

**Breeze-Eastern Corp.**  
**(AMEX:BZC)**

**Analyst:** Hugo Perrin  
**Sector:** Aerospace and Defense

**BUY**

Price Target: \$15.56

**Key Statistics** as of 04/21/2014

Market Price: \$10.07  
Industry: Industrials  
Market Cap: \$98.8 M  
52-Week Range: \$9.01 – \$15.15  
Beta: 0.13

**Thesis Points:**

- Constant increase in EBITDA margins
- New management team that changed the company
- Industry forecasts greater than originally set
- Stock undervalued

**Company Description:**

Breeze-Eastern Corporation designs, develops, manufactures, sells, and services engineered mission equipment for specialty aerospace and defense applications. It primarily offers mission-critical helicopter rescue hoist and cargo hook systems; hydraulic and electric aircraft cargo winch systems; cargo and aircraft tie-downs; and hoists for aircraft and weapons systems. The company also manufactures weapons handling systems, including weapons handling equipment for land-based rocket launchers, and munitions hoists for loading missiles and other loads using electric power or exchangeable battery packs; and actuators and specialty gearboxes for specialty weapons applications. In addition, it provides overhaul, repair, maintenance, and engineering services for various products. The company sells its products through internal marketing representatives, and independent sales representatives and distributors primarily to military and civilian agencies, and aerospace contractors in the United States; and exports its products internationally. Breeze-Eastern Corporation was founded in 1962 and is headquartered in Whippany, New Jersey.

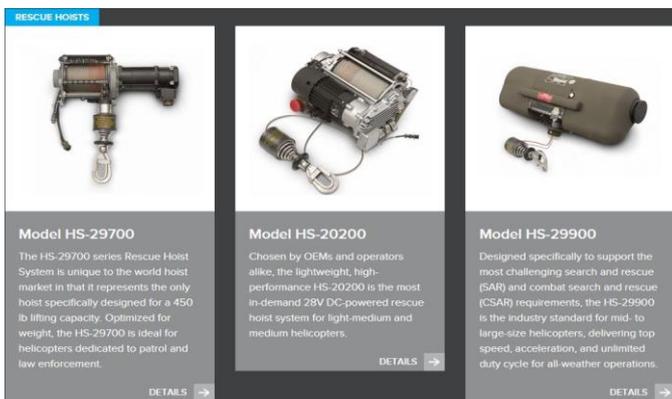


## Thesis

Breeze-Eastern is operating in a market with no existing competition, which allows them to fully take advantage of the market trends. Additionally, the new management team has been able to reduce the debt to zero while increasing margins. The recent forecast are more bullish than what they were a year ago, which means that the firm is going to increase its revenues and its margins. Another interesting factor is the very light coverage that the company has, which is a sign of undervaluation in this case.

## Products

Breeze-Eastern Corporation is the “only dedicated hoist and winch specialist”, according to the company. Consequently, it sells its products to the military forces law enforcement, along with few civilian operations. It has been successfully operating more about 70 years now, which enable the firm to have a long-time experience in its domain which makes it perfectly operational.



The picture above shows some of the products that the company is offering to its customers. The firm’s products are covering most of the helicopters available, such as patrol and law enforcement helicopters, light-medium and medium helicopters.

The company is one of the only one that offers such products. As developing such things requires time and a number of regulatory laws and safety measures that are needed in the law enforcement industry, most competitors do not try to copy Breeze-Eastern, which eliminates any potential threats for potential new competitors. Today, BZC has only one competitor, which is Goodrich Corporation, but is a much smaller company that does not allow them to come up with new products that would lead BZC to decrease its market share.

An advantage that Breeze carries is that its products are available for the newest planes/helicopters, meaning that as soon as a new machine comes out, the firm is able to quickly respond to the potential demands.

## Management Team

An important factor that also leads the company to be where it is currently is the change in the management team. In 2012, Breeze-Eastern Corporation announced that Brad Pedersen has been assigned at the firm’s CEO. Also in 2013, Breeze announced James Cashel as the company’s new General Counsel and Corporate Secretary. Most recently, the company continued to change the management team. As a result, the company has successfully decreased its level of debt to zero FY 2013. In the meantime, Breeze Eastern has also been able to constantly increase its cash & equivalent position from \$6.4 million in 2011 to \$15.7 million currently.

Brad Peterson, the current CEO appears to be a relevant choice as he has always been working in the aviation industry, and spent notably 17 years at Boeing, which is what Breeze Eastern is exclusively evolving. As reported by the company, “he has a track record of generating profitable growth by successfully managing engineering development programs and providing strong customer service.”

As the company is free of debt since FY2012, the firm’s Altman Z-Score is constantly increasing. In mid-2010, the Z-Score was lower than 0, but is now 3.54, higher than the bankruptcy level. The new management team has defectively changed the fate of the company and is penetrating new markets as discussed later.

## Customers

As Breeze Eastern Corporation works in a typical industry, its major competitors comprises the U.S. Government, United Technologies Corporation, and Finmeccanica SpA (an Italian engineering company) which accounted for 30%, 14%, and 13% of the sales for the FY 2014. This means that more than half of the company’s revenues are generated by 3 clients.

Concerning the reliance to the U.S. Government and other governments, they generated 81% of the total sales in FY 2014. As most contracts used based on a fixed

price, revenues can most of the times be predetermined ahead. In the option that of a partial or complete termination of a contract, provisions for recovery are generally incurred.

Geographic Sales	2014		2013	
U.S.	\$ 48,832	57%	\$ 51,020	64%
Italy	\$ 7,500	9%	\$ 6,186	8%
Germany	\$ 4,491	5%	\$ 216	0%
England	\$ 3,225	4%	\$ 5,420	7%
Other European Countries	\$ 4,620	5%	\$ 5,225	7%
Pacific and Far East	\$ 8,888	10%	\$ 2,651	3%
Other International	\$ 8,377	10%	\$ 9,238	12%
<b>Total</b>	<b>\$ 85,933</b>	<b>100%</b>	<b>\$ 79,956</b>	<b>100%</b>

The table above depicts the geographic sales for the last two fiscal years. It is interesting to see that the firm is becoming less dependent on the U.S. market. Sales went from 64% in 2013 to 57% in 2014. On the other side, the sales to European countries increased from 21% to 23%. However, the majority of the sales come from the U.S. The most significant increase percentage wise are the sales to Pacific and Far East countries that went from 3% to 10%, an increase of \$6.2 million.

However, it appears that the importance of the U.S. market is still predominant for Breeze-Eastern.

	1990s				2000s									2010s						
	96	97	98	99	00	01	02	03	04	05	06	07	08	09	10	11	12	13	14	15
Defense Budget (Billions)	266	270	271	292	304	335	362	456	491	506	556	625	696	698	721	717	681	610	614	637
Total Budget (Trillions)	1.58	1.64	1.69	1.78	1.82	1.96	2.09	2.27	2.41	2.58	2.78	2.86	3.32	4.08	3.48	3.51	3.58	3.48	3.64	3.97
Defense Budget %	16.8	16.5	16.0	16.4	16.7	17.1	17.3	20.1	20.4	19.6	20.0	21.9	20.9	17.1	20.7	20.4	19.1	17.5	16.8	16.0
Defense Spending Change	-0.1	1.6	0.2	7.8	4.0	10.1	8.2	26.0	7.6	3.1	10.0	12.5	11.3	0.2	3.4	-0.6	-5.0	-10.5	0.6	3.8

The table above reconstitutes the USA Defense Budget from 1996 to the current period. According to Wikipedia, the US defense budget for 2013 was \$610 billion or 17.5% of the overall government's budget versus \$681 billion, or 19.1% of the total budget a year earlier. However for 2014, the defense budget went back up to \$614 billion, but still carried a lower percentage out of the total budget, at 16.8%. For 2015, it is going back up at a faster pace at \$637 billion, or 16% of the overall country's budget. Consequently, even with a defense budget that is significantly lower compared to the year 2010 to 2012 (around \$700 billion), the company has still been able to generate revenue, and most importantly, increase its EBITDA margin, as this will be discussed later. Concerning the EBITDA margin, it has been constantly improving since FY 2012, from 10.3% to currently

14.4%.

As the contracts with the U.S. Government are long-term services the likelihood for the government to stop its contracts is very low.

## Firm's Financials



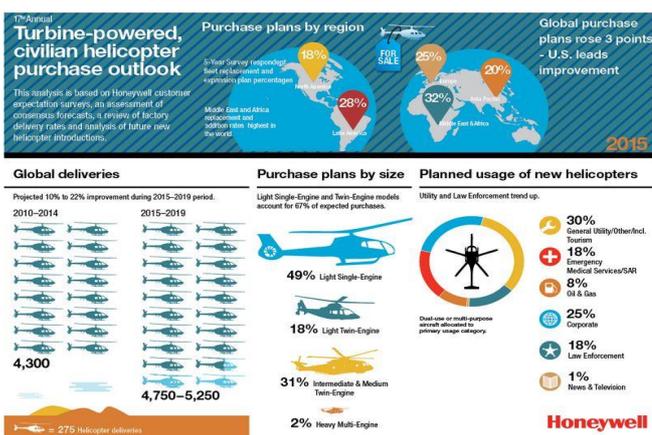
	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	Current FY
Revenue	52.6	55.4	49.8	32.8	43.8	64.9	60.9	79.7	79.7	85.9
EBITDA	1.5	2.2	2.1	1.9	2.7	3.4	5.4	12.2	6.7	6.8
EBITDA Margin	2.8%	3.9%	4.2%	5.8%	6.2%	5.2%	8.9%	15.3%	8.4%	7.9%
Operating Profit	28.3	28.8	22.5	22.3	30.1	29.7	31.0	32.2	32.8	31.1
Operating Profit Margin	53.8%	51.8%	45.2%	68.0%	68.7%	45.8%	51.1%	40.4%	41.1%	36.1%
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industry, the firm is still able to already increase its margins, which is remarkable.

As for the capital expenditures that are not significantly important compared to the firm's revenue, (generally less than 2%) they are allocated for production test equipment and information technology. This relative low capital expenditure as a percentage of sales is something new as the firm is near to end of some significant new product development that should increase the company's revenue and increase the free cash flow.

For the first nine months of FY 2014, Breeze Eastern has its highest cash position at \$15.7 million, or 18% of the company's total assets. As said previously, despite constantly investing in new products, the firm is still able to generate cash. As for the CCC, it is relatively stable at 165 days. This reveals a higher proportion of inventory with lower proportion of account receivables and account payable. Since 2011, the firm is taking more time to collect its receivables, 85 days versus 71 days. The day inventory outstanding remains relatively flat at 122 days while the days payable outstanding has decreased from 55 days to 42 days. Even if the decrease in DPO might not be a good sign for Breeze-Eastern Corporation as the proportion of payable is decreasing, this offset the effect of lower DPO.

## Forecasts



The picture above shows the forecasted global deliveries for the helicopters for the 2015-2019 periods; this forecast is provided by Honeywell Aerospace. As said in the picture, there is a projected 10% to 22% improvement during the forecasted period. Which is also interesting is that the Middle East and Africa are the parts of the world that predict to have the highest replacement rate in the world for the next four years. Those two locations are the ones where the company

does not operate the most. This implies that Breeze-Eastern will have the opportunity to increase its market share and take advantage of an increase of demand from a new market. Concerning the parts of the world where the firm already operates, the replacement rate is still positive with 18% in the USA, 25% in Europe and 20% in Asia Pacific.

European demand also increased despite the weakened buying plans from Russia. Other countries such as India and other BRICs members are currently increasing their demand for helicopters. Consequently, this is another factor that will drive the revenue growth for Breeze-Eastern.

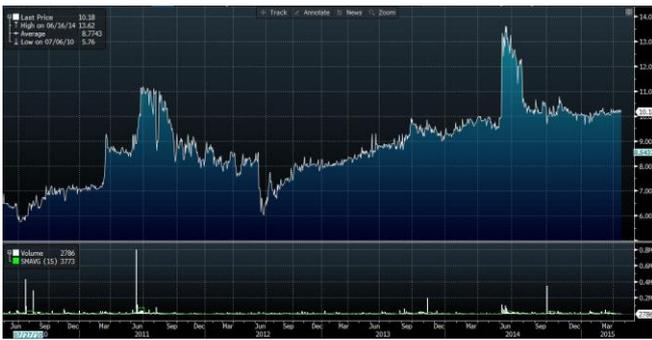
The forecast goes along with the current sales trend of Breeze-Eastern where sales in the US are decreasing while sales in the other part of the world is increasing. It is for those reasons that it seems appropriate to forecast a continuing revenue growth for the next four years. An interesting point is the fact that the U.S. and Canada share of demand is up 7% compared to last year's survey. Also, the main factor that conducts operators who intend to purchase new helicopters is due to the age of their vehicles. Also, the report suggests that "Purchase interest for helicopters in training, tourism, firefighting and law enforcement categories is trending up, influenced by increased utilization rates and helicopter replacement cycles." Additionally, as it has been stated before, the sales of spare parts and overhaul did bring an increase in the gross profit. By assuming that helicopters' age is growing, the spare parts sales should increase for the companies that decide not to buy new helicopters, which is also a positive sign for the firm's revenue and gross profit. Therefore, Breeze-Eastern should be able to create more value to its shareholders.

When it comes to the purchase plans by size, as the company is offering products that are compatible on most helicopters, the share of purchase plan for any type of helicopters do not specially matters. However, concerning the planned usage of new helicopters for the coming four years, 18% is predicted to be used for law enforcement and the emergency medical services is also at 18%. Therefore, it seems very likely that at least a third of the new helicopters will need the products that the firm is offering. Additionally, as the firm is also selling its product to the general public, the share of the general utility helicopters that are going to be sold during the next four years at 30% might use the products offered to them.

Additionally, the use of helicopters is a sure technology that should not go away rapidly, which insure a future for Breeze. Also, it does not seem to be other alternatives that hoists and winches in the markets and nothing appears to replace that technology anytime soon.

is for those reasons that I recommend this stock as a BUY with a target at \$15, representing an upside of 46% from its current price.

## Valuation



As referred earlier, the new management team that got rid of the debt in 2012 has been able to shape a new company. Since that moment, the stock of the company has only appreciated on a constant basis. In a little more than three years, the stock price constantly increases from \$6 per share to currently roughly \$10 per share. It seems that the low volume of traded stocks for this company can represent a mispricing of the company. With less than 3,000 shares exchanged on average during the last three months, it seems appropriate to believe that the mispricing comes from that factor. The rapid increase in the share price in Q2 2012 comes from positive earnings, but still due to the low volume, investors did not continue to buy the stock, but still; the stock slightly continued to appreciate. The short interest ratio of 0.17% also proves this statement. With 0.6 days to cover, the short ratio is almost inexistent, which shows that none of the current investors believe that Breeze-Eastern is a stock that has to be shorted.

One of the only that lies with owning that stock is that three insitutional investors, Tinicum Inc, Wynnefield Capital Management LL and VN Capital Management own 67.75% of the floating shares. If for any reasons, one of those three shareholders were to sell a part of the globality of the shares, the stock price could plunge; but nothing for the moment would talk in favor of such move.

Even if the little risk mentionned above, it appears that the stock has significantly more upside than downside. It

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Breeze-Eastern Corporation		BZC		Analyst Hugo PERRIN		Current Price \$10.24		Intrinsic Value \$17.70		Target Value \$15.59		Divident Yield 0%		Target Return 1-y Return: 52.26%		BULLISH	
General Info			Peers			Market Cap.			Management			Historical Median Performance					
Sector	Industrials		Figeac-Aero Société Anonyme			\$525.86			Professional			Title					
Industry	Aerospace and Defense		Precision Castparts Corp.			\$28,906.50			Pedersen, Brad			Chief Executive Officer, President :					
Last Guidance	(Invalid Identifier)		Curtiss-Wright Corporation			\$3,634.39			Cashel, James			Chief Compliance Officer, General					
Next earnings date	6/5/2015		Air Industries Group			\$72.51			Dupuis, Serge			Chief Financial Officer and Treasur					
Enterprise value	\$84.77		Kontron AG			\$303.97			Hahneman, Rodger			General Manager of Production O					
Market Capitalization	\$2,032.29		Goodrich Corp.						Koons, Mike			Vice President of Contracts and Cu					
Daily volume	0.25		CPI Aerostructures Inc			\$95.64			Repp, Brad			Vice President of Product Develop					
Shares outstanding	9.82		Melrose Industries PLC			\$2,671.14											
Diluted shares outstanding	9.92																
% shares held by institutions	99.58%																
% shares held by insiders	4.61%																
Short interest	0.07%																
Days to cover short interest	0.71																
52 week high	\$15.15																
52-week low	\$9.01																
5y Beta	0.29																
6-month volatility	19.31%																
			Current Capital Structure														
			Total debt/market cap			0.00%											
			Cost of Borrowing			#DIV/0!											
			Interest Coverage			3.7x											
			Altman Z			3.70											
			Debt Rating			AA											
			Levered Beta			0.89											
			WACC (based on market value weights)			7.59%											
			Past Earning Surprises														
			Revenue			EBITDA			Norm. EPS								
Last Quarter			-24.7%			0.0%			-60.0%								
Last Quarter-1			-32.8%			0.0%			NM								
Last Quarter -2			23.3%			0.0%			200.0%								
Last Quarter -3			25.1%			0.0%			466.7%								
Last Quarter -4			-19.9%			0.0%			NM								
			Proforma Assumptions														
			Money market rate as of today			0.54%											
			Annual increase (decrease) in interest rates			0.1%											
			Yield Spread acceleration			1.2											
			Marginal Tax Rate			37.5%											
			Risk-Free rate			2.6%											
			Tobin's Q			0.80											
			Op. Cash/Rev.			7%											
			Growth in PPE			NPPE Growth follows Revenue Growth											
			Long term Growth			2.0%											
			Base Year Unlevered Beta			is equal to 0.89											
			Long term Unlevered Beta			0.89											
			Forecast														
			Period			Rev. Growth			Adj. Op. Cost/Rev			Invested Capital					
			LTM			7.5%			84.9%			\$138.26					
			NTM			3.0%			84.9%			\$98.55					
			NTM+1			3.0%			84.9%			\$100.06					
			NTM+2			2.0%			84.9%			\$101.82					
			NTM+3			2.0%			84.9%			\$103.79					
			NTM+4			2.0%			85.0%			\$106.15					
			NTM+5			3.0%			85.0%			\$108.64					
			NTM+6			3.0%			85.0%			\$111.09					
			NTM+7			3.0%			85.0%			\$113.24					
			NTM+8			2.0%			85.0%			\$115.32					
			Continuing Period			2.0%			85.0%			\$106.31					
			Valuation														
			Period			Invested Capital x (ROIC-WACC)			Total Debt			Other non-interest bearing claims					
			LTM			\$0.00			\$0.00			-\$2.26					
			NTM			\$0.28			\$0.00			-\$4.91					
			NTM+1			\$3.38			\$0.00			-\$12.22					
			NTM+2			\$3.33			\$0.00			-\$19.46					
			NTM+3			\$3.29			\$0.00			-\$26.71					
			NTM+4			\$3.32			\$0.00			-\$33.85					
			NTM+5			\$3.35			\$0.00			-\$41.15					
			NTM+6			\$3.37			\$0.00			-\$48.79					
			NTM+7			\$3.32			\$0.00			-\$58.18					
			NTM+8			\$3.28			\$0.00			-\$66.36					
			Continuing Value			\$41.58											
			Pricing Model														
			DCF (Weight = 100%)			Relative (Weight = 0%)			Distress (Weight = 0%)			Weighted Average Price Per Share					
			\$17.82			\$16.74			\$18.99			\$17.82					
			\$15.74			\$17.51			\$15.36			\$15.74					
			\$16.82			\$18.64			\$16.58			\$16.82					
			\$17.75			\$19.72			\$17.49			\$17.75					
			\$18.71			\$20.82			\$18.44			\$18.71					
			\$19.77			\$22.04			\$19.43			\$19.77					
			\$20.74			\$23.34			\$20.44			\$20.74					
			\$21.84			\$24.70			\$21.49			\$21.84					
			\$23.00			\$26.09			\$22.68			\$23.00					
			\$23.76			\$27.33			\$23.76			\$23.76					
			Monte Carlo Simulation Assumptions														
			Base			Stdev			Min			Max					
			Revenue Variation			0			10%			N/A					
			Op. Costs Variation			0			10%			N/A					
			Country Risk Premium			6%			N/A			5%					
			Long term Growth			2%			N/A			3%					
			Monte Carlo Simulation Results														
			Mean est.			\$17.82			\$15.74								
			σ(e)			\$0.04			\$0.05								
			3 σ(e) adjusted price			\$17.70			\$15.59								
			Current Price			\$10.24											
			Analysts' median est.						\$0.00								