KAL Capital - Aerospace & Defense

Year In Review

Introduction

Year in Review 2019

Dear Friends,

Happy New Year! KAL Capital Markets finished the year with six closed transactions; each of the businesses were well received by an aggressive set of strategic and financial buyers. We are set to embark on our fourth year, and we are proud to say that both our transaction activity and number of team members have continued to grow each year.

The year has gotten off to a wild start with headlines for the defense sector (Iran) and commercial aerospace (B737MAX halt) competing for top bill. In the near-term the MAX news has had a broader effect on the supply-chain as Q4 news went from bad to worse as the supply-chain is now grappling with a full halt of MAX production. The whipsaw of going from rate-readiness checks for 60 plus airplanes to a full-halt within a twelve-month period has very few parallels.

From an M&A perspective, we expect the near-term reverberations to be profound as B737MAX content will be heavily discounted and likely create a meaningful gap in expectations between buyers and sellers. The open question will be how long following return to service this gap will remain; we are optimistic but unfortunately believe that the primary source of 2020 M&A activity for the MAX supply-chain will be distressed in nature. That said, we strongly believe that the MAX problems will be not only isolated but have a positive effect on M&A activity for businesses either with limited MAX content or outside of the commercial OEM space entirely. We have already seen private equity and strategic buyers looking to deploy capital aggressively in the defense and aftermarket sectors as well as to balance MAX heavy investments with other growing platforms (F-35, B777x, etc).

Getting down to it, we believe 2020 will be the most active year for M&A over the past decade. This prediction is driven by a combination of factors including a continuation of extremely seller friendly valuations and the upcoming presidential elections. Election years tend to be busy as business owners look to transact ahead of any major policy (especially defense spending) changes, but we expect activity to be amplified by the proposed tax changes being suggested by essentially all Democratic presidential candidates. While progressive ideas such as wealth taxes have garnered most headlines, several of the more centrist candidates are proposing material increases in the tax treatment of capital gains. Rightfully so, capital gains tax treatment is critical when considering a M&A event, and we saw a smaller version of this in 2012 as sellers rushed to transact ahead of the Obama Administration's more minor increases in tax rate.

Sincerely,

Trevor Bohn
Partner

Ryan Murphy
Partner

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KAL Capital

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**

Team

- Founders have worked together for 10+ years with a combined 25+ years of A&D experience
- Deep team of highly-seasoned support staff

A&D Sector Knowledge

- Deep A&D sector knowledge vital to articulating unique major macro-drivers
- KAL team understands that each business has a highly unique story and accumulation of history

Transactions

- KAL has vast experience throughout the supply chain with a comprehensive understanding of each subsector's growth drivers and strategic buyers
- Cross-border transaction experience

Relationships

- KAL has long-term relationships with financial buyers as well as C-Suite executives at leading A&D public companies who prioritize KAL clients

Clients First

- KAL is built on the belief that M&A processes should be built to maximize transaction outcomes for clients

2019 KAL Transactions

- *KAL closed 6 deals in 2019; advising on over $1bn in transaction value*

Closed Deals

Aviation Services
Jan-2019

- STS Aviation Group provides one-stop aviation solutions. The Company offers aerospace staffing, line maintenance, engineering, and aircraft component distribution services.

Engineering
Feb-2019

- Florida Turbine Technologies is a leader in the engineering, development, and testing of gas turbines, propulsion components, and turbopumps for A&D.

Component MRO
Mar-2019

- NAAS provides line maintenance support to airlines, MROs, government operators and OEMs and has a specialization in fuel systems maintenance, leak detection and bladder cell repair.

Metal Finishing
Jul-2019

- Valence Surface Technologies is the world's largest independent provider of aerostructure surface technology services. The Company provides specialized metal processing and finishing services.

Solar Racking
Sep-2019

- IronRidge is the industry-leading designer and provider of racking hardware systems in the rapidly growing residential solar energy market.

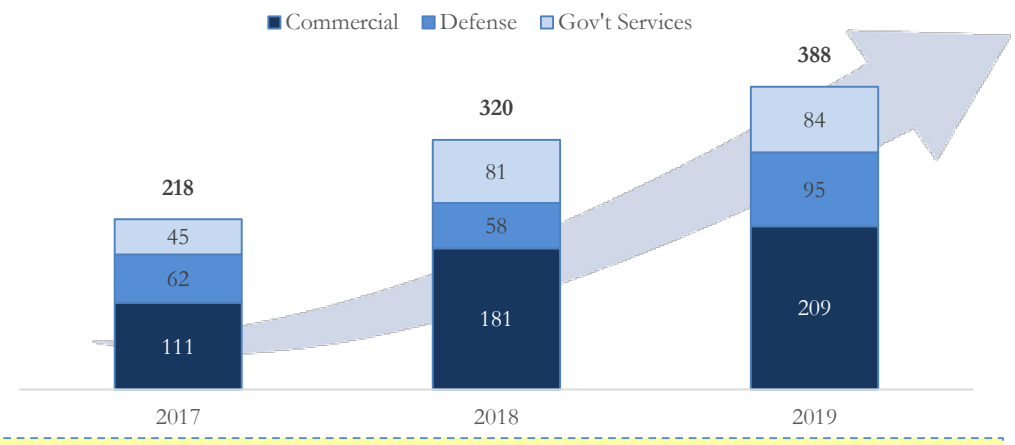
Aerostructures
Nov-2019

- Aero Pacific Corporation is a leading manufacturer of aerostructures and assemblies, specializing in machined complex airframe structural components, and complex multi-level assemblies.

2017-2019 M&A Overview

- *An increasingly seller friendly market has generated record high deal flow, transaction value, and multiples*

2017-2019 Deals by End-Market

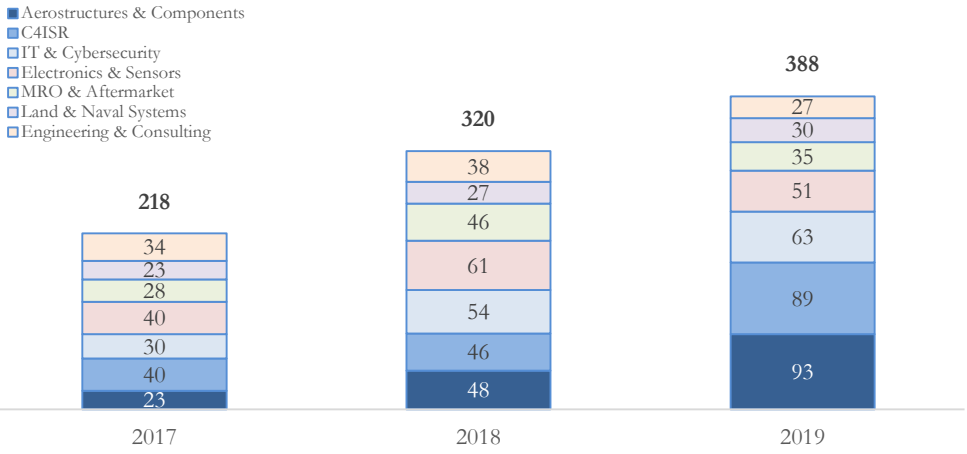


EBITDA:	9.0x	9.5x	10.1x

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

- *Aerostructures & Components topped 2019 deal flow by product category*

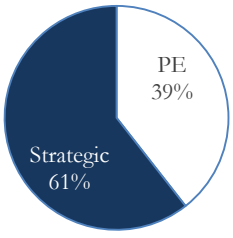
2017-2019 Deals by Product Category



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

- *Private equity firms have record high levels of cash deploy*

Analysis



Over 39% of 2019 deals were executed by private equity firms compared to only 31% in 2018. Private equity firms have an unprecedented amount of cash to deploy. Some of the busiest buyout firms included AE Industrial Partners, Arlington Capital, Greenbriar Equity Group, and the Jordan Company, all of which are exhibiting the overall investment trend of diverse government services and high-margin A&D component manufacturing acquisitions.

HEICO Corp., FLIR Systems, Inc., and CACI International were some of the most active strategic acquirers in 2019 and focused on IT & Cybersecurity, C4ISR, and Electronics & Sensors deals, all of which continue to gain traction as technology improves and cyber threats become more prevalent.

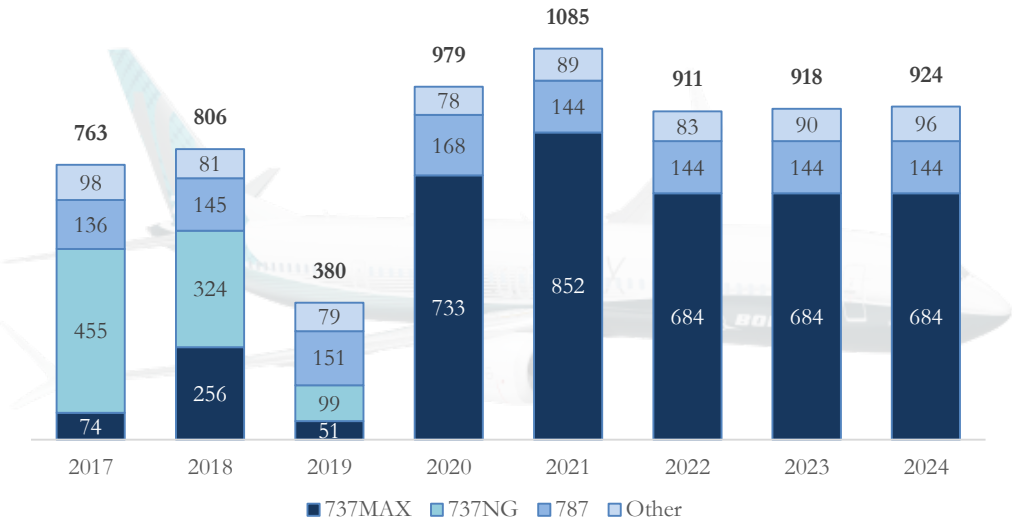
HIGHLIGHTS

- *The 737 MAX crisis led to Boeing's lowest delivery total since 2008*

- *Despite the recent turmoil, a healthy Boeing backlog buoys long-term optimism*

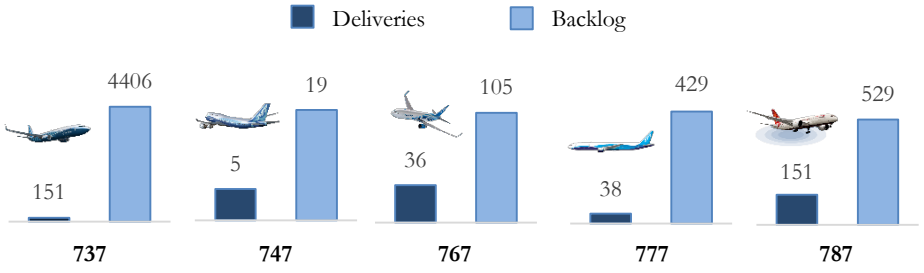
Commercial Focus: Boeing 737 MAX

Boeing Aircraft Deliveries Per Year



Source: Boeing

2019 Backlog Vs. Deliveries Analysis



Boeing suffered in 2019 as the 737 MAX made headlines after two fatal crashes were reported within five months of each other. As a result, the plane has been grounded worldwide since March as Boeing works to fix what appears to be a design flaw.

As of January 2020, Boeing has halted 737 MAX production and is redeploying 3,000 workers to other projects. The halt of the 737 MAX has placed stress on the supply chain as Boeing's biggest supplier, Spirit AeroSystems, announced that it will layoff roughly 2,800 employees.

Despite the recent turmoil, there is growing optimism that the 737 MAX will be certified to return to service this upcoming year. The fact that Boeing has not laid off workers is a good sign and reiterates their confidence in the MAX's eventual return to service. In addition, the 737 MAX still boasts over 4,400 orders in backlog which is expected to keep Boeing busy for years to come.

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HIGHLIGHTS

- *The DoD looks to increase its hypersonic capabilities in response to ambitious programs in Russia and China*

Defense Focus: Hypersonics

Hypersonics are a new weapons class designed to travel at rates greater than 5 times the speed of sound. Hypersonics are expected to be a key priority for DoD as the U.S. looks to keep up in the arms race with Russia and China. Hypersonic systems provide advantages in terms of speed to target, maneuverability and survivability to reach hard and well-defended targets.

U.S. Army Secretary Ryan McCarthy said the still-in-development weapons would likely change the future of war. The Army along with the Air Force, Navy, and Missile Defense Agency has been advancing work on a variety of hypersonic capabilities. The Army expects to begin testing aspects of its Long-Range Hypersonic Weapon this year, with full flight testing expected in 2023. The U.S. is pressing ahead with new missiles, but questions remain about engineering, tactics, and even geopolitics.

Key Hypersonic RDT&E Programs Can Lead to First Procurement Programs

Air Force	Hypersonic Conventional Strike Weapon	RDT&E	Air Force Program of Record
Navy	Intermediate Range-Conventional Prompt Strike	RDT&E	Navy Program of Record
Army	Long Range Hypersonic Weapon	RDT&E	Army Program of Record
DARPA/ Air Force	Air –Launched Rapid Response Weapon	Glide Vehicle Concept	Feeds R&D efforts in other services
	Hypersonic Air-breathing Weapon Concept	Cruise Missile Concept	
Various Dept / Agencies	Classified Hypersonic Weapons Research	Various Concepts	Classified weapons procurement programs

Hypersonic weapons R&D activities have now transitioned to the Services, and if successful in flight and operational tests, are likely to transition to formal procurement Programs of Record.

Source: Fairmont Consulting Group

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California Brazing HAS BEEN ACQUIRED BY TRIVE CAPITAL SALE OF COMPANY	Mountain Secure Systems HAS BEEN ACQUIRED BY CACHE CREEK INDUSTRIES SALE OF COMPANY	Beaver Aerospace & Defense, Inc. HAS BEEN ACQUIRED BY HEROUX DEVTEK SALE OF COMPANY	PrimeFlight HAS BEEN ACQUIRED BY THE CARLYLE GROUP SALE OF COMPANY	Triumph Processing Embee Division HAS BEEN ACQUIRED BY AMP SALE OF COMPANY
Air Transport Components A PORTFOLIO COMPANY OF GENCAP AMERICA HAS BEEN ACQUIRED BY HOLDER FAMILY INVESTMENTS SALE OF COMPANY	MAYDAY MANUFACTURING HI-TECH METAL FINISHING HAS BEEN ACQUIRED BY ESCO TECHNOLOGIES SALE OF COMPANY	BIMCO Industries Inc. HAS BEEN ACQUIRED BY SENIOR SALE OF COMPANY	AMP HAS BEEN RECAPITALIZED BY WATSON Family Investments RECAPITALIZATION	PRYER HAS BEEN RECAPITALIZED BY TCP TULSA CAPITAL PARTNERS RECAPITALIZATION
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