KAL Capital - Aerospace & Defense

Quarter In Review

Introduction

Quarter in Review Q2 2020

Dear Friends,

Despite it almost being cliché at this point, we hope that you are staying safe and healthy. The past quarter has been a wild ride as we saw COVID-19 emerge as the most important global event of many of our lifetimes.

We are very pleased to announce the sale of Aero Systems Engineering, a portfolio company of GenCap America, to Calspan. ASE is a market leader in the engineering-centric world of engine and wind tunnel testing. The unique capabilities of ASE and its access to next-generation commercial engine programs as well as hypersonic missile development were critical in attracting a strong response from the buyer community. This is our second closed transaction working on behalf of GenCap America; we are grateful for the trust placed in our firm on both of these assignments.

For KAL Capital, it has been amazing to witness (less so to participate in) the dramatic shifts in M&A sentiment over the past few months. During April and May, we witnessed M&A activity slow to levels below the depths of the Global Financial Crisis. What followed were "green shoots" of activity level that have matured into a very sector-specific recovery. As we had cautiously expected, this improvement has been led by defense-focused businesses. This dynamic is being led by ease of end-market diligence as the defense world has seen very limited virus-induced reductions in demand. For our friends in the private equity community, the expectation of "COVID discounts" never materialized in the defense world. While there are certainly lower valuations aplenty in commercial aerospace, the defense sector remains seller friendly.

For our clientele, the major non-COVID, conversation topic has been the upcoming Presidential Elections and the potential effect of a Biden Administration on both defense spending as well as capital gains tax treatment. On defense spending, the nature of many large procurement programs leads to a very broad manufacturing base, supporting well-paying employment. One of the few (maybe the only) topics that both sides of the aisle agree on is that manufacturing jobs are critical to the eventual broader economic recovery. To us, reductions in procurement spending seem to fly in the face of that sentiment, but the scale of economic stimulus leads to inevitable questions about corresponding spending reductions and/or tax increases. On taxes, the Biden Administration has been clear on its goal of raising capital gains tax rates to normal income, which would effectively double the tax bill of many of our clients. While avoiding economic theory, we expect these proposed changes to lead to a massive surge in M&A activity as business owners will be looking to transact ahead of any change. We witnessed a similar effect on M&A activity when the Obama Administration increased capital gains tax treatment by a much more modest degree.

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

KAL Advises AeroSystems Engineering (ASE)

Calspan Completes ASE Acquisition

- *GenCap America completes sale of ASE to Calspan; they will support ASE's next phase of growth*

ASE
A PORTFOLIO COMPANY OF
GENCAP AMERICA
HAS BEEN ACQUIRED BY
Calspan
SALE OF COMPANY

- KAL Capital announced the sale of AeroSystems Engineering (ASE), a portfolio company of GenCap America, to Calspan, where KAL served as a sell-side advisor on the transaction.
- ASE is leading global provider of mission-critical engine testing and engineering services to manufacturers of jet engines and industrial gas turbines, MRO providers, governments and militaries.

End-to-End AeroEngine Test Facility Solutions

- *ASE provides an end-to-end test facility solution including turnkey new test facility construction, test cell modification, or engine kit upgrade*

Aftermarket Support

- Upon installation, ASE offers a variety of support services including spare parts, facility upgrades, training programs, and on-going service & maintenance contracts

Test Cell Conceptual Design

- Multidisciplinary facility design package includes test cell facility concept level design as well as design of all the special test equipment with a local A&E to execute.

Test Cell Equipment and Software

- ASE engine test cell equipment set the industry standard for engine test equipment including thrust stands, TNE, adapters, DACS, and engine mechanical systems.

Facility Construction

- Provides complete construction oversight and project management.
- ASE facility engineers provide continuous support throughout the construction process.

Investment Highlights

- *ASE brings complementary services to the Calspan portfolio, specifically wind tunnel testing which will further leverage Calspan's vast experience in wind tunnel testing and jet engine development systems*

- Full Lifecycle Solutions Provider for Engine and Airframe Testing
- Technical Leader in Aerodynamic, Acoustic, and Thermal Design
- Fully Embedded with Engine OEMs
- Strong Market Position with Global Footprint and Robust Backlog
- End-to-End Test Facilities Solutions
- Strong Management Team with Best-in-Class Operations System

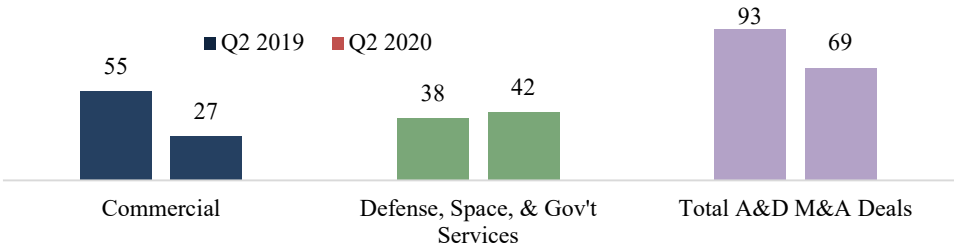
Public and M&A Market Focus

Q2 Aerospace and Defense M&A Activity

❖ *Defense, space and gov't services M&A activity remains robust, eclipsing the number of transactions for Q2 2019*

- As uncertainty surrounding COVID-19 reached its peak and air travel traffic at its lowest in decades in Q2 of 2020, , commercial aero M&A activity experienced more than 50% decline over the same period in 2019.
- Conversely, defense M&A activity remained robust, eclipsing the number of transactions for Q2 of 2019. KAL believes that trend will continue for the foreseeable future as A&D-focused buyers looks towards defense assets insulated from the impact of novel virus in an environment with increasing budgets and rising geopolitical tensions.

Aerospace & Defense M&A Deal Activity Q2 1019 vs. Q2 2020



Q2 Aerospace and Defense Public Market Activity

❖ *Market responded favorably to Boeing announcement that it will resume 737MAX production in May, hoping to return to service in late Q3 or Q4 of 2020*

- Commercial stocks experienced modest gains over the precipitous declines at the end of Q1 when it became clear that the pandemic was set to significantly disrupt the global A&D supply chain and the its effect on air travel reached its peak.
- Boeing's gains were as a result of the announcement that it will resume 737MAX production in May with the Company hoping to gain regulatory approval to return to service in late Q3 or Q4 of 2020.
- Despite some initial skepticism at the timing of the transaction, the market responded favorably after Raytheon closed its merger with UTC in April-20.
- Aerojet Rocketdyne experienced gains after securing $1.8 billion contract from NASA for engines for future deep space missions.

Q2 Share Price Performance

Company	Q2	YoY
Aerojet Rocketdyne	5.0%	-13.0%
Boeing	12.0%	-52.8%
Crane	4.6%	-30.5%
General Dynamics	13.3%	-19.1%
HEICO	9.8%	-29.6%
L-3 Communications	-5.8%	-4.8%
Leidos	7.1%	13.8%
Lockheed Martin	-2.0%	7.2%
Moog	8.6%	-33.5%
Northrop Grumman	-1.3%	-4.5%
Raytheon	13.3%	-21.5%
Spirit AeroSystems	-11.6%	-74.4%
Textron	32.6%	-29.0%
Triumph Group	-3.7%	-71.9%

Lending / Private Equity Market Focus

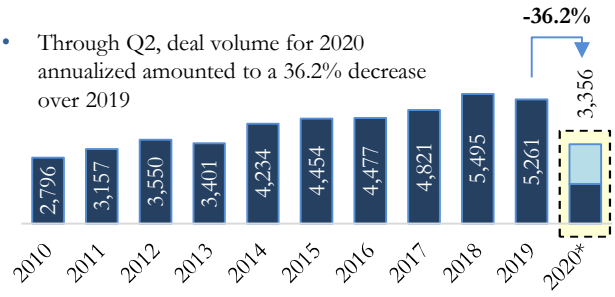
COVID Halts Private Equity Deal Activity in Q2

❖ *Deal volume in Q2 fell by 53.7% over the first quarter in 2020*

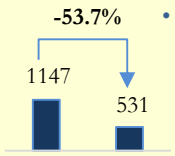
- The private equity community has experienced a period of extraordinary performance over the past 10 years with both transaction and leverage multiples reaching historic levels, specifically in the A&D space.
- As the pandemic unfolded over the second quarter of 2020, private equity exercised caution and remained on the sidelines.

US Private Equity Deal Volume

- Through Q2, deal volume for 2020 annualized amounted to a 36.2% decrease over 2019



2020 YTD Deal Volume

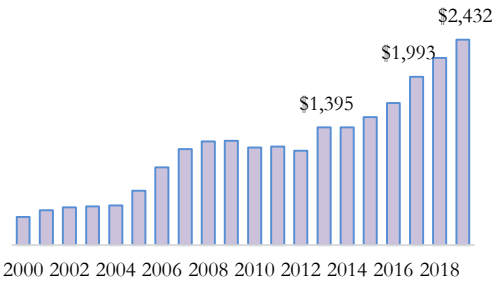


- Deal volume in Q2 fell by 53.7% over the first quarter in 2020

❖ *After years of record multiples, private equity firms will be eager to invest in quality assets in search of outsized multiples*

- Lessons learned from the financial crisis remain fresh in the mind of the private equity community. With dry powder still at record levels, funds will be pressured to deploy capital to take advantage of a buyer friendly environment after years of record high valuations.
- From our perspective, there are two key certainties: 1) Private Equity dry powder is at record highs and will be deployed sooner rather than later to maximize returns and 2) Once the dust settles, the virus is contained and the economy is set towards a path to recovery, the competition for quality assets will only increase.
- The key uncertainty remains on when the virus will be contained.

Global Private Equity Dry Powder ($Bn)

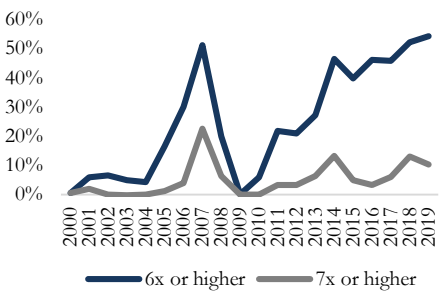


Specialty Lenders Could Be Significant Hurdle Towards Recovery

❖ *Despite record dry powder, buyout leverage multiples are set to decline as specialty lenders exercise prudence due to uncertain economic landscape*

- Increased defaults in Q2 point to specialty lenders becoming a substantial hurdle to the recovery of the buyout market.
- Specialty lending companies rely on credit lines from banks to help fund their investments in buyout transactions and if lenders are worried about their standing with banks, they will be less likely to make new loans to businesses, which would inevitably translate into lower leverage levels.

US Leveraged Buyout Market by Leverage Level

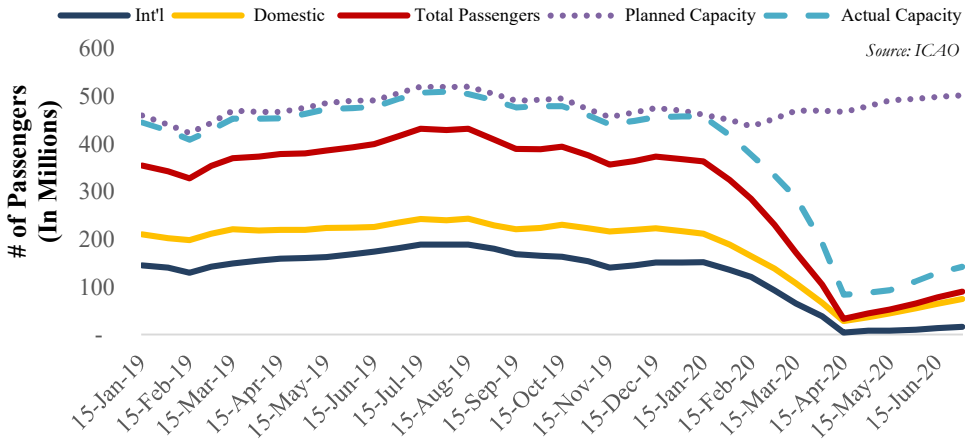


Commercial Aftermarket Focus

Uptick in June Highlights Keys to Recovery

❖ *Regions with higher share of domestic traffic are expected to recover faster*

- In the second quarter of 2020, the novel coronavirus brought global air travel to a halt but a slight uptick in activity in June in the US and Europe gives us some insight into the challenges ahead for commercial aviation and what the recovery will look like over the next few months, and possibly years.
- According to the ICAO, the estimated impact of COVID-19 on global passenger traffic will be:
  - Overall reduction ranging from 42% to 52% of seats offered by airlines
  - Overall reduction of 2,369 to 2,947 million passengers
  - Approx. $316 to $390 billion potential loss of gross operating revenues of airlines

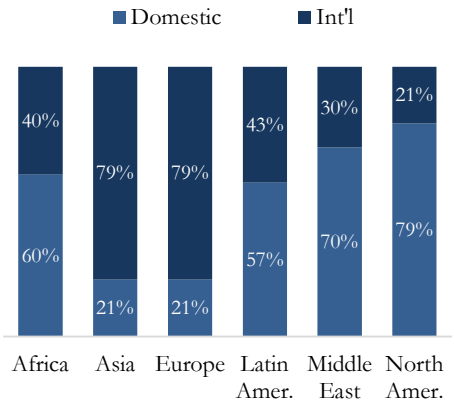


Domestic Traffic Will Rebound More Quickly Than International

❖ *Due to its high domestic to international traffic mix, the US air traffic is well-position to recover once the pandemic is contained*

- There is no precedent for air traffic recovery from a global pandemic but other regions which have been more successful in containing COVID-19 offer a glimpse into what recovery will look like in the US.
- The US high domestic-to-international mix will greatly benefit the US compared to other regions as domestic air travel will recover significantly faster than international. Domestic passenger traffic in China which bottomed out in mid-February recovered to around 76% of last June.
- The timing of the domestic travel recovery remains unknown. Cases continue to rise in many regions across the country coupled with quarantine restrictions being implemented in larger markets means a Q3 recovery remains in doubt.

Domestic / International Mix by Region



Source: ICAO

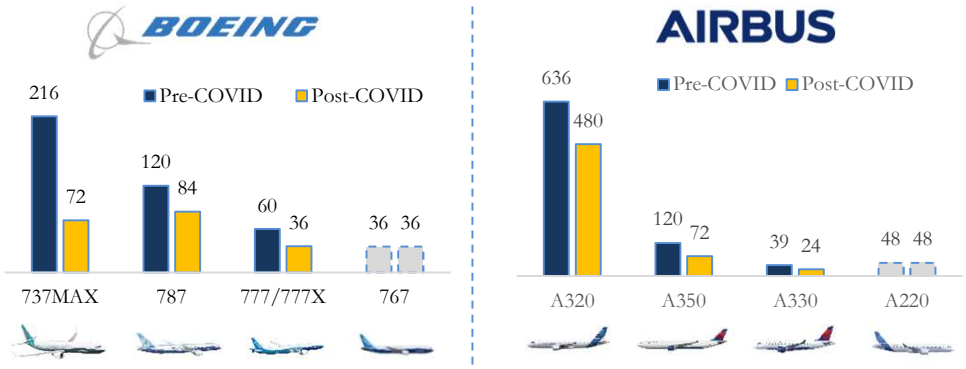
Commercial OEM Focus

❖ *Boeing and Airbus face an uphill battle as both OEMs temporarily shut down production at their US and European manufacturing plants*

OEMs Slash Production Rates

- As of result of COVID-19, both Boeing and Airbus were forced to temporarily shut down production facilities and have announced sweeping production cuts.
- The announced cut in production rate suggests that Boeing is anticipating additional cancellations or deferrals to its pending orders.

Boeing and Airbus OEM Production Cuts

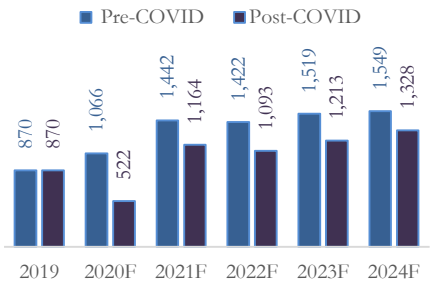


❖ *Forecasted aircraft deliveries were revised downward*

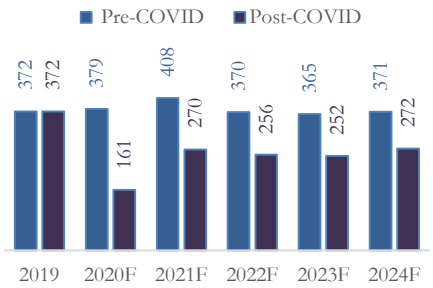
COVID Has Changed the Aircraft Delivery Landscape

- Oliver Wyman predicts the impact of COVID-19 on aicraft deliveries will be substantial with a -21.3% for narrowbodies and a -30.1% reduction for widebodies through 2024

Narrowbody Deliveries



Widebody Deliveries



❖ *Boeing resumed 737MAX production and hopes to gain regulatory approval to return to service in Q4 of 2020*

- With Boeing and Airbus competing for a significantly smaller market than had been anticipated, the 737MAX recertification process remains key. News of the 737MAX resuming production at its Renton facility in May was a welcome announcement for commercial aero supply chain and while it will be a few years before the Company can hit its 57/month production goal, the 737MAX returning to service is a step in the right direction towards recovery.

Source: Oliver Wyman analysis

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ASE — A PORTFOLIO COMPANY OF GenCap America — HAS BEEN ACQUIRED BY Calspan — SALE OF COMPANY	AEVEX — A PORTFOLIO COMPANY OF Trive Capital — HAS BEEN ACQUIRED BY Madison Dearborn / Covant — SALE OF COMPANY	Aero Pacific — HAS BEEN ACQUIRED BY ARCH — A PORTFOLIO COMPANY OF The Jordan Company — SALE OF COMPANY	Valence Surface Technologies — A PORTFOLIO COMPANY OF Trive Capital — HAS BEEN ACQUIRED BY BCI — SALE OF COMPANY	Triumph Aviation Services - NAAS Division — HAS BEEN ACQUIRED BY STS Aviation Group — SALE OF COMPANY
Florida Turbine Technologies — HAS BEEN ACQUIRED BY KRATOS — 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	STS Aviation Group — EQUITY INVESTMENT FROM Greenbriar Equity Group LLC — EQUITY PARTNERSHIP
California Brazing — HAS BEEN ACQUIRED BY Trive Capital — SALE OF COMPANY	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	Pesco Industries Inc. — HAS BEEN ACQUIRED BY Senior — SALE OF COMPANY	AMP — HAS BEEN RECAPITALIZED BY Watson Family Investments — RECAPITALIZATION
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