

KAL Capital - Aerospace & Defense

Quarter In Review

Introduction

Quarter in Review Q1 2020

Dear Friends,

Unprecedented times. Simply put, we at KAL Capital are still trying to get our arms around the profound impact of COVID-19 as it pertains to the aerospace and M&A industries, but perhaps, most importantly, these times serve as reminder of the importance of friendships and family. From our family to yours, we truly hope that you are safe and healthy and managing through this unprecedented disruption in your business.

For our business, we are fortunate to remain active with a book of clientele that are relatively insulated from much of the disruption. Given the current environment, we are particularly pleased to announce our role in the sale of AEVEX Aerospace to Madison Dearborn Partners (details enclosed). This transaction was particularly satisfying as we represented the family owners in their original recapitalization with Trive Capital in 2014, watched the business continue to grow and finally assisted in the second exit.

We remain cautiously optimistic that later this quarter or early next, life as we knew it returns to normal. We will cover in greater detail, but as demonstrated by our recently closed transaction, defense-focused M&A activity continues to march forward, albeit subject to new social distancing complications! In the mean-time, we want to engage in as much dialogue as possible as we can assist outside of our normal scope of sell-side M&A activity. We have access to both conventional and non-conventional financing sources, should the need arise.

We will take the remainder of this Industry Review to share our specific thoughts on the current implications on M&A for each of the major sub-sectors of the aerospace world, which we break out into commercial OEM, commercial aftermarket and defense. The duration and the extent of the reduction in valuations varies dramatically by sector, but overall the M&A market has abruptly shifted away from a seller friendly backdrop to one where the market is still trying to reach a point of price discovery as many M&A processes have been paused.

Reflecting on the Great Financial Crisis of 2008-2009 has been an invaluable source of perspective and a way to articulate differences, both positive and negative from today. First, the previous crisis began as a housing/banking issue that migrated into the broader economy. This amplified the negative effect on M&A activity as a prolonged lack of access to debt capital dramatically reduced private equity activity. In comparison, today's crisis is an economic shock that did not originate from what was previously, a healthy financial system which should somewhat mitigate the adverse effect on lending risk-appetite. Additionally, many of today's private equity and middle-market debt capital sources are from committed funds and other non-traditional banking sources. According to PitchBook estimates, these private debt funds have \$275 billion of committed capital base. Secondly, private equity's strong performance coming out of the previous recession led to an unprecedented, exponential increase in the number of funds and total committed capital that institutional investors have allocated to the sector.

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Total private equity “dry powder” sits at \$2.4 trillion; simply put, this capital can only stay sidelined for a limited period before fund life and other economic considerations force equity groups to again deploy capital via M&A activity. These facts are positive but are unable to balance out the negative shock that the market is experiencing; in whole we do face the grim reality that 2020 M&A activity for many sectors will be down considerably and may in fact be lower than 2009.

For the aerospace/defense sector, the comparisons between the Great Financial Crisis and today again point to a very different near-term future for M&A activity. During 2008-2009, the resiliency of the commercial OEM cycle, driven by a deep (international) order book, allowed for M&A activity in the sub-sector to continue with only limited disruption. Ultimately, the length of this crisis will determine the impact on the OEM orderbook, but today many strategic and private equity buyers are taking a “wait and see” approach that we expect to last several months particularly now that Boeing has halted nearly all production and Airbus has announced material reductions in build-rate. While the commercial OEM market will undoubtedly be adversely impacted, the nature of today’s crisis has impacted air traffic to a degree that has the aftermarket supply-chain facing unprecedented challenges. In the near-term, we expect commercial aftermarket M&A activity to be primarily distressed sellers or restructuring as the total collapse in passenger traffic will have a debilitating effect on ground handling, component MRO and other aviation services businesses. Cargo has remained a bright spot as the global economy is still requiring the movement of goods across countries; many participants in this sector have seen revenue increases and will likely emerge from this crisis in strong financial shape. Finally, in contrast to the Great Financial Crisis, we expect defense-driven businesses to continue to transact at seller friendly multiples. While sequestration hamstrung the DoD during the previous crisis, today’s funding environment is robust with strong funding for a variety of programs and platforms. We believe that private equity and strategic buyers will be drawn to these types of opportunities driven by the comparative ease of end-market diligence and the lack of alternative deal flow that will likely characterize the remainder of 2020. Additionally, many strategic buyers (public and PEG-owned) have already reached out to KAL Capital expressing a desire to rebalance existing revenue mix towards a more defense-focused model via M&A.

These are crazy times. Please stay safe and as always reach out to either of us with any questions.

Sincerely,

Trevor Bohn

Partner



Ryan Murphy

Partner



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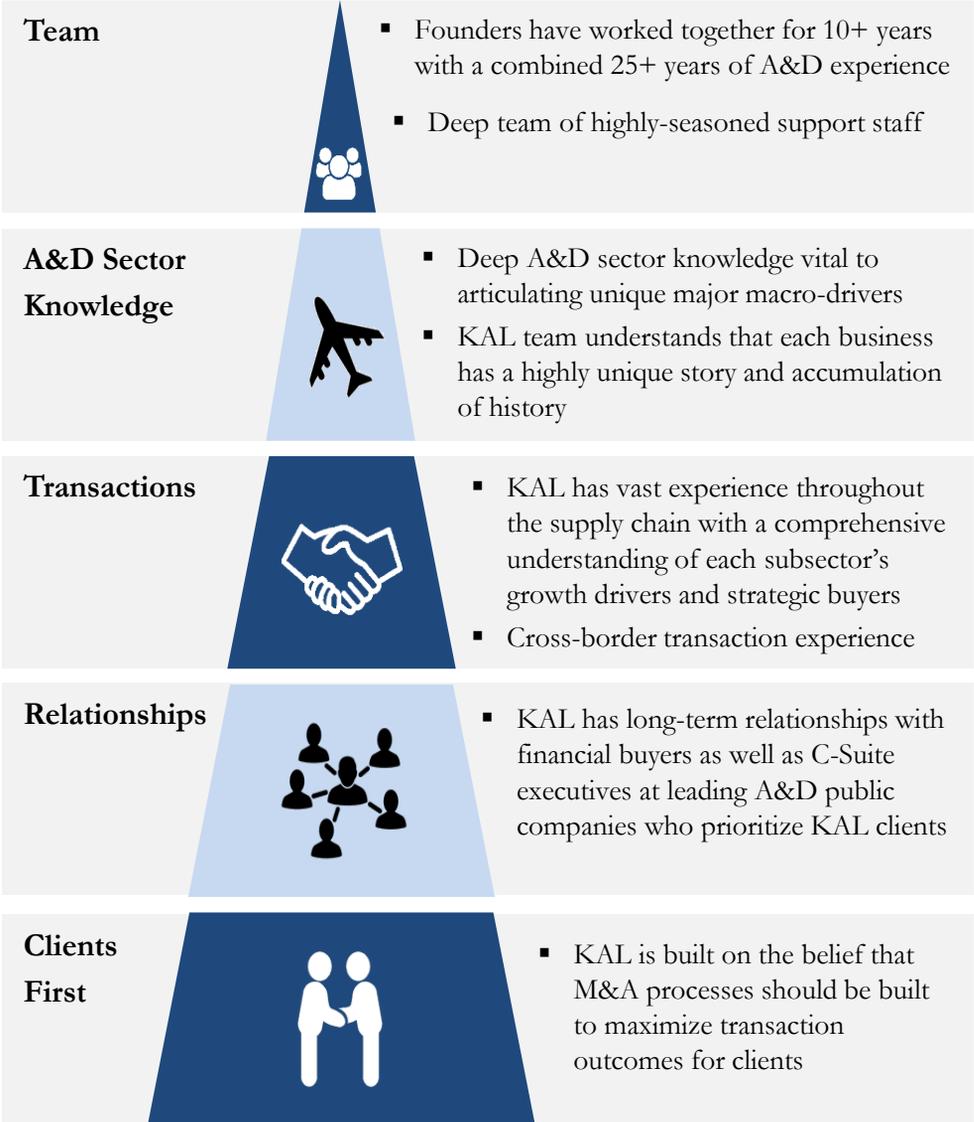
KAL Capital Overview

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**



KAL Advises AEVEX Aerospace

Madison Dearborn Completes AEVEX Acquisition



- KAL Capital announced the sale of AEVEX Aerospace, a portfolio company of Trive Capital, to Madison Dearborn Partners (MDP) and CoVant, where KAL served as a sell-side advisor on the transaction.
- AEVEX is a leading provider of full spectrum, airborne Intelligence, Surveillance, and Reconnaissance (ISR) solutions for defense and intelligence agencies around the globe.

Services and Capabilities



Investment Highlights

Resilient, Well-Funded End Market with Growing Demand for ISR

Comprehensive Platform and Technology Agnostic Service Offering

Strong Forward Revenue Visibility and Growth on Enduring Programs

Broadly Diversified Across Contracts, End-User Agencies, and Geographies

High Barriers Driven by Unique Capabilities & Entrenched Relationships

Attractive Financial and Margin Profile with Exceptional FCF Conversion

❖ *Trive Capital completes sale of AEVEX Aerospace to Madison Dearborn Partners and CoVant; They will support AEVEX's next phase of growth*

❖ *Through this combination of end-to-end services, AEVEX provides agile and customized approaches to the full spectrum of airborne intelligence collection needs*

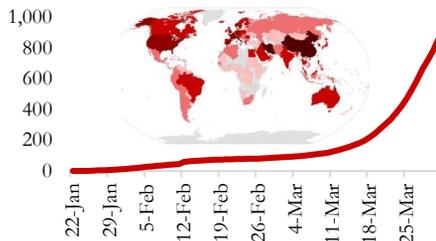
❖ *Utilizing a deliberate strategy, AEVEX has developed multiple avenues leading to a robust, diversified pipeline of sustained growth*

Aftermarket Focus: Air Traffic Slowdown

Unprecedented Decline in Global Air Traffic

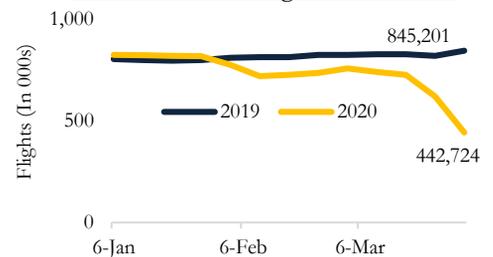
- The COVID-19 pandemic has taken a dramatic toll on the global economy as businesses shutter, international commerce is restricted, and domestic and global supply chains are disrupted.
- As border closures and travel restrictions are enacted, perhaps no other sector has seen such a precipitous and drastic decline than air travel. In the final week of March, global air travel fell ~50% compared to 2019.

COVID-19 Global Cases (In 000s)



Source: World Health Organization

Global Scheduled Flights 2019 vs. 2020

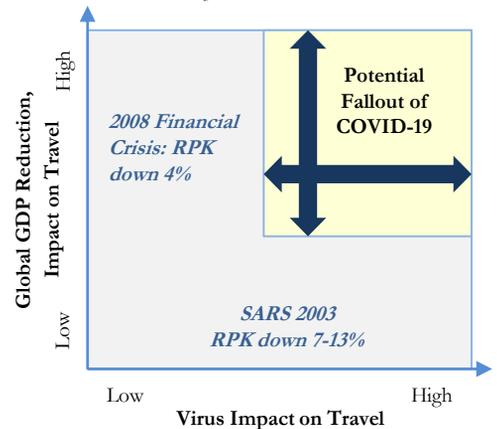


Source: Official Airline Guide (OAG)

COVID-19 Economic and Air Travel Impact

- In 2003, SARS primarily spread in Asia Pacific and led to a reduction of RPK of 7-13% for the year for regional carriers. During the trough, Asian capacity was down 40% and took 6 months to recover.
- The financial crisis in 2008 led to an RPK reduction of 3-4% globally, but it took 12 months before growth resumed.
- With the global impact of COVID-19, there is a high probability of a general economic slowdown. Both the virus and the slowdown could in tandem have significant impact on global travel.

Source: AeroDynamic Advisors – COVID-19 Assessment



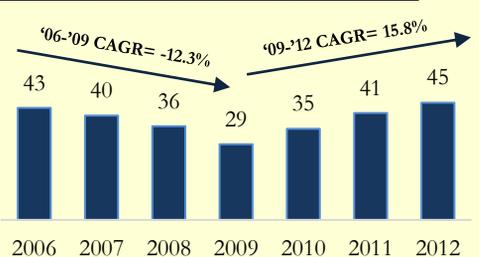
❖ The rise in global COVID-19 cases will affect the aviation industry in an unprecedented way

❖ SARS and H1N1 flu provide models on how COVID-19 will affect global air traffic in the medium and long-term

KAL Capital M&A Outlook

- During the 2008 financial crisis, aftermarket M&A activity experienced a significant decline, KAL expects a more dramatic effect as a result of COVID-19 as it paralyzes air travel and grounds fleets across the globe.

A&D Aftermarket M&A Deals 2006 - 2012



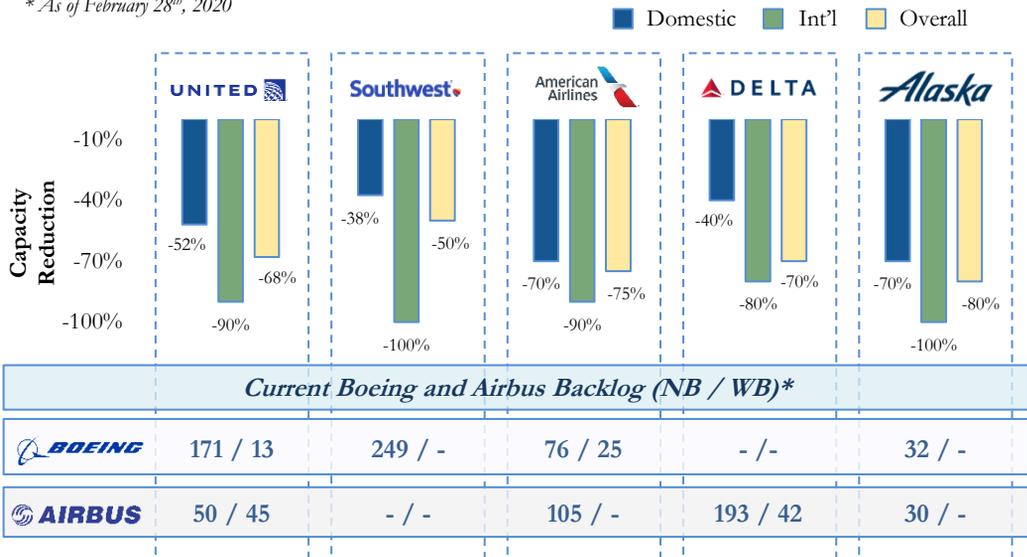
Commercial Focus: Production Rate Declines

Reduction in Airline Capacity Threatens the OEM Supply Chain

- As the COVID-19 crisis reaches pandemic levels and triggered a stark decline in demand, airlines have been forced to adapt to the new reality by drastically cutting both domestic and international capacity, up to 80% in some cases.

Will Airline Capacity Reductions Lead to Order Cancellations?

* As of February 28th, 2020

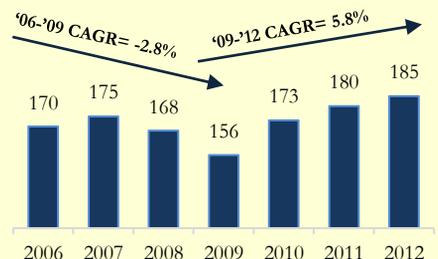


- While the near-term effects on airlines will be capacity reductions as they struggle to preserve cash, the medium- and long-term effects on the OEMs remains unclear with both Boeing and Airbus temporarily halting production.
- Airbus:** Airbus announced it will be cutting its production rates by a third for the next 3-6 months.
- Boeing:** With production on the 737MAX already halted since January with recertification issues, Boeing has hinted at production cuts but has yet to detail how it plans to adjust production rates.

KAL Capital M&A Outlook

- During the 2008 recession, while air travel declined, aircraft deliveries increased and as a result M&A activity saw mild declines.
- The impact of COVID-19 on the sector will again be tied to aircraft production rates; KAL anticipates a 30-40% reduction in production with potential for more dramatic rate slashes if the crisis is not contained by Q2 of 2020.

A&D Commercial M&A Deals 2006 - 2012



❖ As travel demand shrinks precipitously, airlines have been forced to cut capacity

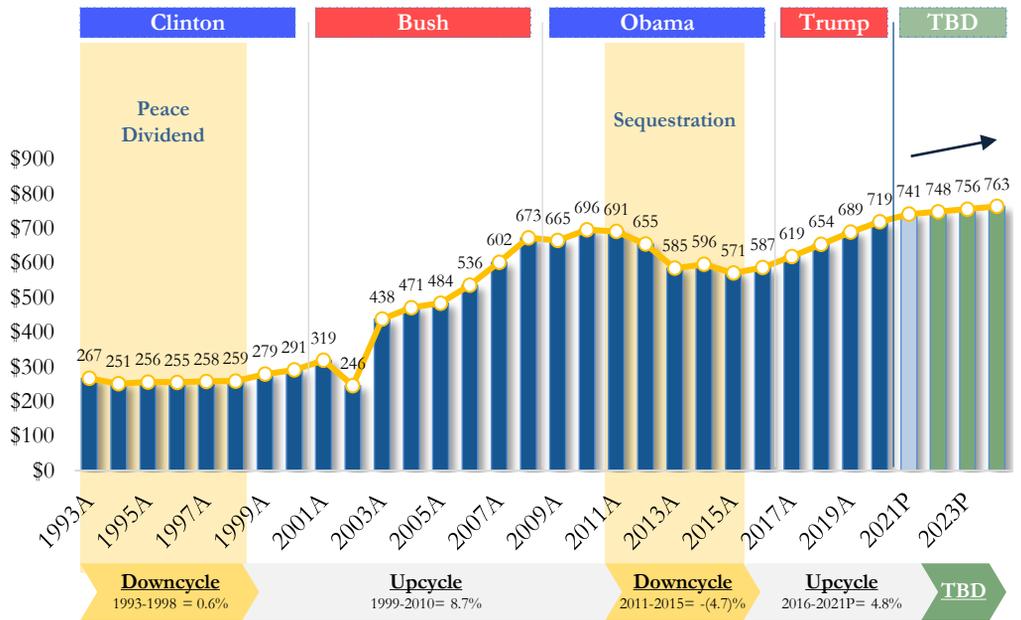
❖ Boeing and Airbus face an uphill battle as both OEMs temporarily shut down production at their US and European manufacturing plants

Defense Focus: Defense to Remain Resilient

FY21 President's Budget Request Highlights Unchanged Priorities

Source: DoD and other publicly available information

US Defense Budget Cycle Over Time



❖ Congress will be wary of repeating the detrimental effects of sequestration on military readiness in a time of global political and economic uncertainty

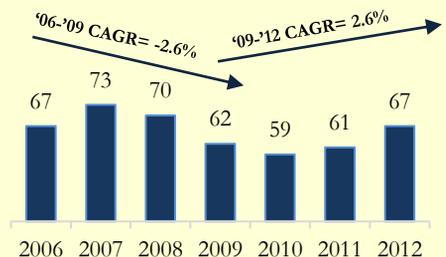
❖ While the main DoD priorities remain unchanged, there is a slight shift from readiness and maintenance towards new weapons

- While the President's budget released in Feb-20 signaled that in the near-future, growth will not match the last 4 years, the DoD budget is expected to experience moderate YoY growth .
- The Pentagon's priorities will remain unchanged from previous years: 1) Modernization of fighter jet fleet (F-35, F/A-18, and F-15) 2) Continued funding of missile defense systems and 3) Investing in capabilities to counter Russia and China like space, artificial intelligence, and hypersonics.
- The Budget did indicate a slight shift from readiness and maintenance towards new weapons development with \$107 billion devoted develop a next-gen of weapons while procurement would drop slightly to \$137 billion from \$144 billion.

KAL Capital M&A Outlook

■ KAL expects defense to be the most resilient sector in A&D. With increased global economic and financial uncertainty, the military is seen as vital to the crisis response and defense budgets will remain resilient over the next few years as budget cuts have historically lagged in challenging economic times.

A&D Defense M&A Deals 2006 - 2012





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