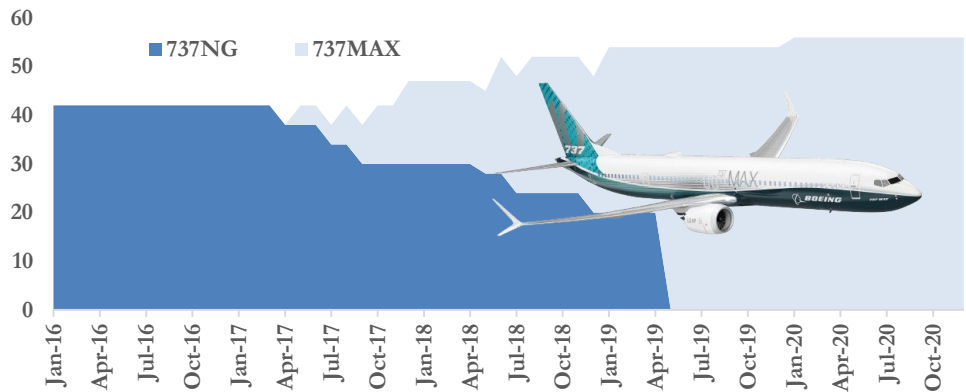
- ❖ The 737MAX's current backlog ensures production well beyond 2026 discounting any future orders
- ❖ Boeing shifts energies away from the NG line to MAX aircraft by mid 2019
- ❖ September MAX deliveries jump to 61 from 48 in August
- ❖ 22% of all single-aisle deliveries in commercial aerospace have gone to China over the past 5-years

Boeing Update: 737MAX Program

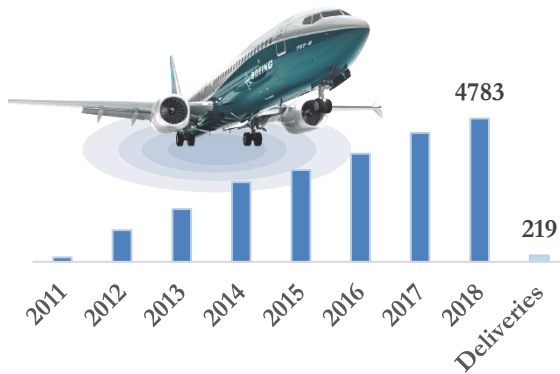
Overview

While much of Q3 news focused on delays, the MAX supply chain has much to look forward to as this transitional phase progresses. September MAX deliveries skyrocketed to 61, lifting Boeing shares and overall supply chain optimism well past Q3 August concerns. September deliveries indicate Tier II and Tier III are adjusting to ramped production exceptionally well, and soon the number will grow as Boeing transitions a NG production line to a MAX line.

MAX Vs. NG Production Rates



Cumulative 737MAX Orders & Deliveries



Highlights

- > 4,700 Orders
- > 200 Delivered
- > 4,500 Backlog
- > 1 Book-to-Bill Ratio

~5% of total MAX orders have been delivered. The backlog is a signal to the imminent supply chain growth and the upcoming aftermarket services surge.

China Update

Select Customers

Customer	Orders	Deliveries
China Dev. Bank	78	N/A
China Southen Air	50	11
CALC China	50	N/A
Donghai Airlines	25	N/A
Air China	11	11

- Despite tariff struggles, Chinese customers remain in consistent cooperative dialogue
- Boeing to deliver its first MAX from the new finishing plant in Zhoushan by year end
- Through long-term logistical synergies, incentive to negotiate continued trade is very high
- China expected to buy 7,690 new aircraft over next 20-years, accounting for over 18% of commercial air fleet

HIGHLIGHTS

❖ Aftermarket services firms benefit from high valuation multiples as acquisition appetite increases

❖ Public cos like BBA and KLX continue momentum in growing high-margin aftermarket services divisions

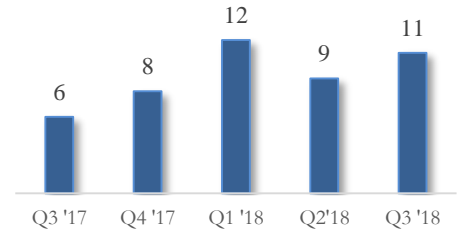
❖ Private equity shows heightened interest in new aftermarket platforms with niche proprietary offerings

Aftermarket Update

Aftermarket M&A Performance





- Q3 Avg. EV/EBITDA: **8.0 – 9.0X**
- Strategics and PEGs continue strong appetite for PMA & component repair
- Public market ramps interest in key aftermarket services businesses to capitalize on higher margins

Deals by Quarter







Select Q3 Aftermarket M&A

Strategic Transactions

		<ul style="list-style-type: none"> ▪ Firstmark provides aftermarket services and proprietary electronic & mechanical components. The deal was announced at \$97mm with a 11.1x multiple.
		<ul style="list-style-type: none"> ▪ Hassall's Laboratory Controlled at Source (LCS) assets provide engine-related services in testing and quality management. The deal includes a partnership agreement with Novaria, to include exclusivity on product lines and preferred pricing.

Private Equity Transactions

		<ul style="list-style-type: none"> ▪ Jet Parts Engineering provides proprietary PMA parts and Delegated Engineering Representative (DER) repair services. Jet Parts will serve as Vance Street's new aftermarket platform.
		<ul style="list-style-type: none"> ▪ Precision Aviation Group (PAG) provides Aviation supply chain and Inventory Supported MRO services. PAG is expected to continue an aggressive M&A approach under GenNx360 ownership.

Analysis

PMA parts have caught a lot of attention from private equity lately. This is due to the strong cost-savings interest from airlines who seek aftermarket solutions to the OEM originals. A PMA part can provide cost-savings of 25-45% and compounded over the life of an aircraft savings are significant.

Private equity noticed this trend quite early and over the past few years we've witnessed their growing interest in PMA and the aftermarket as a whole. The continuous demand has driven valuations for these businesses higher each year. Not only are more private equity firms involved, but now the OEMs are competing head to head for opportunities to capture some of the historically high demand in the space. More deals like Boeing/KLX, Ontic/Firstmark are certain to follow. Due to increased competition, aftermarket deals will continue to trade at premium multiples.

HIGHLIGHTS

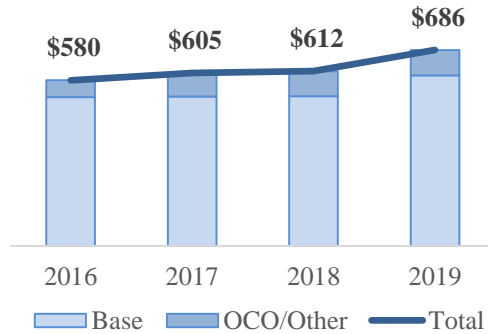
- ❖ DoD budget at 5% real growth FY '18 to FY '19

- ❖ Virginia and Columbia class are built by Navy's joint force agreement, Submarine Unified Building Strategy (SUBS) with GD/EB & HI/NSS

- ❖ Columbia Class budget will triple in size in 2019, sending a tremendous growth wave through the SSBN supply chain

Defense: Submarine Focus

DoD Budget – FY '18 Vs. FY '19



Highlights

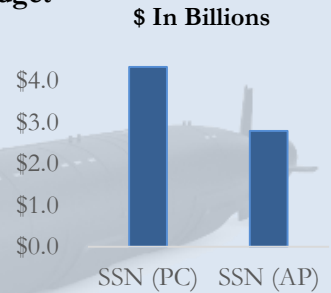
- 5% Real growth over FY '18 Budget
- Reversed 7-year decline in spending

The budget is reflective of 2010/2011, when OCO spending was at its highest due to overseas conflict. Current administration has allocated most of the increases to base support and missile defense initiatives.

SSN-774 - Virginia Class Budget

SSN 774	2017	2018	2019
Quantity	2	2	2
Amount (\$ Bn)	5.3	5.5	7.4

PC	▪ Program Construction (PC): \$4340.6MM
AP	▪ Advanced Procurement (AP): \$2796.4MM

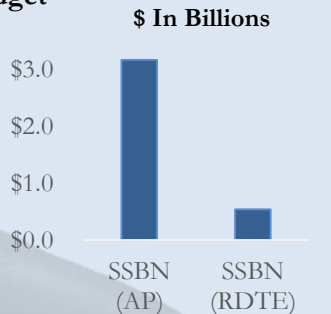


- The program will experience a 1.35x YoY budget increase. The SSN supply chain has secured a minimum 2 subs production per year through 2023, though 3 has been in discussions with Congress. Strong production forecast and funding jumps have peaked interest for private equity and strategic acquirers alike. We expect to see aggressive M&A objectives in the months to come, resulting in rising valuations for target suppliers.

SSBN - Columbia Class Budget

SSBN	2017	2018	2019
Quantity	-	-	-
Amount (\$Bn)	1.9	1.9	3.7

AP	▪ Advanced Procurement (AP): \$3173.4
RDTE	▪ RDTE: \$542.846



- The Columbia Class program has nearly tripled with the 2019 budget increases. The implications for supply chain growth are tremendous. Consequently we will likely see materials manufacturers and subassembly specialists throughout the supply chain grow dramatically, spurring what we believe will be M&A consolidation with buyers seeking targets with invaluable contract seats and high-profit margins.



100 West Broadway
 Suite 205
 Long Beach, CA 90802
www.kalcap.com
 P: (949) 404-4201

 HAS BEEN ACQUIRED BY SALE OF COMPANY	 HAS BEEN ACQUIRED BY SALE OF COMPANY	 A PORTFOLIO COMPANY OF GenCap AMERICA HAS BEEN ACQUIRED BY HOLDER FAMILY INVESTMENTS SALE OF COMPANY	 HAS BEEN ACQUIRED BY SALE OF COMPANY	 HAS BEEN ACQUIRED BY SALE OF COMPANY
 HAS BEEN ACQUIRED BY SALE OF COMPANY	 HAS BEEN ACQUIRED BY SALE OF COMPANY	 HAS BEEN ACQUIRED BY SALE OF COMPANY	 HAS BEEN RECAPITALIZED BY RECAPITALIZATION	 HAS BEEN RECAPITALIZED BY Capco Growth Partners, LLC RECAPITALIZATION
 HAS BEEN RECAPITALIZED BY RECAPITALIZATION	 A PORTFOLIO COMPANY OF Vance Street Capital LLC HAS BEEN ACQUIRED BY A PORTFOLIO COMPANY OF SALE OF COMPANY	 A PORTFOLIO COMPANY OF GRAYCLIFF PARTNERS HAS BEEN ACQUIRED BY SALE OF COMPANY	 HAS BEEN ACQUIRED BY SALE OF COMPANY	 HAS BEEN ACQUIRED BY SALE OF COMPANY
 HAS BEEN ACQUIRED BY SALE OF COMPANY	 HAS BEEN ACQUIRED BY SALE OF COMPANY	 HAS ACQUIRED ACQUISITION ADVISORY	 HAS BEEN ACQUIRED BY SALE OF COMPANY	 A PORTFOLIO COMPANY OF VICTORY PARK CAPITAL HAS BEEN ACQUIRED BY SALE OF COMPANY



Trevor Bohn
 Partner
 (949) 404-4203
trevor@kalcap.com



Ryan Murphy
 Partner
 (949) 404-4204
ryan@kalcap.com

This presentation has been prepared by KAL Capital Markets LLC ("KAL Capital") for the exclusive use of the party to whom KAL Capital delivers this presentation (together with its subsidiaries and affiliates, the "Recipient") using publicly available information. KAL Capital has not independently verified the information contained herein, nor does Salem make any representation or warranty, either express or implied, as to the accuracy, completeness or reliability of the information contained in this presentation, or any other information (whether communicated in written or oral form) transmitted to or made available to the Recipient. Any estimates or projections as to events that may occur in the future (including projections of revenue, expense, net income and stock performance) are based on publicly available information as of the date of this presentation. There is no guarantee that any of these estimates or projections will be achieved. Actual results will vary from the projections and such variations may be material. Nothing contained herein is, or shall be relied upon as, a promise or representation as to the past or future. KAL Capital expressly disclaims any and all liability relating to or resulting from the use of this presentation.

This presentation has been prepared solely for informational purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. The Recipient should not construe the contents of this presentation as legal, tax, accounting or investment advice or a recommendation. The Recipient is urged to consult its own counsel, tax and financial advisors as to legal and related matters concerning any information described herein. This presentation does not purport to be all-inclusive or to contain all of the information that the Recipient may require. No investment, divestment or other financial decisions or actions should be based solely on the information in this presentation. The Recipient should not rely on any information contained herein.

This presentation has been prepared on a confidential basis solely for the use and benefit of the Recipient. The Recipient agrees that the information contained herein and in all related and ancillary documents is not to be used for any other purpose, that such information is of a confidential nature and that Recipient will treat it in a confidential manner. Distribution of this presentation to any person other than the Recipient and those persons retained to advise the Recipient who agree to maintain the confidentiality of this material and be bound by the limitations outlined herein, is unauthorized without the prior consent of KAL Capital. This material must not be copied, reproduced, distributed or passed to others at any time without the prior written consent of KAL Capital.