HEICO

ROADRUNNER FINANCIAL GROUP at Ramapo College

Heico (HEI)
Analyst: Yanni Leakas, Chris Kownacki
Themes: Parts suppliers, Recovery

Current Price $133 | PT $163 (23% upside)
Market Cap: $16.3B
Industry: Aerospace

Revenue / Earnings Data

Revenue (Millions)

FY Ending	Oct '20	Oct '21	Oct '22E	Oct '23E
Q1 (Jan)	506	418	496	538
Q2 (Apr)	468	467	537	591
Q3 (Jul)	386	472	547	575
Q4 (Oct)	426	509	571	589
Fiscal Year	1,787	1,866	2,144	2,366
CY Ending	Dec '20	Dec '21	Dec '22E	Dec '23E
Cal. Year	1,801	1,912	2,181	2,394

Earnings Per Share

FY Ending	Oct '20	Oct '21	Oct '22E	Oct '23E
Q1 (Jan)	**0.89**	**0.51**	**0.61**	**0.67**
Q2 (Apr)	**0.55**	**0.51**	**0.64**	**0.74**
Q3 (Jul)	**0.40**	**0.56**	**0.67**	**0.74**
Q4 (Oct)	**0.45**	**0.62**	**0.71**	**0.79**
Fiscal Year	**2.29**	**2.21**	**2.62**	**2.99**
P/E (x)	**45.9**	**63.1**	**51.6**	**45.2**
CY Ending	**Dec '20**	**Dec '21**	**Dec '22E**	**Dec '23E**
Cal. Year	**2.28**	**2.28**	**2.68**	**3.04**
P/E (x)	**58.1**	**63.3**	**50.4**	**44.5**

Investment Thesis

HEICO Corp. is a rapidly growing aviation, aerospace, defense and electronics company that specializes in niche markets and reliable products. They are the largest independent non-OEM commercial jet engine and commercial aircraft part replacement manufacturer, dominating two-thirds of the fast growing Parts Manufacturer Approval (PMA) market of which represents 2-3 percent of the total aircraft parts replacement market. Heico is a balanced and diversified business with its two segments, Flight Support Group (FSG) and Electronic Technologies Group (ETG) each representing between 40-60% of their operations. Since the onset of the pandemic, strength in their ETG segment permitted Heico to remain cash flow positive even as revenues from their FSG division decreased by a quarter.

Pursuing an aggressive yet meticulous acquisition strategy, Heico has successfully merged with over eighty companies since 1990, increasing exposure to various niche markets while fueling sustainable growth. The strategy targets companies with 20% operating margins that are expected to provide returns of 3-5 times their value within a few years. Heico maintains a strong balance sheet, having paid off over half of its debt this past year and increasing its abundance of cash on hand for new acquisition deals.

Heico has maintained an impressive history of exceeding analyst expectations, posting EPS beats for the past twenty quarters. Backing the company's success are strong macroeconomic tailwinds as commercial air travel is not expected to fully recover until between 2023 and 2025 (of which the market has not priced in) with an increase in demand for Heico's products following suit. Heico is an exceptional growth company that has consistently outperformed the market, maintains solid margins, and generates strong cash flow. We recommend Heico's inclusion to the RFG portfolio as it offers exposure to a low-risk and unique space within the aerospace industry.

Our price target of $163 assumes a 43x P/E multiple on our CY24 EPS of $3.80, representing 23% upside from the current stock price. Our EPS estimate is about 10% higher than the street consensus and our P/E multiple is 3.4% below their 5-year average as a result of multiple contractions during this correction. Heico has historically beat EPS expectations by 12% in pre-pandemic quarters and has consistently held a high P/E valuation on par with the industry average. Normally, we wouldn't go out to 2024 for estimates, but given the nature of the pandemic, we believe the industry will normalize around that time.

Company Description

HEICO Corp. engages in the manufacturing of electronic equipment for the aviation, defense, space, medical, telecommunications, and electronics industries. It operates through the Flight Support Group and Electronic Technologies Group segments. The Flight Support Group segment designs, manufactures, repairs, overhauls, and distributes jet engine and aircraft component replacement parts. The Electronic Technologies Group segment designs and manufactures electronic, data and microwave, and electro-optical products, including infrared simulation and test equipment, laser rangefinder receivers, electrical power supplies, back-up power supplies, power conversion products, underwater locator beacons, emergency locator transmission beacons, flight deck annunciators, panels and indicators, electromagnetic and radio frequency interference shielding and filters, high power capacitor charging power supplies, amplifiers, traveling wave tube amplifiers, photo detectors, amplifier modules, microwave power modules, flash lamp drivers, laser diode drivers, arc lamp power supplies, custom power supply designs, cable assemblies, high voltage power supplies, high voltage interconnection devices and wire, high voltage energy generators, high frequency power delivery systems, and memory products. The company was founded in 1957 and is headquartered in Hollywood, FL.

Business Segments:

1. *Electronic Technologies Group (51%)*: Collectively designs, manufactures and sells various types of electronic, data and microwave, and electro-optical products.
2. *Flight Support Group (49%):* Uses proprietary technology to design and manufacture jet engine and aircraft component replacement parts for sale at lower prices than those manufactured by OEMs.

Management Profile:

- Laurans Mendelson is Chairman, Chief Executive Officer, and Director at HEICO Corp. since 1990. Mr. Mendelson is a member of the Board of Governors of the Aerospace Industries Association ("AIA") in Washington, D.C., of which HEICO is a member. He is also on the Board of Trustees of Columbia University and Mendelson International Corp., and Member of Mount Sinai Medical Center of Florida, Inc. and Mount Sinai Medical Center Foundation, Inc. Laurans Mendelson is the father of Eric Mendelson and Victor Mendelson.
- Eric A. Mendelson is Co-President and Director of HEICO, having served as the head of 6 different companies prior. He is also on the board of Aerospace Industries Association and Ransom-Everglades School, Inc. (former Chairman) and Director-Alumni Association at Columbia College (Vancouver, Canada). He previously was Co-President & Chief Executive Officer at Flight Support Group, Inc. and Chief Executive Officer noof HEICO.
- Victor H. Mendelson founded Mendelson International Corp., HEICO Electronic Technologies Corp. and Electronic Technologies Group, Inc. Currently, Mr. Mendelson occupies the position of Co-President & Director at HEICO Corp., President & Chief Executive Officer of HEICO Electronic Technologies Corp. and Chief Executive Officer for Electronic Technologies Group, Inc. (both are subsidiaries of HEICO Corp.) and President & Director at Mendelson International Corp. He is also on the board of five other companies and previously held the position of Chief Operating Officer for MediTek Health Corp.

A 30 Year Track Record of Enhancing Shareholder Value

Heico has an impressive 30 year track record of both operational excellence and stock price performance. An Investment in Heico at the start of 1990 would have returned 59,337%* (including dividends) or a compound annual growth rate of 22.03%. This compares to a 10.56%* average return for the S&P 500.

30 Year CAGR Operating Highlights

- Net Revenue 15%
- Operating Income 19%
- Operating Cash flow 21%

These strong long-term operating highlights give us confidence that Heico has a strong management team and a time tested business model that has successfully weathered every economic climate imaginable.

Management and other insiders collectively own over 25% (32.25% according to Factset) of Heico common stock which strongly aligns their interests with those of shareholders and employees. This is significantly more insider ownership than any other RFG holding.

- One of the “100 Most Trustworthy Companies In America” based on accounting and governance practices according to Forbes.

*Info from Factset

Key RFG Investment Criteria Metrics

With RFG moving towards a growth oriented investment approach it is worth highlighting how well HEI screens with our new criteria.

- Long-term EPS Growth Rate of 15%
- 10% Revenue growth through 2024
- Consistently Strong ROE with a 5-Year average of 18.1%
- Strong and stable operating margins > 20%
- Strong Free Cash Flow generation- FCF Margin of 23% (2020)
- Low Net Debt / Equity of 14.4% (2020)

Investment Highlights

- Disciplined acquisition strategy (82 companies since 1990) that supplements organic growth, broadens product offerings, services and technologies, while expanding customer bases and geographic reach.
- Faster recovery rate than the total aftermarket since commercial airlines will prioritize cost savings after the pandemic; PMA parts are about 30% cheaper than OEM parts in the aftermarket.
- Morgan Stanley believes that the PMA market will grow faster than the overall market as airlines look for ways to reduce current costs and retain these structural costs savings throughout the lifecycle of an aircraft
- Strong barriers to entry due to regulatory requirements set by the FAA; Heico maintains a competitive advantage given its reliable engineering and cordial relationships with the FAA and major airline operators.
- Heico holds over 11,500 FAA approvals on parts while adding between 300-500 new PMA’s each year.
- Improving global commercial air travel that is unrecognized by the market, though impaired since the pandemic’s onset.
- Increasing global COVID-19 vaccinations will return the industry towards normal expected commercial aviation growth.

Q4 2021 Earnings:

- Revenue increased by 19.5% from Q4 2020 to $509.42M
- EPS increased by 37% to $0.63
- Net income increased by 38% to $86.06M
- Net profit margin increased to 16.89%
- Operating income increased by 28.6% to $114.97M

➢ Net change in cash increased by an impressive 1,495% to $161.52M and cash on hand increased by 73.3% to $108.3M. Heico paid off a large share of debt and is maintaining an ever increasing positive cash flow.

FY21 Earnings:

➢ EPS decreased by 3%* from FY20 to $2.21

➢ Revenue increased by 4.2% from FY20 to $1.866B

➢ *The slight decline in profitability is a result of the pandemic's impacts on the industry

Future Guidance:

➢ FY22 EPS is expected to increase by 16% to $2.64

➢ FY23 EPS is expected to increase by 26% from FY21 to $3.00

➢ FY22 Revenue is expected to increase by 13% to $2.144B

➢ FY23 Revenue is expected to increase by 21% to $2.370B

Investment Risks

➢ Success is highly dependent on the performance of the aviation industry which continues to be adversely affected by the COVID-19 pandemic.

➢ Shift towards younger aircraft fleets by low-cost airline operators could decrease demand for aftermarket parts.

➢ Inability to effectively execute acquisition strategy would hinder growth prospects.

➢ Competition from OEMs, major commercial airlines, and other independent service companies may harm business.

➢ Reductions in defense spending would adversely affect the Electronic Technologies Group (66% of sales in ETG segment).

Competition

Raytheon Technologies $RTX ($128B) - An aerospace and defense company that engages in the provision of aerospace and defense systems and services for commercial, military, and government customers. One of the largest aerospace, intelligence services providers, and defense manufacturers in the world, Raytheon researches, develops, and manufactures advanced technology products in the aerospace and defense industry; including aircraft engines, cybersecurity, guided missiles, air defense systems, satellites and drones. Raytheon is a large military contractor, receiving a significant portion of its revenue from the U.S. government.

General Electric $GE ($104B) - Engages in the provision of technology and financial services, mainly focusing on power, renewable energy, aviation, and digital industry, but in November of 2021 they announced they will split the company into three public companies. One focusing on renewable energy by 2024, the other focusing on aviation, and the last focusing on healthcare by 2023. It operates through the following segments: Power, Renewable Energy, Aviation, Healthcare, and Capital.

Safran $SAF ($51.5B) - A French multinational aircraft engine, rocket engine, aerospace-component and defense corporation that engages in the design, manufacture, and sale of aircraft, defense and communication equipment and technologies. Employing over 95,000 people and generating €24.64 billion in sales in 2019, it operates through the following business segments: Aerospace Propulsion, Aircraft Equipment, Defense & Aerosystems and Aircraft Interiors.

**Rolls-Royce Holdings $RR ($13.6B) -** A British multinational aerospace and defense company that designs, develops, manufactures, and services integrated power systems for use in the air, on land, and at sea. The company operates its business through following segments: Civil Aerospace, Power Systems, Defense and ITP Aero. In 2018, they were the 16th largest defense contractor, which is measured by defense revenues. It secured orders for 2,700 engines for wide-body aircraft and business jets and expects to produce over 600 wide-body engines a year to power over half of the world's wide-body fleet within a few years, up from 22% a decade before.

Aerospace Peer Group Valuation Comps*

Ticker	Market Cap (Bil)	52 Wk Change	EPS '22E	EPS '23E	P/E '22E	5 Yr Avg P/E	P/E vs. Avg	LT Growth Rate	PEG	Sales (3 Yr CAGR)	P/S '22
RTX	134.7	28.14%	4.99	6.01	18.0	18.82	(4.36%)	18.7%	1.0	(1.8%)	1.9
GE	109.1	9.98%	4.02	5.66	24.7	226.32	(89.1%)	5.7%	4.3	(12.8%)	1.4
SAF-FR	53.42	(3.92%)	2.64	4.08	27.6	28.42	(2.89%)	35.4%	0.8	(0.6%)	3.4
TDG	35.58	7.66%	15.97	21.19	40.4	30.88	30.82%	22.2%	1.7	8.0%	7.9
HEI	**18.63**	**9.03%**	**2.63**	**2.99**	**55.7**	**49.42**	**12.71%**	**15%**	**3.6**	**1.6%**	**10.9**
RR-GB	14.41	13.71%	5.31	8.14	23.8	33.23	(28.4%)	N/A	N/A	(10.2%)	0.9
WWD	7.11	(13.14%)	4.80	5.53	28.3	26.10	8.43%	15%	1.8	(1.2%)	3.2
HXL	4.69	6.83%	1.25	2.08	43.5	55.30	(21.3%)	46.5%	0.9	(8.9%)	3.6
Avg		7.29%			32.75		(12%)**	20.41%	2.01	(3.32)	3.77

*Info from Factset
**P/E vs. Avg is (0.71%) without GE

Summary Statement / Conclusion:

As the leading company in the PMA market, Heico would provide unique exposure to the aerospace industry and industrials as a whole, a sector that RFG is currently underweight in and lacks exposure to. Heico is poised to capture increased demand from the expansion of the PMA market given their large market share. Our conviction reflects historically strong growth and upside that is being accelerated by Heico's position as the leading non-OEM aftermarket supplier, its sound acquisition strategy, and the improving commercial aviation outlook. Our $163 Price Target reflects this upside, and we reiterate our Buy Rating and recommendation for Heico's inclusion to the RFG portfolio.