Gorham Technical Associates, Inc.

GORHAM PMA/DER TECHNICAL CONFERENCE

19th Annual Industry Conference

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San Diego, CA

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I. Market Observations

- Economic & Industry Drivers
- Aftermarket in Focus
- Quick Case: Zodiac Aerospace

II. The Death of a Super Cycle

- The Last Nail in the Coffin
- When Markets Turn

III. Private Equity Playbook

- OEM Aftermarket | TransDigm Group, Inc.
- PMA Aftermarket | Our Mystery Contestant
- Strategic & Organic Growth

Market Observations

Economic & Industry Drivers

EMERGING THESIS | CYCLICAL AFTERMARKET ROTATION

A Lot of Moving Parts, but Properly Assembled they Just Might Fly

Our industry thesis for 2017 and beyond represent the intersection of a broad range of changing factors that are changing in response to the global recovery, capital markets and a near term rotation of opportunities in the aerospace & defense markets.

Macro Drivers Creating Headwinds for OEMs

But the broader ecosystem stands to benefit.

Commodities

Brent Crude Oil :	$51.74/BBL	-0.14%
Light Crude Oil :	$48.75/BBL	-0.23%
Natural Gas :	$2.90/MMBtu	-2.76%
Unleaded Gasoline :	$1.59/gal	0.63%

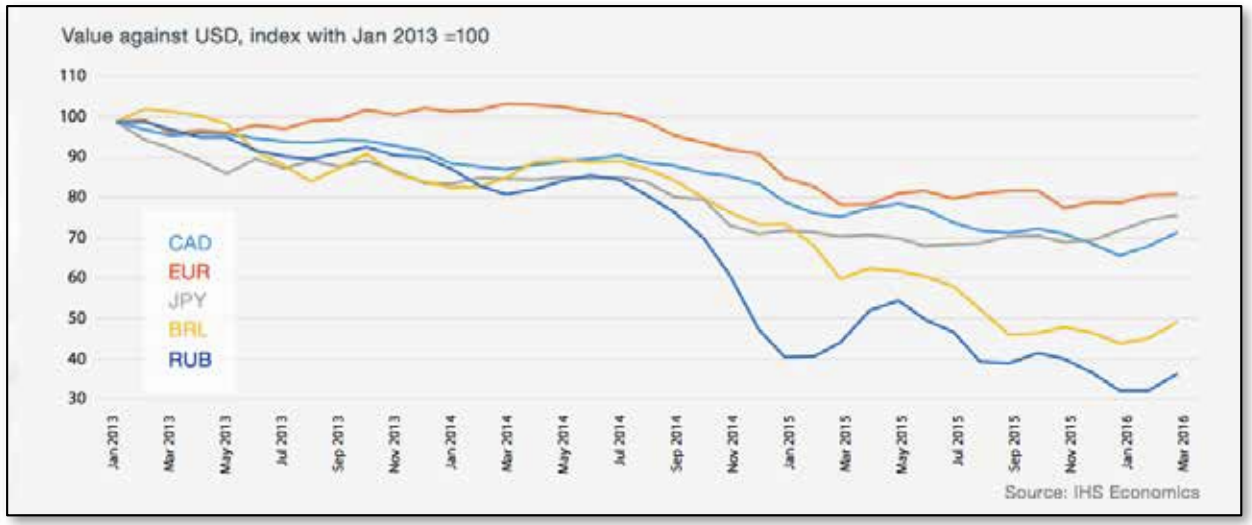
Energy Prices

- ▲ Airlines
- ▼ Airframers
- ▲ Aftermarkets
- ▲ Passengers/Consumers
- ▲ MRO/FBO

Currency P…	Price	Change	% Change
EUR/USD	1.0750	+0.0016	+0.15%
USD/JPY	112.8730	+0.183	+0.16%
GBP/USD	1.2393	-0.0001	-0.01%
AUD/USD	0.7722	+0.0019	+0.24%

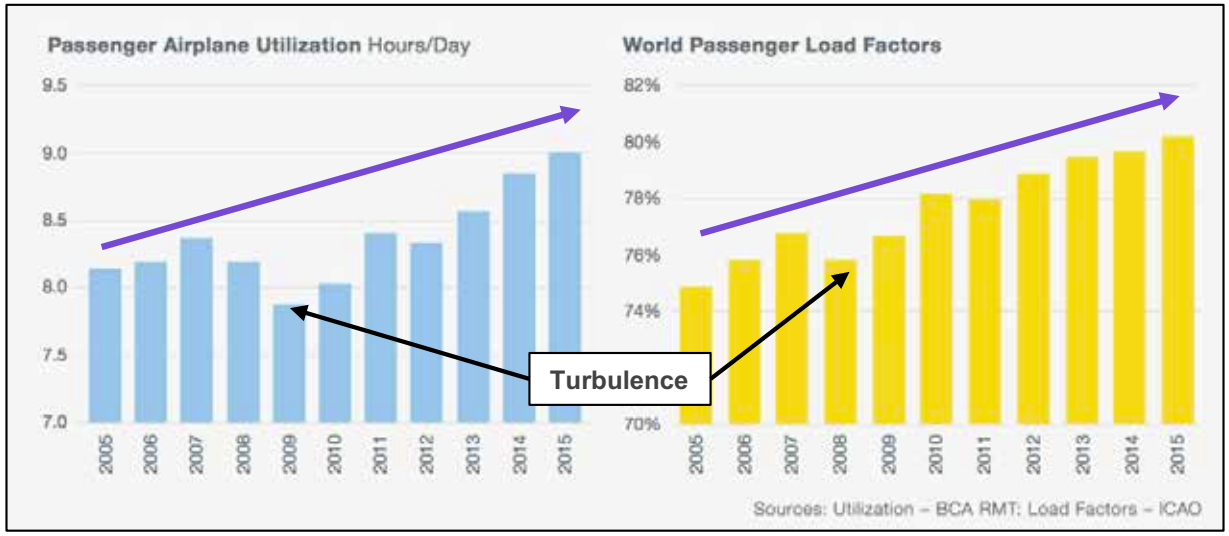
Exchange Rates

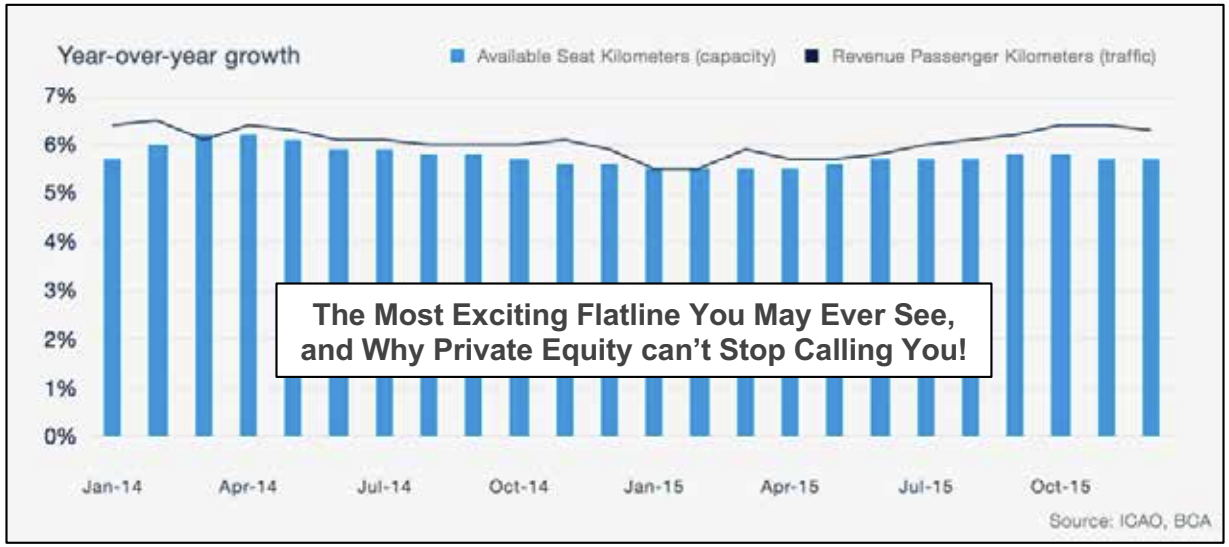
- ▲ Airlines
- ▼ Airframers
- ▲ Aftermarkets
- ▲ U.S. Travelers
- ▲ Foreign Tourism



AIR PASSENGER TRANSPORT IS VIBRANT AND EXPANDING

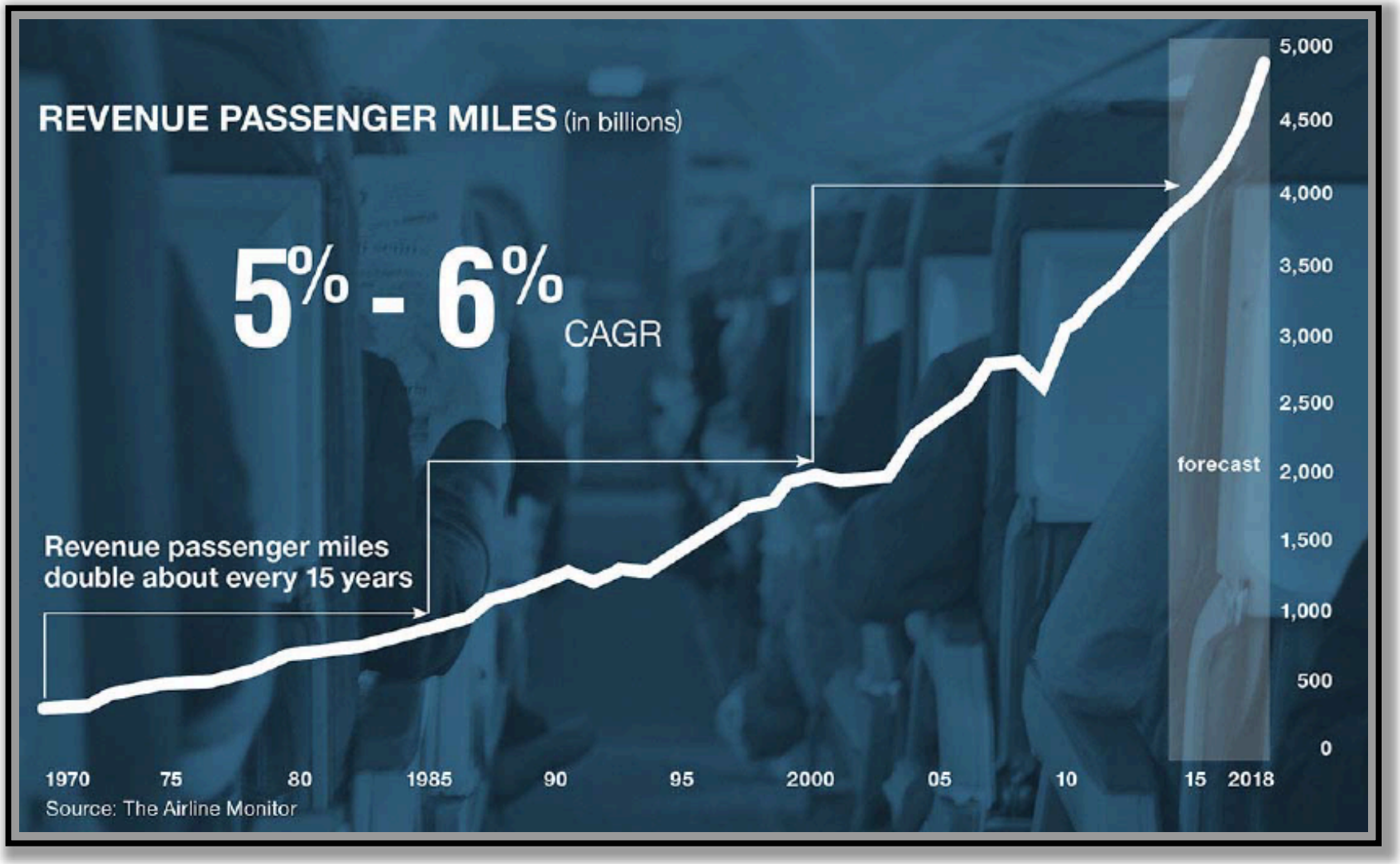
Capacity & Traffic Growing 3x Faster than U.S. GDP Forecast (2.1% in 2017)





AIR PASSENGER TRAFFIC DOUBLING EVERY 15 YEARS

It's the same chart, but it looks much better in miles!



EVEN THE BAD NEWS HAS A SILVER LINING

"If you're looking for a friend on Wall Street, get a dog." – Bankers Proverb

Citron's Left Says TransDigm Could Drop 40% in Two Weeks

Jefferies refutes Citron, says TransDigm like the Amazon of Aerospace

TransDigm Bulls Rebuffed as Short-Sellers Heed Citron's Call

Analysts dismiss Citron's sour take on TransDigm

TransDigm | Friend or Foe?

- Citron Research recently charged TDG as the "Valeant of the aerospace industry"
- Jefferies' equity analyst responded saying TDG was "more like the Amazon of Aerospace"
- Asset Managers and Hedge Funds are all scrambling to figure out where the industry is headed, who's going to win/lose viz. TDG, and what in the world PMA has to do with all of this.

Margin Analysis: TransDigm to Comparable Peers

Name	EV / Next 12 Months EBITDA	EV / Last 12 Months EBITDA	Last 12 Months EBITDA Margin	Last 12 Months EBIT Margin
Safran SA	9.3x	7.0x	18.4%	13.50%
Thales SA	9.2x	9.0x	11.5%	8.20%
L3 Technologies	10.2x	12.2x	7.9%	5.90%
Spirit Aerospace-A	6.9x	4.2x	14.1%	11.30%
Zodiac Aerospace	14.2x	17.0x	6.6%	3.90%
HEICO Corp	15.5x	15.7x	23.7%	19.30%
Meggitt PLC	10.0x	10.7x	11.9%	8.80%
Esterline Tech	10.2x	9.2x	13.6%	8.50%
Ultra Electronics	11.0x	10.5x	18.4%	12.10%
Triumph Group	6.1x	5.4x	10.9%	7.30%
AAR Corp	7.7x	12.0x	4.2%	4.60%
Senior plc	8.1x	8.1x	7.3%	7.20%
Average	**9.9x**	**10.1x**	**12.40%**	**9.20%**
Median	**9.6x**	**9.9x**	**11.70%**	**8.40%**
TransDigm	**13.8x**	**15.3x**	**47.10%**	**40.00%**

The One Line from Citron's Research that Matters Most

"If TransDigm were to operate with the same margins as **HEICO, their next closest competitor on EBITDA margin**…"

PMAs Remain Profitable Bright Spot

EVERYONE WANTS A PIECE OF THE AFTERMARKET

Insourcing & Consolidation

BOEING CLAWS BACK AFTERMARKET SPARES FROM SPIRIT

Reuters | Mar 31, 2016

- "Spirit's contract with Boeing allowing them to make and sell spare parts using Boeing intellectual property expired February 29 and will not be renewed," Boeing said in response to questions from Reuters.
- The change marks the loss of a small but lucrative segment of Spirit's business and **a potential gain for Boeing, which has been building up its aftermarket sales to help lift profit margins, partly through its Aviall unit** based in Dallas.
- Chicago-based Boeing said it was changing the longstanding licensing agreement with Spirit because it was "**best positioned to support our customers with aftermarket parts and repair**." Boeing said it was "providing that support directly to customers instead of licensing suppliers to do it, **in a timely manner that supports their operations and at market competitive prices**".
- Spirit's spares business involves wing, fuselage and propulsion systems and it manufactures the parts under license from Boeing and under so-called part manufacturing approval from the Federal Aviation Administration. Sales of **spares are less than 5 percent of Sprit's $6.6 billion in annual revenue**, …but the business is important and helps supply Spirit's own repair operations with replacement parts at low cost.
- Spirit supplies spares on the Boeing 737 (classic and Next-Generation models), 777, 767, 757 and 747 models [and] also builds spare components for multiple Airbus aircraft.

August 31, 2006 – Boeing spins-off its aircraft parts business

- **Boeing sold its former Wichita operations in 2005 to shed its aircraft-parts business — seen as an expensive in-house operation with high labor costs.**

ROCKWELL COLLINS ACQUIRES B/E AEROSPACE - $8.3B

Why Buy B/E?

- Triples Rockwell's widebody content
- Doubles Rockwell's narrowbody content
- Complementary Cockpit/Interiors Land Grab
- Catalyze Rockwell's ability to offer connected parts
- Develop a fully integrated aircraft automation, communication and intelligence system
- Aka. The Flying Internet of Things (FIoT)

SAFRAN CHASING ZODIAC AEROSPACE - $10.5B

If nothing else, this will be fun to watch

- Standard challenges closing deals w/ governments
- Extra complexity of family shareholders seeking preferred treatment for tax purposes
- Estimated close in Early 2018???
- **VERY interesting development if you'd like to know what the Tier I's are thinking these days.**

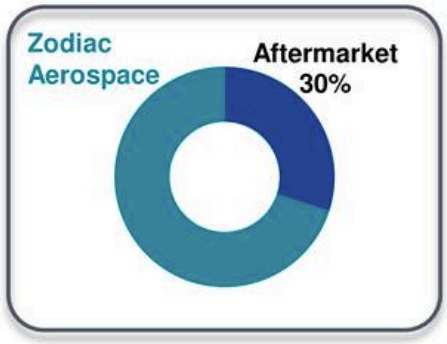
What's the Sign for the Aftermarket? – Slide 5 of SAFRY's M&A Deck

Zodiac Aerospace: unique opportunity to strengthen further Safran

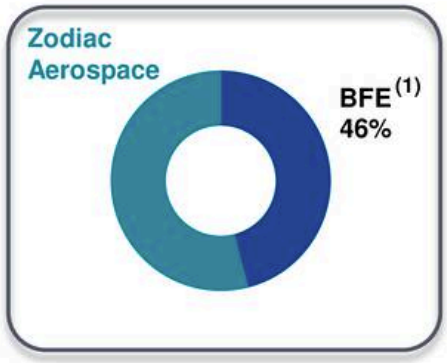
High technological content	▪ Zodiac Aerospace state-of-the-art technologies and track record in complex certification ▪ First class R&D capabilities with over €300m of annual R&D budget, more than 4,000 engineers, 725 innovations p.a. and 1,540 registered patents	☑
Tier 1 supplier with market leading positions	▪ Over 90% of Zodiac Aerospace revenues generated as Tier 1 supplier ▪ Zodiac Aerospace enjoys #1 or #2 positions in its segments (e.g. Aerosafety, Aircraft Systems, Seats, Cabins...) which are complementary to Safran's	☑
Maintain a high share of aftermarket and services	▪ Share of aftermarket / retrofit revenues bolsters Safran's business mix ▪ Increased decorrelation from aircraft delivery cycles thanks to (i) seats and cabins shorter replacement cycles and (ii) balanced mix of BFE/SFE activities	☑
Dollarization of cost base creating a natural hedge	▪ Acquisition strengthens footprint in the US, improving Group's proximity to American aircraft manufacturers and airlines ▪ ~50% of Zodiac Aerospace's revenues realized through US subsidiaries	☑

Did We Mention We Love Your Aftermarket? – Slide 13 of SAFRY's M&A Deck

Further balancing cyclical exposure to OEM production rates



- In line with Safran Aircraft Equipment aftermarket exposure
- Recurring flows of spares and repair revenues
- Dedicated Zodiac Aerospace Services division and team



- Tied to passenger traffic growth and airline profitability
- Cabin is a top priority and key differentiating factor for airlines
- Cabin retrofit cycle:
  - > 5 years for narrowbodies
  - > 8 years for widebodies

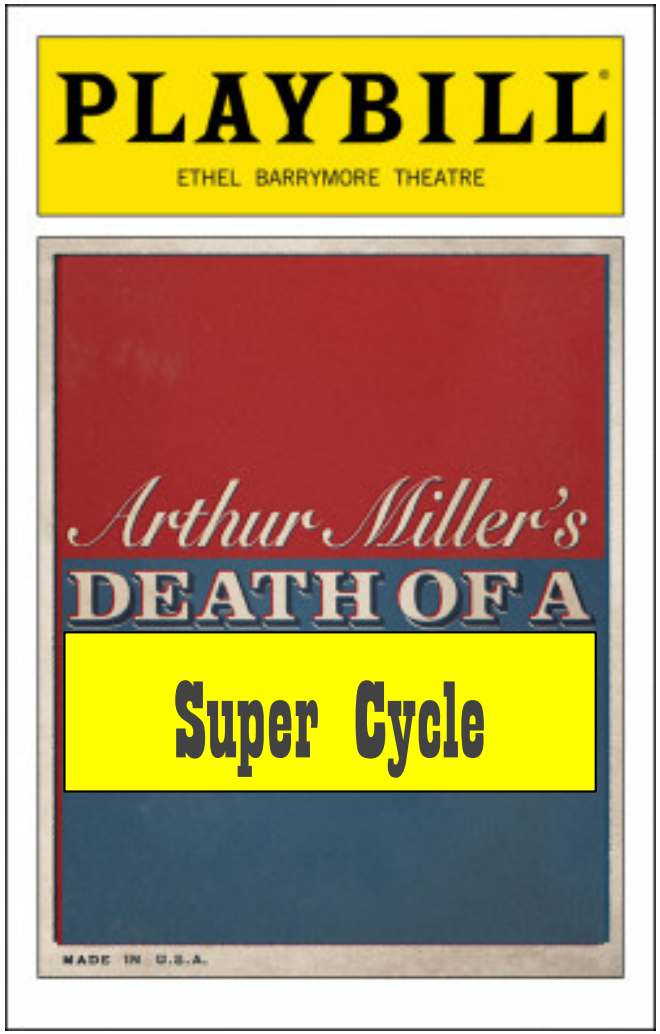
PMA Me A.S.A.P.

Strong flow of aftermarket and retrofit opportunities

) *Buyer Furnished Equipment (« BFE ») as opposed to Supplier Furnished Equipment (« SFE »).*

Death of a Super Cycle

12 Years…that's like 98 in airplane years!



BREXIT ON DISPLAY AT FARNBOROUGH

"In this business, if you don't blow your own horn, there's no music." – Gov. Mario Cuomo

- Articles
- Profile

BREXIT on Display at the Farnborough International Airshow

By Daniel Servent | Jun 30, 2016

Like 4 Tweet G+1 0 Share Email Print

Front Row Seats for the End of the Commercial Aerospace "Supercycle"?

It goes without saying that Britain's vote to exit the European Union, or the now familiar BREXIT, has had the media buying ink by the containership as opposed to the proverbial barrel. Wall Street analysts, corporate forecasters and a fresh wave of armchair economists are all weighing in on what BREXIT will mean for global trade, U.S. interest rates and their retirement portfolios.

The Economics of Commercial Aircraft Orders

While it may appear overly simplistic the principle remains fundamental; a stronger dollar drives dollar-denominated commodity prices lower. The aerospace industry is aware not only of the sharp contraction in crude oil prices since the Thanksgiving Massacre in 2014 (who could miss the relentless media attention), but also of the nearly silent decline in jet fuel prices which has gone virtually unnoticed in the headlines. As those lower prices have eased a major cost pressure, operators have drawn back the throttle and next generation aircraft and engine acquisitions driving slowdown in new order velocities. Read more »

http://www.cfaw.com/blog/brexit-display-farnborough-international-airshow/

British Pound Loses both Engines over the English Channel

Just How Relevant are Exchange Rates Anyway?

FX Rates	Pre-BREXIT	Post-BREXIT	Current
Date	6/23/16	6/24/16	3/17/17
GBP/USD	1.5000	1.3482	1.2384
% Chg	----------	-10.12%	-17.44%

Narrowbody List Price Proxy

Price (USD)	$ 100,000,000.00	$ 100,000,000.00	$ 100,000,000.00
Cost (GBP)	£ 66,666,666.67	£ 74,172,971.37	£ 80,748,375.95
$ Chg	----------	£ 7,506,304.70	£ 14,081,709.28
% Chg	----------	11.26%	21.12%

Parity Price Equivalent

Price (USD)	$ 100,000,000.00	$ 91,856,920.34	$ 82,561,000.00

In order to sell the same number of A/C, the OEMs need to slash pricing by 17.5%.

Alternately, by holding prices fixed they will face at least that much (likely more) of a reduction in volume demand.

Meaning: 2017 orders could fall dramatically even from 2016 levels.

BUT DON'T TAKE MY WORD FOR IT…

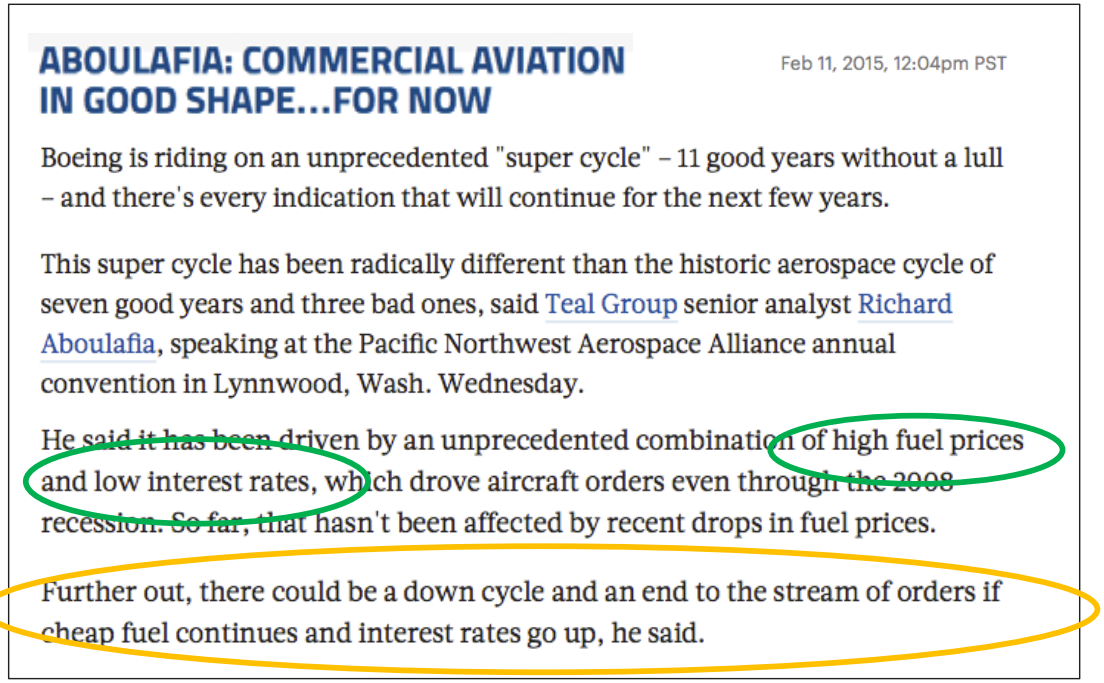
Richard Aboulafia at Teal Group Braced for Impact 2 Years Ago.

AVIATIONWEEK & SPACE TECHNOLOGY — Daily Updates, Access Anywhere

Opinion: The End Of The Airbus-Boeing Supercycle

Richard Aboulafia | *Aviation Week & Space Technology* — Jan 11, 2017

After a remarkable 12-year boom, world aircraft industry output growth sputtered to a halt in 2016. The market fell 1.2% (in constant dollars) relative to 2015, the first aggregate decline since 2003. While military demand remains robust, most civil segments are feeling the impact of negative macroeconomic and geopolitical developments.



ABOULAFIA: COMMERCIAL AVIATION IN GOOD SHAPE…FOR NOW

Feb 11, 2015, 12:04pm PST

Boeing is riding on an unprecedented "super cycle" – 11 good years without a lull – and there's every indication that will continue for the next few years.

This super cycle has been radically different than the historic aerospace cycle of seven good years and three bad ones, said Teal Group senior analyst Richard Aboulafia, speaking at the Pacific Northwest Aerospace Alliance annual convention in Lynnwood, Wash. Wednesday.

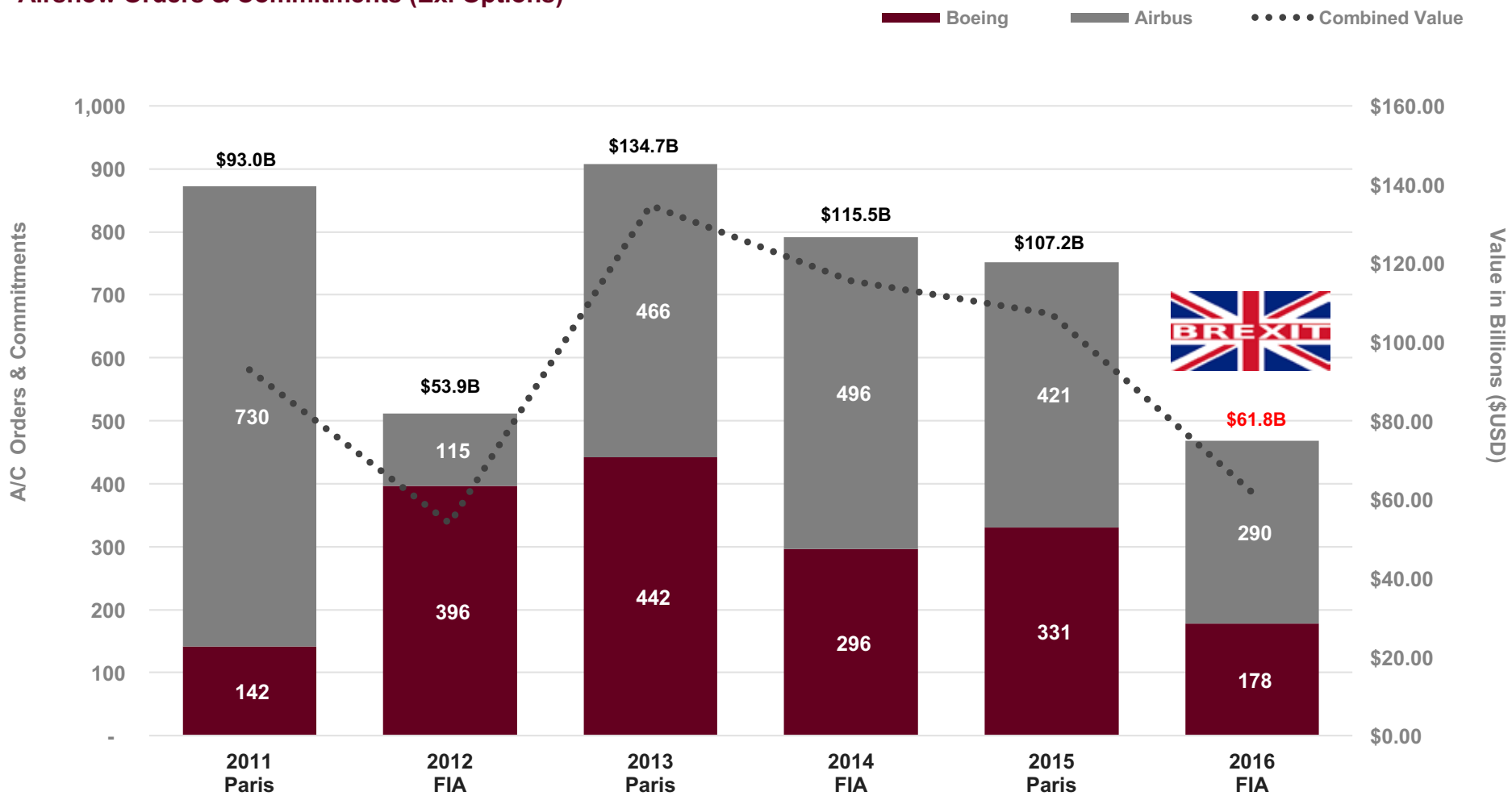
He said it has been driven by an unprecedented combination of high fuel prices and low interest rates, which drove aircraft orders even through the 2008 recession. So far, that hasn't been affected by recent drops in fuel prices.

Further out, there could be a down cycle and an end to the stream of orders if cheap fuel continues and interest rates go up, he said.

BREXIT WINS BEST IN SHOW AS ORDERS FOLLOW THE STERLING

Both OEMs get "Pounded" at Farnborough

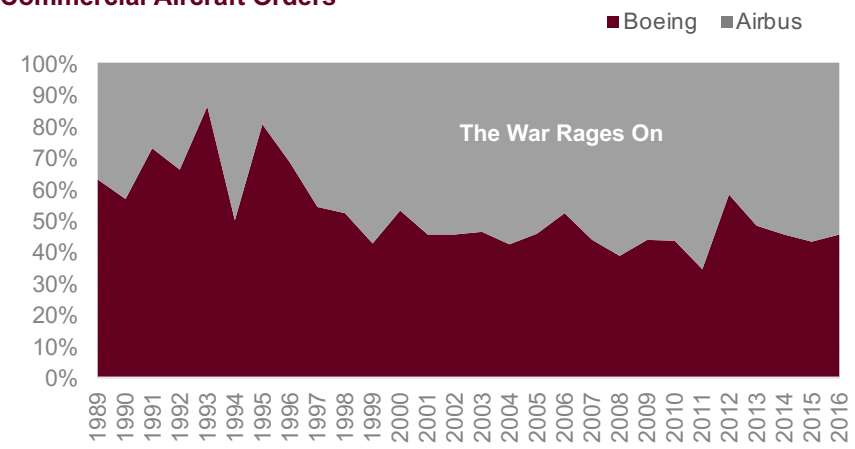
Airshow Orders & Commitments (Ex. Options)



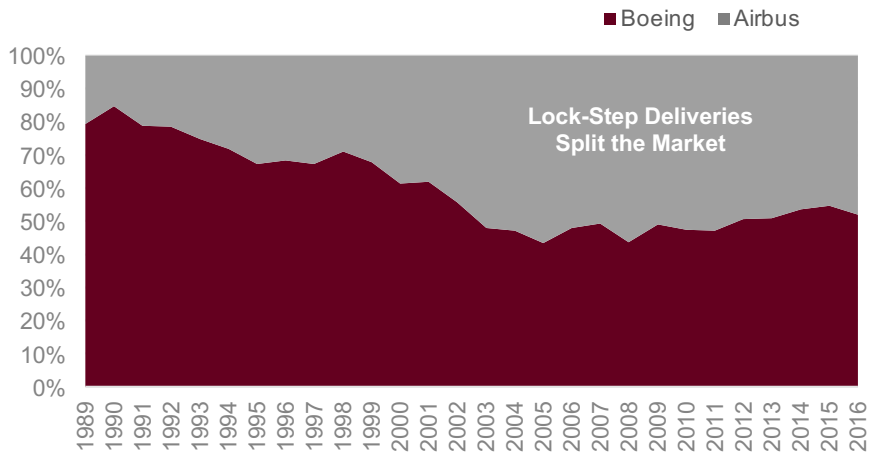
SITUATION REPORT: AIRBUS V. BOEING

So where do we go from here?

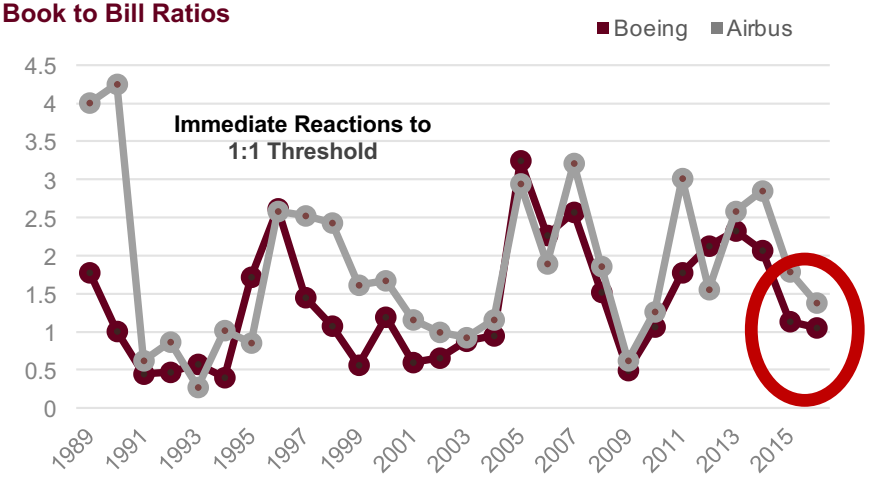
Commercial Aircraft Orders



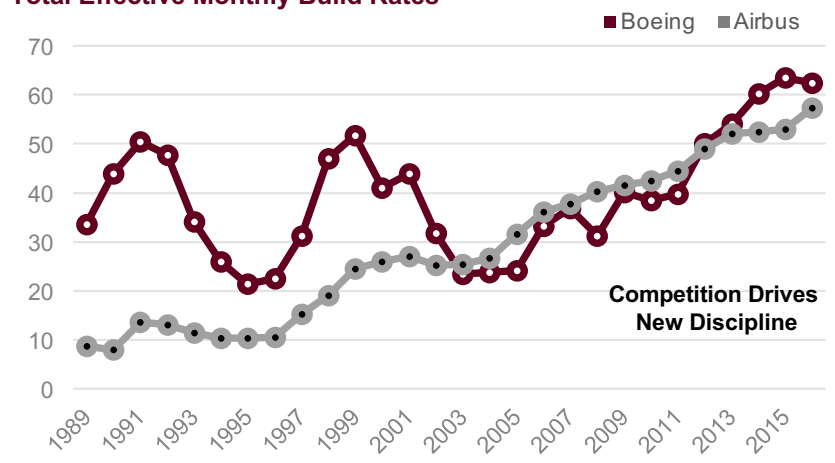
Commercial Aircraft Deliveries



Book to Bill Ratios

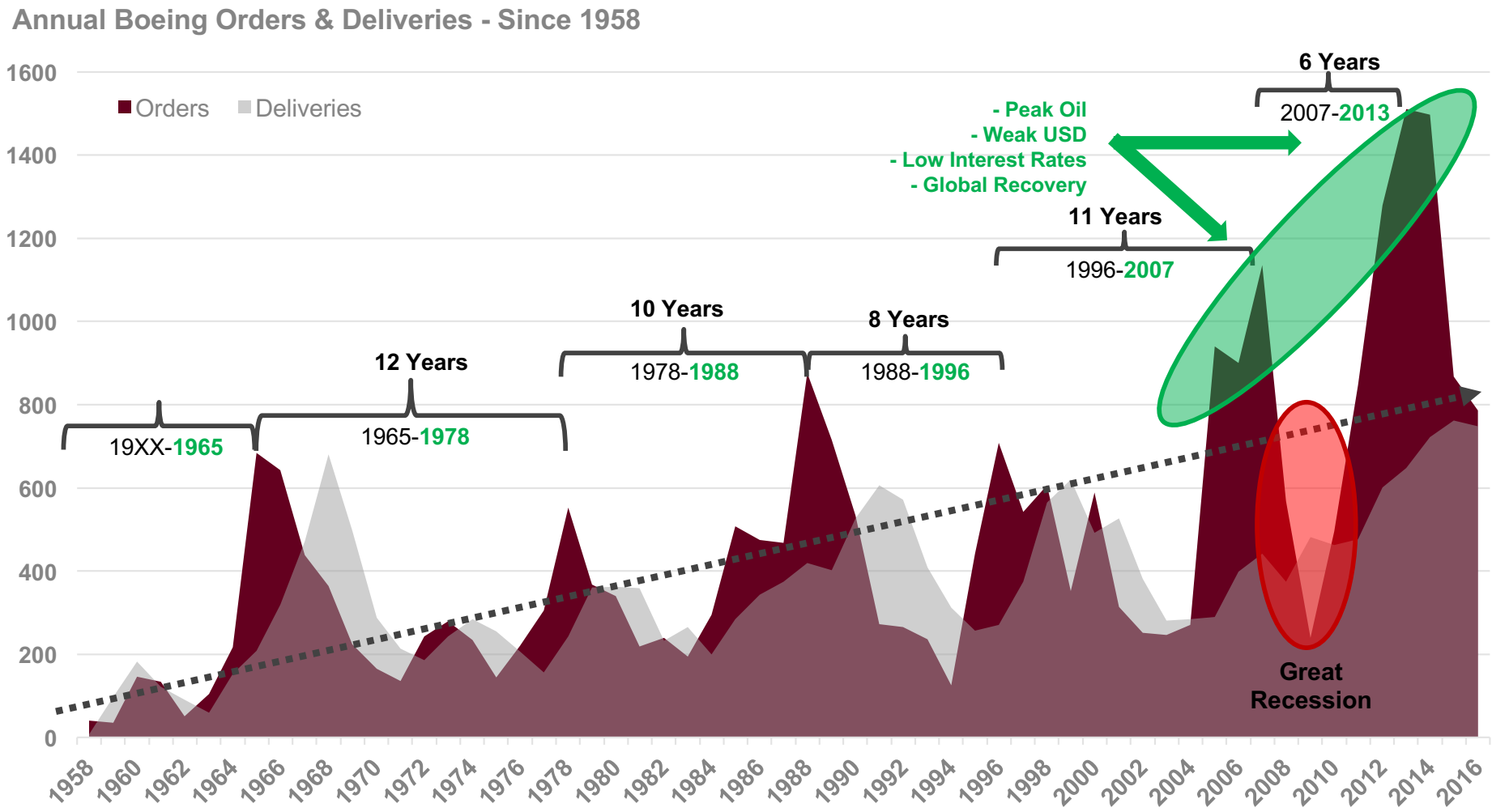


Total Effective Monthly Build Rates



ANATOMY OF A SUPER CYCLE

17 Years Peak-Peak | 12 Year Super Cycle Expansion



Is Boeing Pushing the Envelope…

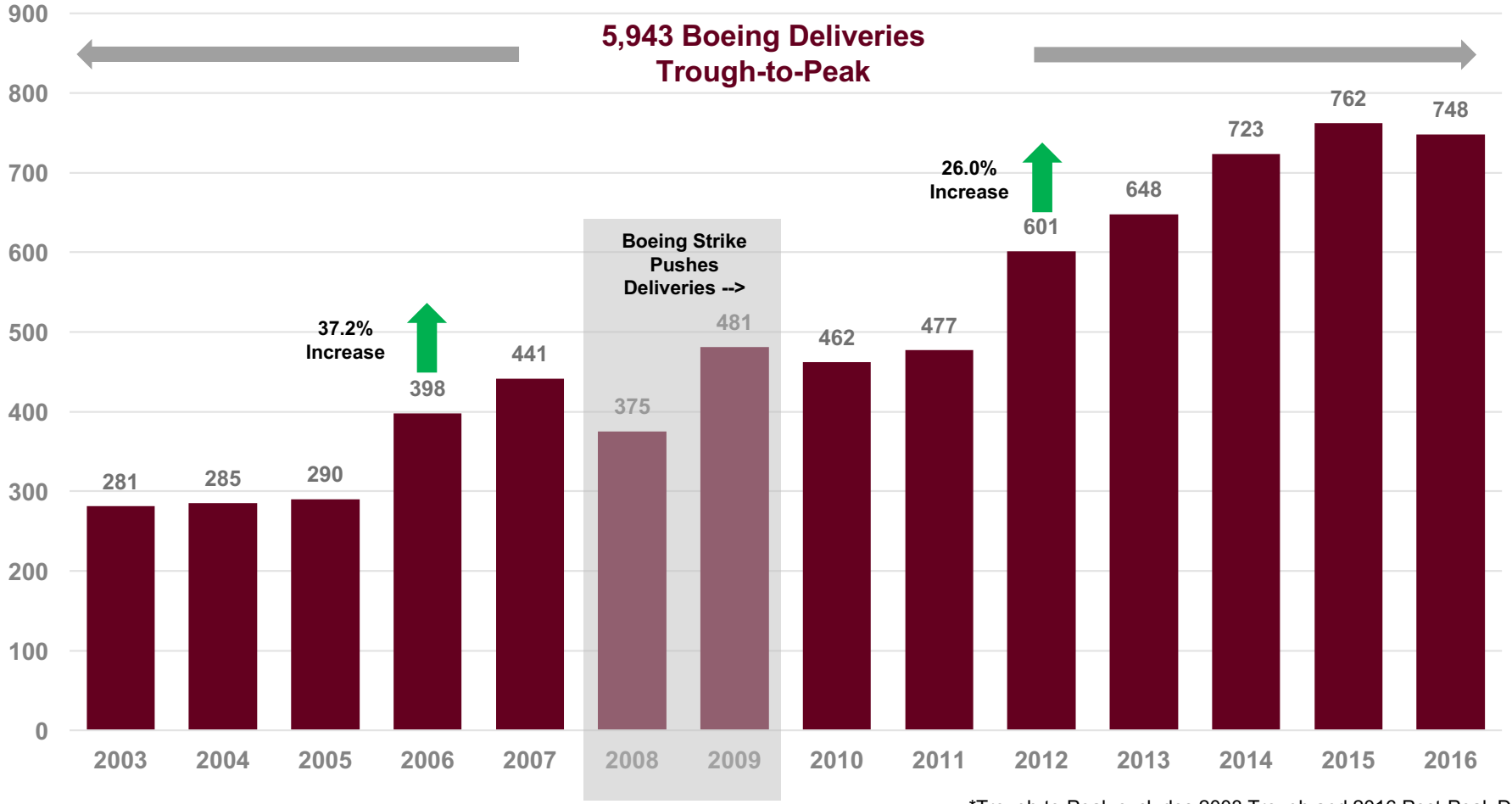
Or has it strayed from its "Doghouse"? (See what I did there?)

Boeing Company [NYSE:BA] – Closing Share Prices

As Orders Slow, Eyes on Deliveries

Deliveries have started to follow suit behind order weakness.

Annual Boeing Deliveries Since Prior Trough - 12 Year Super Cycle



*Trough-to-Peak excludes 2003 Trough and 2016 Post-Peak Deliveries

RATE REDUCTIONS ON THE HORIZON

4 Year Downtrend in Book to Bill Ratio suggests Weaker Rates Ahead

METHODOLOGY

We examined Boeing's published O&D data, using Net Orders in Year of Order, to compute the company's Book to Bill Ratio

- We looked for the subsequent production response in the year immediately following a year in which the Book to Bill ratio fell below 1:1.
- We observed that the only instances in which BA failed to reduce delivery rates occurred in 2004 & 2005, following 3 successive years of production cuts representing a cumulative 57.7% reduction from the previous base.
- While BA did reduce production slightly in 2010, it appears that they attributed the sharp volatility in Bookings to the credit crisis which rebounded quickly the following year and resumed the broader 2002 uptrend.
- Despite a minor drawn down in 2016 we are not projecting any reduction in rates for 2017. However, if orders remain soft and deliveries rise a 2018 production cut could be on the horizon given the recent B:B trend.

Metrics	Orders	Deliveries	Book:Bill	% Change	Cum % Chg
1968	364	680	0.54	-26.8%	-26.8%
1969	223	498	0.45	-42.4%	-57.8%
1970	165	287	0.57	-25.8%	-68.7%
1971	136	213	0.64	-13.1%	**-72.8%**
1974	234	284	0.82	-10.2%	-10.2%
1975	144	255	0.56	-18.8%	**-27.1%**
1980	340	363	0.94	-1.1%	-1.1%
1981	219	359	0.61	-35.4%	-36.1%
1983	195	266	0.73	-24.8%	**-51.9%**
1991	273	606	0.45	-5.6%	-5.6%
1992	266	572	0.47	-28.5%	-32.5%
1993	236	409	0.58	-23.7%	-48.5%
1994	125	312	0.40	-17.9%	**-57.8%**
1999	352	620	0.57	-20.6%	-20.6%
2001	314	527	0.60	-27.7%	-42.6%
2002	251	381	0.66	-26.2%	**-57.7%**
2003	246	281	0.88	1.4%	-57.1%
2004	271	285	0.95	1.8%	-56.3%
2009	240	481	0.50	-4.0%	-4.0%
2010	495	462	1.07	3.2%	3.2%
2011	846	477	1.77	26.0%	30.1%
2012	1279	601	2.13	7.8%	40.3%
2013	1511	648	2.33	11.6%	56.5%
2014	1497	723	2.07	5.4%	64.9%
2015	868	762	1.14	-1.8%	61.9%
2016	787	748	1.05	TBD	TBD

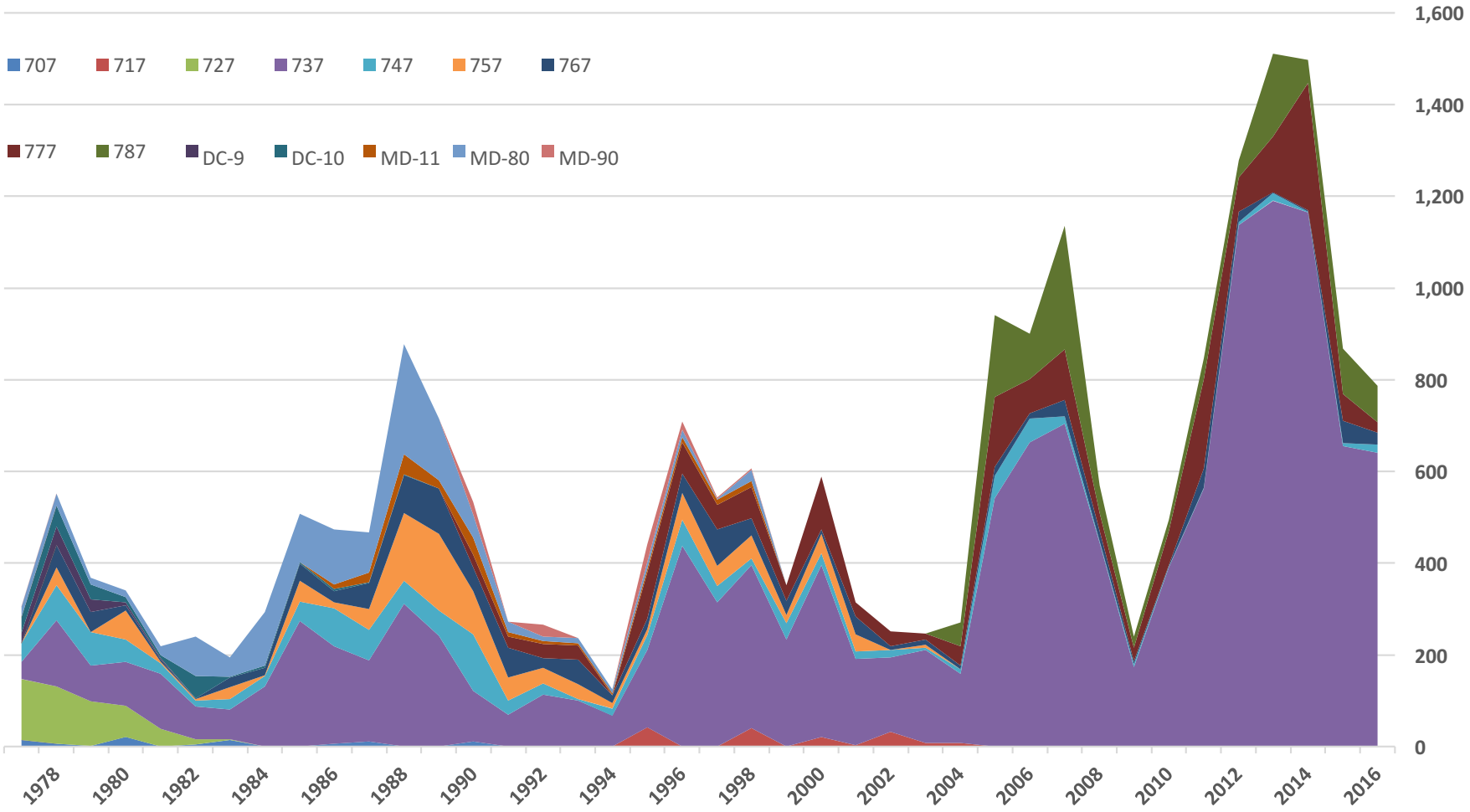
In December, Boeing announced its 2nd 777 rate reduction down to 5/mo and will defer plans on a previously planned 787 rate increase.

(i) % Change represents the reduction in deliveries in the following calendar year.
(ii) Cumulative % change represents the cumulative reduction from the beginning base level prior to cuts.

PLATFORM RATIONALIZATION CREATES OPPORTUNITIES

Dramatic Reduction in Platform Offerings, replaced by Platform Variants

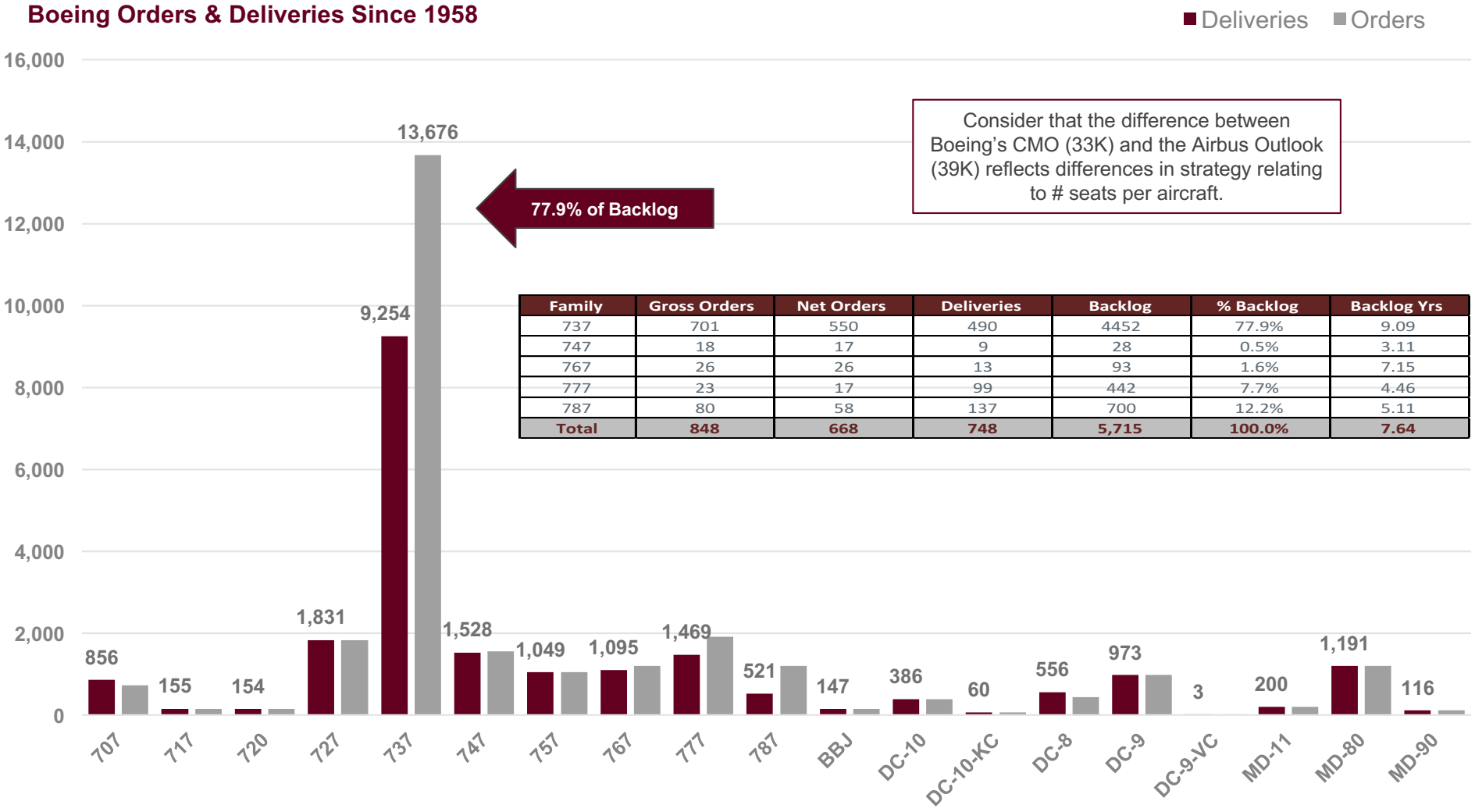
Boeing Commercial Order Stack - Last 40 Years



BOEING'S LOVE AFFAIR WITH NARROWBODIES

Past, Present and Future??

Boeing Orders & Deliveries Since 1958



Consider that the difference between Boeing's CMO (33K) and the Airbus Outlook (39K) reflects differences in strategy relating to # seats per aircraft.

Family	Gross Orders	Net Orders	Deliveries	Backlog	% Backlog	Backlog Yrs
737	701	550	490	4452	77.9%	9.09
747	18	17	9	28	0.5%	3.11
767	26	26	13	93	1.6%	7.15
777	23	17	99	442	7.7%	4.46
787	80	58	137	700	12.2%	5.11
Total	**848**	**668**	**748**	**5,715**	**100.0%**	**7.64**

Private Equity Playbook

A Tale of Two Deals

OEM AFTERMARKET | TRANSDIGM GROUP

Private Equity Playbook

TRANSDIGM GROUP INC.

Warburg Basis - Avg Price of $5.96/share
$230MM Proceeds - Warburg sells 11MM Shares

$375MM Sales
$155MM EBITDA

$405MM Proceeds
Warburg sells 11.5MM Shares @ $35.25
~45% Remaining Stake / ~22MM Shares

~$2.0B Dividends
To Warburg @ ~45% Remaining Stake / ~22MM Shares

Special Dividends
Total $91.50/shr

	1993	1997	1998	2001	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Enterprise Value	~$50MM		~$450MM		~$1.2Bn			~$2.0Bn	~$2.5Bn									
	Founded		Odyssey Investment Partners		Warburg Pincus			IPO $21/shr	Secondary Offering									
											Dividend $7.65/shr		Dividend $12.85/shr		Dividend $22.00/shr	Dividend $25.00/shr		Dividend $24.00/shr

TDG has acquired 57 companies since 1993, including 42 since its IPO.

Privately Held

1993 – 2006

- Adel
- Aeroproducts
- Wiggins
- Controlex
- Marathon
- Adams Rite Aerospace
- Christie
- Champion
- Honeywell Lube Pump
- Fuelcom
- Norco
- Avionic Instruments
- Skurka
- Fluid Regulators
- Eaton Motors

NYSE

2006 – 2010

- Sweeney
- Electra-Motion
- CDA InterCorp.
- Avtech
- ADS/Transicoil
- Bruce
- CEF
- Unison/GE
- APC/GE
- Acme
- Woodward HRT
- Dukes
- Semco

2011 – 2012

- Hartwell
- Electromech
- Tyee
- TAC
- Linread (1)
- Valley-Todeco (1)
- AQS (1)

McKechnie

- Talley Actuation
- Schneller
- Harco
- AmSafe Passenger Restraints
- AmSafe Commercial Products
- AmSafe Cargo Restraints & Specialty Devises

AmSafe

- Aero-Instruments

2013 - 2016

- Beams
- Aerosonic
- Arkwin
- Whippany Actuation
- Airborne Systems – North America
- Airborne Systems – Europe
- Elektro-Metall Export
- Telair International
- AAR Cargo Systems

Telair

- Nordisk Aviation
- Franke Aquarotter
- Pexco
- PneuDraulics
- Breeze-Eastern
- DDC (pending)

All figures and estimates are based on company documents, SEC Filings, analyst estimates and publicly available information.
Figures should not be replied upon and have been included for illustrative purposes only.

Today's PMA Manufacturing leader was founded in 1955 and later merged with a defense manufacturer in 1981.

- 1985 – 1st PMA Approval
- 1997 – 1st PMA Contract with Delta Airlines
- 2000 – Acquires PMA manufacturer **?????**; Expands into Europe
- 2002 – Signs Major PMA Contracts w/ American, Delta, United and Lufthansa
- 2008 – Established Joint-Venture in China
- **2010 – Acquired by Private Equity Fund A (3,000 PMA Approvals)**
- 2011 – Acquires PMA Portfolio from **?????** (>4,000 PMA Approvals)
- 2011 – Acquires **?????**
- 2012 – Acquires **?????** & **?????**
- 2014 – Acquires **?????** & **?????** (>7,000 PMA Approvals; 2,000 DER Repairs)
- 2014 – Expands into Turkey, Netherlands and Mexico
- **2014 – Acquired by Private Equity Fund B**
- 2015 – Acquires **?????**
- 2016 +

Today's PMA Manufacturing leader was founded in 1955 and later merged with a defense manufacturer in 1981.

- 1985 – 1st PMA Approval
- 1997 – 1st PMA Contract with Delta Airlines
- 2000 – Acquires PMA manufacturer Dixie Aerospace; Expands into Europe
- 2002 – Signs Major PMA Contracts w/ American, Delta, United and Lufthansa
- 2008 – Established Joint-Venture in China
- **2010 – Acquired by Odyssey Investment Partners (3,000 PMA Approvals)**
- 2011 – Acquires PMA Portfolio from AAR (>4,000 PMA Approvals)
- 2011 – Acquires Aerospace Coatings International
- 2012 – Acquires Absolute Aviation Services & Soundair Aviation Services
- 2014 – Acquires Flight Line Products & Xtra Aerospace (>7,000 PMA Approvals; 2,000 DER Repairs)
- 2014 – Expands into Turkey, Netherlands and Mexico
- **2014 – Acquired by Warburg Pincus for an estimated $800-900MM (Reuters)**
- 2015 – Acquires PHS/MWA Aviation Services
- 2016 – A Very Quiet Year for Wencor Group
- **2017 – IPO in the Wings????**

BUILDING M&A COMPETENCY

Invest Aggressively When:

- Identifying the Right Types of Targets
- Locating the Targets that Match Your Goals
- The Right Opportunities are In Front of You

Maintain a Disciplined Process

- TDG's Process is Simple, but Why Isn't Everyone Else Doing It?

- Proprietary, Sole Source Aerospace Businesses with Significant Aftermarket
- Analyze Target & Model Value
- Negotiate Purchase & Raise Cash
- Acquire & Create Value
  - Restructure into Product Lines
    - Maximize Pricing
    - Improve Productivity
    - Grow New Business

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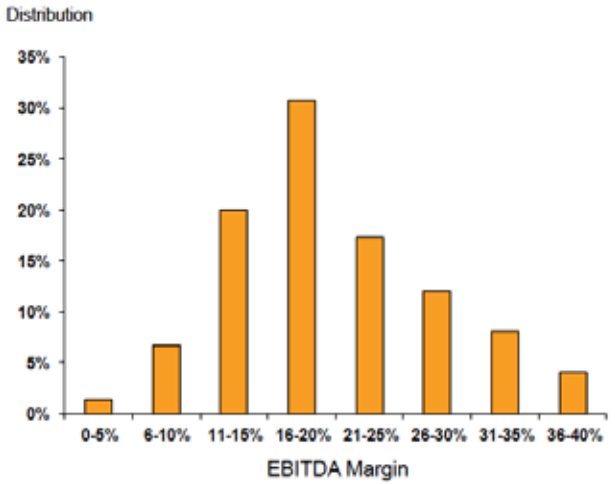
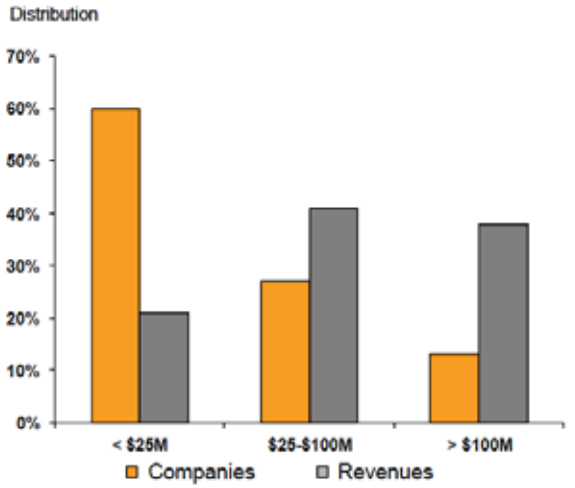
OPPORTUNITY TO CREATE VALUE(1)



FRAGMENTED BASE(2)



(1) Percentages are management estimates.

(2) Frost & Sullivan study estimates a population of 1,600 businesses.

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VALUE CREATION COMPETENCY

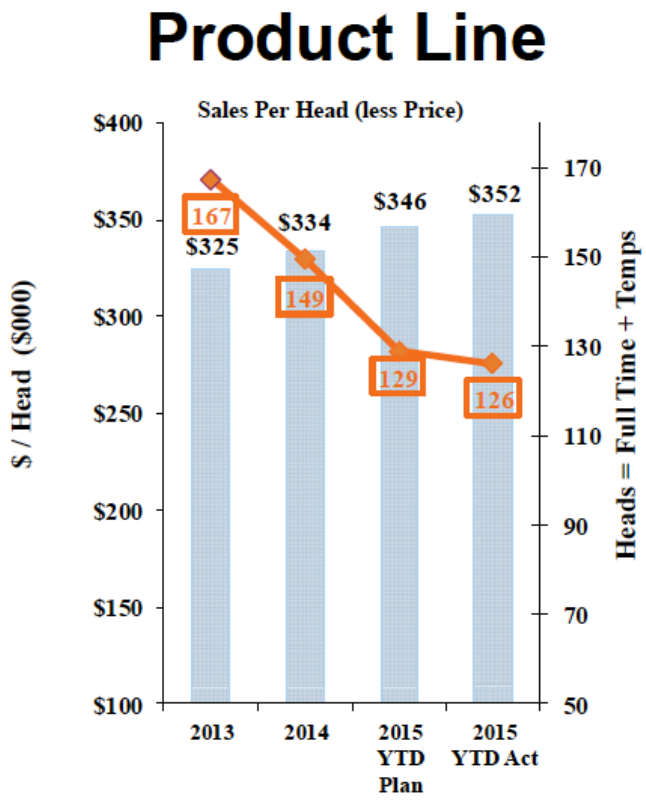
How do You Define Value?

- Revenue Growth?
- EBITDA/Cash Flow?
- Return on Investment?
- Productivity of Resources?

How are You Measuring Value?

- Quality & OTD
- Shop Utilization
- Bid-Win Rates
- Sales/Head
- ROI-HC

- Acquire & Create Value
  - Restructure into Product Lines
    - Maximize Pricing
    - Improve Productivity
    - Grow New Business



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