

KAL Capital - Aerospace & Defense

Year In Review

Introduction

Dear Friends,

For many, 2022 represented a year of challenges as inflation and rising interest rates caused significant disruption that was reflected in declining public equity valuations, choppy credit markets and ultimately reduced M&A activity. While the A&D sector was not totally immune, we repeat our sentiment from the last several quarters that M&A activity within our industry has outperformed by a massive factor. The reason is simply that both the commercial aerospace and defense end-markets are not only recession resistant but are growing at rates that would be attractive in any macro-environment.

As so often the case, public headlines tend to over dramatize the reality of the current M&A environment. While its true that total M&A volume has declined ~37% YoY, this is off a clearly unsustainable 2021 and is inline with 2019 & 2020 activity levels. A&D outperformed the broader M&A market with more modest declines (-4.3%) as the hardest hit sectors were early-stage, low-profitably businesses within tech and healthcare. Perhaps the easiest illustration of the root cause of this discrepancy can be seen in the public equity performance of key defense companies like Northrop (+41%), Lockheed (+34%), Raytheon (+18%) all of which not only outperformed the S&P500 but ended the year well up!

Within A&D, we saw the momentum of the sector improve in 2H 2022 as several large transactions were announced or completed including Parker's acquisition of Meggitt and Audax's take-private of Maxar. This large-scale activity continues to be amplified amongst our core clientele of Tier II/III businesses as transaction activity within several sub-sectors of the supply-chain has picked up, most notably in the aerostructure and aero-engine sectors which have been amongst the last to recover post-COVID.

For 2023, we expect activity levels to be flat to slightly up with continued outperformance versus the broader market as the ongoing strength of commercial and defense end-market demand continues to attract private equity and strategic consolidators looking to deploy capital in growing, recession-resistant industries. Ideally, the debt markets adjust to a new higher-rate environment and provide supportive levels of credit availability to assist private equity groups in closing transactions at seller-friendly valuations.

For KAL Capital, we are proud to have continued to assist our clients in achieving great results from their M&A processes and ultimately achieved a new annual record for the firm of seven closed transactions, which brings our total since our founding in 2017 to over 40 closed deals! We have great expectations for 2023, continue to add to our team, and look forward to bringing several exciting transactions to market in Q1.

Sincerely,



Trevor Bohn
Partner



Ryan Murphy
Partner

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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



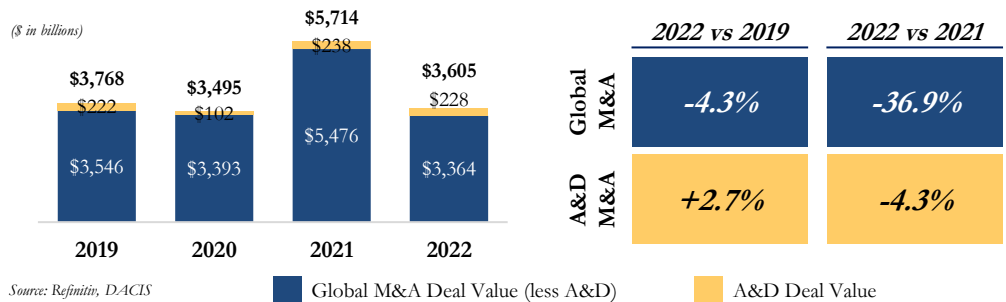
- KAL is built on the belief that M&A processes should be built to maximize transaction outcomes for clients

FY2022 M&A Update

Aerospace & Defense M&A Resiliency Amid an Ailing Broader Market

















❖ The A&D sector continues to outperform the total global M&A market, which saw a 37% decline in global M&A transaction volume in 2022 versus 2021

- Global M&A disclosed transaction value declined by 36.9% in 2022 from the highs of 2021, due to negative market pressures spurred by higher inflation, interest rates, and fear of recession
- The A&D M&A market outperformed the total global market, seeing a slight decrease versus 2021 thanks to the tailwinds of commercial aerospace recovery and bolstered defense spending due to rising global tensions and the return of near-peer competition with Russia and China



❖ Recent large-scale M&A transactions in the A&D sector signal that investors are confident in the industry's resilience in the face of a deteriorating broader market

The Return of the A&D Megadeal

Target	Buyer	Transaction Details
Public Takeovers		
		<ul style="list-style-type: none"> Transaction Date: 12/18/2022 EV: \$4,700 million Propulsion systems
		<ul style="list-style-type: none"> Transaction Date: 12/16/2022 EV: \$6,400 million Space technologies
		<ul style="list-style-type: none"> Transaction Date: 09/14/2022 EV: \$4,200 million Government services
		<ul style="list-style-type: none"> Transaction Date: 08/04/2022 EV: \$5,200 million Cargo airline
		<ul style="list-style-type: none"> Transaction Date: 08/04/2022 EV: \$839 million Airport services
		<ul style="list-style-type: none"> Transaction Date: 06/30/2022 EV: \$7,250 million Defense systems
Large Mergers		
		<ul style="list-style-type: none"> Transaction Date: 12/02/2022 Terms not Disclosed Aerospace manufacturing
		<ul style="list-style-type: none"> Transaction Date: 09/08/2022 EV: \$2,180 million Airport services

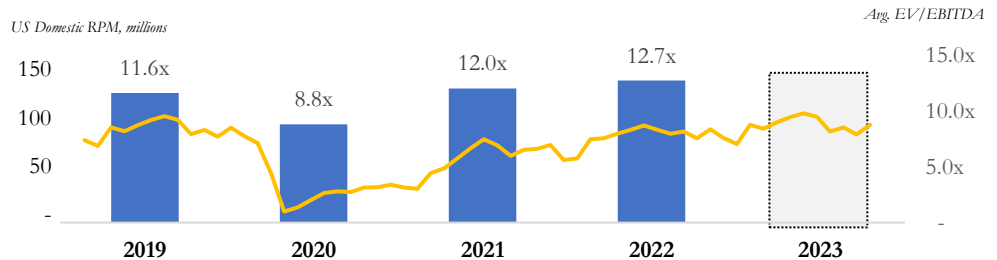
FY2022 M&A Update (cont'd.)

It's Okay to be Early

- In commercial aero, buyers have shown willingness to pay premium multiples for strong thematic tailwinds as strategics have acted selectively targeting differentiated capabilities while private equity has deployed capital to execute buy-and-build strategies seeing an opportunity to build the next Tier I and II suppliers of the upcoming cycle

Commercial Aerospace M&A Reaching Higher

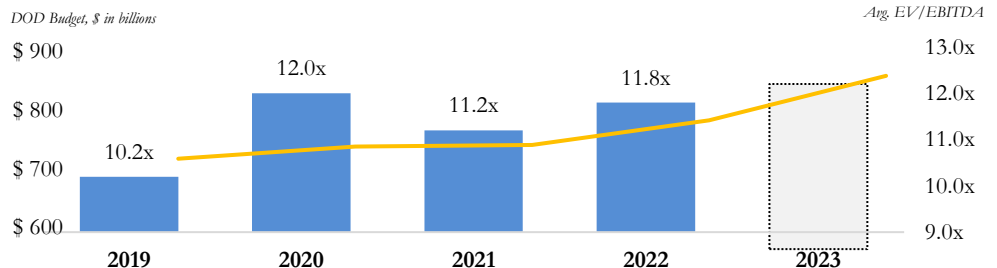
Commercial Aero Deal Multiples vs. Revenue Passenger Miles (RPMs)



- With the recovery in RPMs (Revenue Passenger Miles), commercial aero multiples remained steady as strategics demonstrated willingness to pay premium multiples to add critical capabilities/suppliers in anticipation of the production ramp
- We saw private equity step in seeing an opportunity to solve OEM supply chain issues looking to build new well-resourced, mid-sized Tier I and II suppliers
- On the MRO side, while global air travel still ~12 months away from full recovery, buyers continued to value the aftermarket at premium multiples as it remains a sustainable source of cash flows that is relatively insulated from production cycle

Defense Sector M&A Accelerating thanks to Record DOD Budgets

Source: S&P CapIQ, DoD



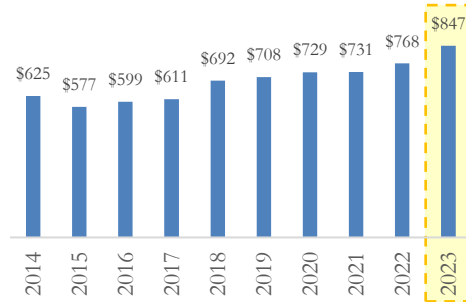
- The increasing DoD budget environment and the rising geopolitical tensions provided the backdrop for the defense M&A activity
- Primes and Tier I strategics focused on adding capabilities through M&A; the theme was larger players bringing unique, mission-critical technology in-house
- Defense electronics, electronic warfare, cyber, hypersonics, as well as space assets remained some of the most sought-after businesses in the sector commanding premium multiples from both strategic and financial buyers

❖ Commercial Aerospace M&A valuations have surpassed 2019 levels, anticipating continued long-term recovery of flight demand and favorable industry tailwinds

❖ An increasing DoD budget environment contributed to healthy multiples across the defense sector

Defense Focus: 2023 Defense Budget

Authorized Funding in the NDAA



- Largest increase (10%) in the NDAA in recent history due to geopolitical uncertainty in China, Ukraine, Iran and North Korea
- Procurement efforts for Naval ships & aircraft, Air Force aircraft, and Army missiles & tracked vehicles saw the greatest increase in terms of dollar amount

Key 2023 Budget Focus

Integrated Global Deterrence focused on the Indo-Pacific

- Budget extends the Pacific Deterrence Initiative through FY2023, with around \$11.5 billion to support the effort



Defense Procurement Increase by 12%

- With \$110 billion dedicated to procurement, there is a focus on air & sea power system readiness



Nuclear Modernization

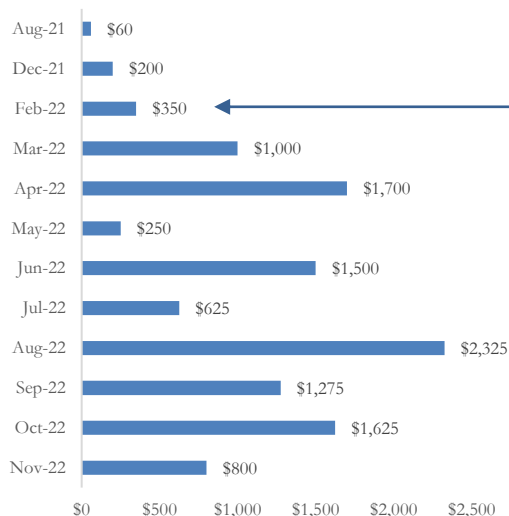
- ~\$300 million dedicated to the development of the hypersonic glide-phase interceptor



U.S. Security Assistance to Ukraine

Presidential Drawdowns for Ukraine FY2021-FY2023

(in millions of dollars)



February 2022 – Russia invades Ukrainian city of Kyiv and US Gov't announces its steadfast commitment to thwart Russian aggression

August 2022 – Successful Ukrainian counteroffensive in which they deploy missile systems & munitions provided by the U.S. and other Western Countries

Since Aug. 2021 U.S. Security Assistance has totaled **\$11.2 billion**

❖ 2023 M&A will be aggressive as consolidation begins to increase and there are less targets to acquire

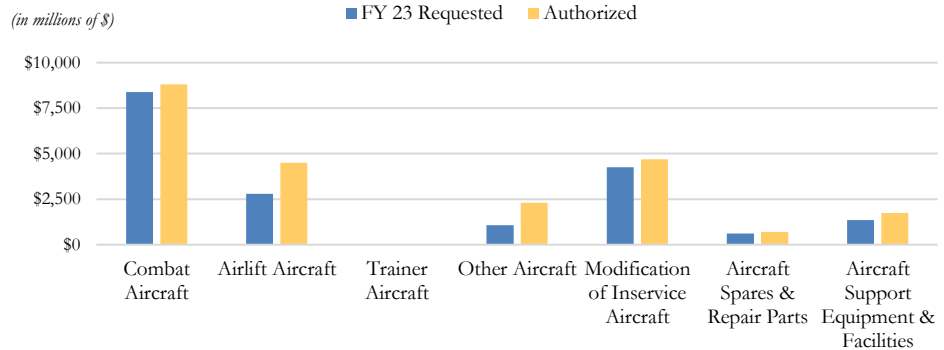
❖ Major focus areas of the budget will drive the growth of the defense industry for the next couple years

❖ With \$11.2 billion in aid provided to Ukraine, the U.S. increased its missile systems and munitions budget partially to replenish its stores of advanced defense equipment

Defense Focus: 2023 Defense Budget (cont'd.)

2023 USAF Combat Aircraft Lead Aircraft Funding Budget

FY23 Request vs NDAA Authorized Aircraft Budgets



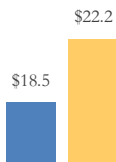
The Combat Aircraft budget primarily represents F-35 and B-21 Raider procurement

DoD Programs of Interest

	Program	Status
USAF Programs	FY23 USAF Budget (in billions of \$) 	F-35 Fighter ❖ Long-term effort with sustained funding for 61 units
	B-21 Raider ❖ Funding ramping up	
	V280 Valor ❖ Bell Textron awarded the FLRAA Contract	
Navy Programs	FY23 Navy Budget (in billions of \$) 	Virginia Class Submarine ❖ Authorized full funding for 2 additional units
	Columbia Class Submarine ❖ Authorized full funding for 1 additional unit	
	Arleigh Burke Class Destroyer ❖ Authorized multi-year contracts for 15 ships	

FY23 USAF Budget

(in billions of \$)

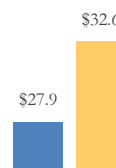


■ FY23 Request ■ Authorized

+20% increase

FY23 Navy Budget

(in billions of \$)



■ FY23 Request ■ Authorized

+17% increase

USAF Programs

Navy Programs




❖ NDAA FY '23 authorized procurement budget higher than requested across the board

❖ Uncertainty in geopolitical landscape has created an environment in which the authorized budget exceeds the requested across all military branches

Defense & Government Services Overview

❖ Public companies in the defense sector are trading near 52-week highs

Public Market Performance								
Company	Share Price	% of 52-Wk.High	Market Cap. (\$bn)		EV/Revenue		EV/EBITDA	
			12/31/22	12/31/21	2022	2021	2022	2021
 Raytheon Technologies	101.56	95.8%	149.46	134.95	2.7x	2.5x	16.5x	13.6x
 LOCKHEED MARTIN	476.27	95.4%	127.1	99.83	2.1x	1.7x	15.3x	12.3x
 NORTHROP GRUMMAN	527.46	94.8%	823.98	62.93	2.75x	1.9x	11.35x	7.5x
 GENERAL DYNAMICS	244.89	95.6%	67.35	59.11	2.0	1.7x	15.1	11.8x
 L3HARRIS™ FAST. FORWARD.	206.41	73.9%	39.3	41.99	2.79x	2.7x	18.45x	12.8x
 BAE SYSTEMS	41.67	97.1%	32.06	17.28	1.87	1.2x	13.33x	9.0x
 leidos	104.68	94.2%	14.37	12.89	1.35x	1.2x	13.54x	9.7x
 Nasdaq	157.49	73.2%	25.94	34.97	5.5x	5.8x	15.6x	16.5x

Notable Transactions		
Target	Acquirer	Description
WNDRVR	• APTIV •	Wind River is a provider of embedded software for intelligent connected systems, providing an edge-to-cloud software portfolio
 HERMETIC SOLUTIONS GROUP Enabling Technology	 Qinetiq	HSG designs and manufactures highly engineered, mission-critical electronic solutions to protect, preserve, and facilitate electronic signal generation
Avantus	QINETIQ	Avantus is a leading provider of cyber, data analytics, and software solutions to the Department of Defense, Intelligence Community, and DHS
 NAVITAR	AMETEK	Navitar is a designer, developer and manufacturer of optical solutions

Active Quarter in Space-Focused M&A

- Space focused M&A market was extremely active in Q4 with numerous deals getting closed before the end of the year. As the market shifts in favor of the defense industry, look for the space market to remain active in the beginning of 2023

Notable Space Transactions

Acquirer	 L3HARRIS™ FAST. FORWARD.	 Viasat™	 eutelsat	 ae Industrial Partners
Target	 Viasat™ Tactical Data Link Business	 inmarsat	 OneWeb	 YORK SPACE SYSTEMS

Commercial Focus: Recovery Mode

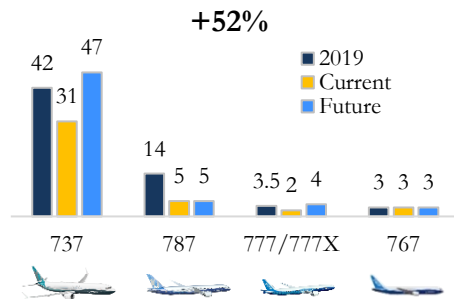
Airbus and Boeing Production Back On Track in 2023

- Boeing and Airbus set to increase narrowbody production on the 737MAX and A320 family 52% and 16% respectively

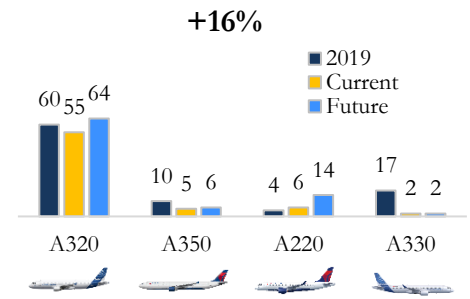
Airbus and Boeing Aim Aggressive Ramp



2022 vs. 2023 Narrowbody Rate Hike



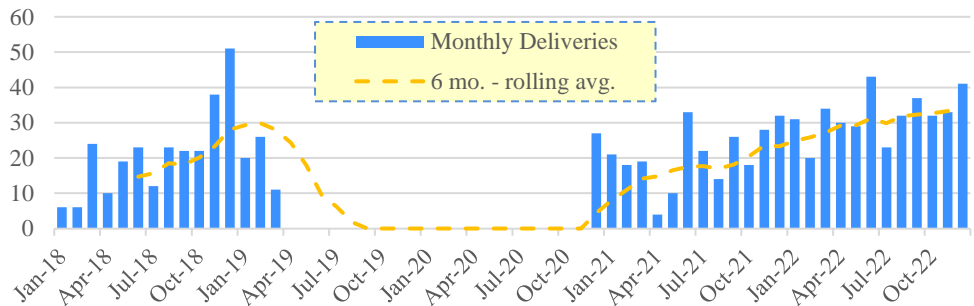
2022 vs. 2023 Narrowbody Rate Hike



Upswing in 737MAX Deliveries

- While 737MAX deliveries have been challenged by the large stock of grounded aircraft, Boeing made strides accelerating its 737MAX production and delivered 385 aircraft in 2022
- Boeing plans to raise production in 1H of 2023 to 37 aircraft and reach 47 per month by end of the year

737MAX Deliveries Jan-18 to Dec-22



- Resuming deliveries in China will be critical to the full recovery of the MAX program as there are currently 140 737MAX aircraft in storage awaiting transfer to Chinese airlines
- While talks to resume deliveries remain on-going, the first commercial flight by the model landed in China in October for the first time since 2019

Source: Boeing and Airbus

❖ Both Boeing and Airbus set to ramp monthly narrowbody production beyond pre-COVID levels

❖ Increased build rate visibility given by OEMs will drive interest to invest in the commercial aero supply chain

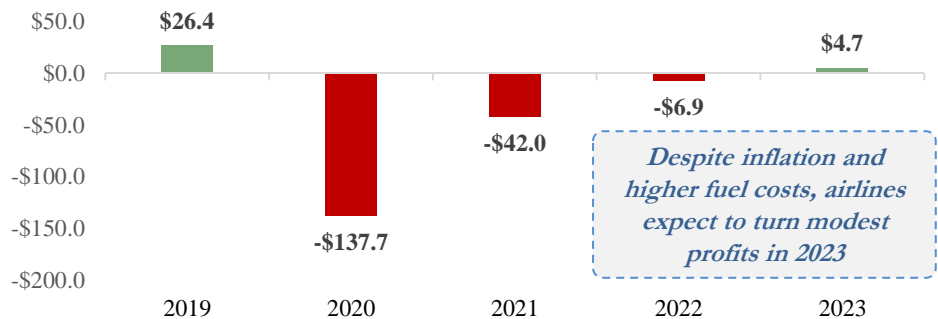
❖ China approving its airlines to resume accepting deliveries will be key for the full recovery of 737MAX program

Commercial Focus: Recovery Mode (cont'd.)

Airlines Will Return to Profitability in 2023

- The challenges facing the industry this year will be familiar as the industry has shown great ability to adjust to economic and major cost fluctuations in labor, fuel prices, and passenger preferences

Airline Industry Profitability Compared to 2019 Levels



Commercial Aero Industry Headwinds

- Talent Shortages Need to be Addressed**
 - A&D companies rely on a vibrant, highly-skilled workforce to maintain their competitive edge and 70% of businesses saw increased turnover in 2022 with increased pay and greater flexibility being the primary causes of higher attrition
 - Boeing said the industry needs to recruit, train, and hire ~610,000 new maintenance mechanics and technicians over the next 20-yr period
- Engine Supply Chains Remains a Bottleneck**
 - While production rebounded significantly, Boeing had to cut its delivery estimates for 2022 due to engine suppliers' inability to match airframe production
 - Boeing has dispatched over 10,000 employees to its suppliers, but efforts to correct the supply chain will take time as Boeing employees work to optimize and integrate into their suppliers' assembly lines

KAL Commercial Aero M&A Themes

- Commercial Aftermarket Primed for Growth**
 - Prior to the pandemic, the big concern in the commercial MRO was Boeing and Airbus growing penetration into the aftermarket
 - Increased focus on upcoming production ramp has put OEM aftermarket ambitions on hold and should allow current providers to gain market share
- Suppliers Able to Solve OEM Supply Chain Issues Will Be Rewarded**
 - Pandemic production cuts affected Tier I and II suppliers' cash flows significantly; that segment of the structures and engine commercial supply chain is ripe for a long-anticipated consolidation
 - OEMs will welcome/reward well-capitalized players who consolidate supply chain and deliver a larger, healthier supplier base capable of matching ramp ambitions






❖ Airlines cut losses significantly in 2022 and are projected to turn a profit in 2023

❖ Talent shortage and engine supply chain issues could continue in the 1H of 2023






❖ Healthy M&A outlook for commercial aero due to the continued upward trajectory of global air travel and a structures/engine supply chain looking to match OEM production targets

Commercial Aerospace Market Overview






Public Market Performance

Company	Share Price	% of 52-Wk.High	Market Cap. (\$bn)		EV/Revenue		EV/EBITDA	
			12/31/22	12/31/21	2022	2021	2022	2021
 BOEING	202.66	88.2%	120.78	125.55	2.55	2.5x	N/A	N/A
AIRBUS	30.54	89.19%	96.2	94.61	1.58x	1.7x	11.38x	10.8x
 SPIRIT AEROSYSTEMS	33.14	62.1%	3.49	2.54	1.32x	1.8x	40.57x	16.4x
HEICO	150.76	91.3%	17.87	18.69	8.3x	9.7x	30.9x	35.7x
 MTU Aero Engines	211.1	95.4%	11.24	10.19	2.43x	1.9x	15.08x	18.8x
TRANSDIGM GROUP INC.	628.37	91.8%	34.37	35.58	9.4x	10.7x	20.79x	24.9x
 Parker	295.1	96.7%	37.89	41.64	3.24x	3.1x	20.83	14.5x
 Nasdaq	157.49	73.2%	25.94	34.97	5.5x	5.8x	15.6x	16.5x

Notable Structures/Engine Production Transactions

Target	Acquirer	Description
 Wheel & Brake Division		<ul style="list-style-type: none"> The division manufactures aircraft wheel and brake systems and related products mainly producing hydraulic valves; shutoff valves; brakes; and wheels
		<ul style="list-style-type: none"> Sequa, through its subsidiary Chromalloy, is a global technology company and a leading solutions provider for aircraft engines and gas turbines
	LATECOERE	<ul style="list-style-type: none"> Avcorp is an aerostructures supplier of wing sub-assemblies, large scale composite parts and after-market services, with exposure to key platforms including F-35, B737 Max, B767 and B787

Notable Aftermarket Transactions

Target	Acquirer	Description
		<ul style="list-style-type: none"> Aero Accessories is a leading provider of aerospace component maintenance, repair, and overhaul ("MRO") services
		<ul style="list-style-type: none"> EB Airfoils, a leading fan blade, compressor blade and vane maintenance, repair and overhaul (MRO) provider for the aero-engine and aero-engine derivative markets
		<ul style="list-style-type: none"> Velocity is a leading provider of aviation maintenance, repair and overhaul (MRO) services as well as manufacturing



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