

HEICO Corporation

Why the Bears have it wrong on this aftermarket leader; Upgrade to Buy

Rating Change: BUY | PO: 220.00 USD | Price: 179.20 USD

Understated aftermarket strength: Upgrade to Buy

Heico (ticker: HEI) shares have pulled back ~10% since recent peak levels in Dec. 2023 (vs. the S&P500 down ~7%. At the end of 2023, investors started to favor names with stronger exposure to ramping OEM production volumes on concerns over deceleration of aftermarket growth. We see continued strength for HEI and believe the pullback is overdone. HEI stands to benefit as 1) a recovery in air traffic demand fuels better than anticipated growth in aftermarket producers, 2) slower than expected OEM deliveries, and 3) recent [GTF/ BA MAX-9 groundings](#) pressuring existing aircraft supply. We think the pullback in HEI stock price is overdone. We upgrade HEI to a Buy rating from Neutral.

FSG set to benefit from continued MRO demand

Flight Support Group (FSG) is poised to benefit from the recovery in air traffic demand and supply chain, quality, and execution headwinds delaying OE production rates and forcing older aircraft continue to fly. Spare parts remain in short supply and MRO shops remain at capacity. Aftermarket Replacement Parts will continue to benefit as airlines weigh dilemma of moving to PMA parts or keeping an aircraft grounded. Additionally, the recently acquired Wencor should benefit from HEI's larger existing customer base, and HEI developing specialty parts (which Wencor currently outsources).

Wencor poised to bolster FSG's aftermarket business

FSG creates approved aircraft parts that can be substituted for original parts, including fuel pumps, generators, fuel controls valves, and compressors. The segment also participates in repair, overhaul, and distribution for engine parts and instruments for commercial air carriers. HEI's Wencor acquisition increases FSG's exposure to the commercial aftermarket, including work win PMA, MRO, and distribution. ETG designs and produced various electric, microwave, and electro-optical products.

PO remains at \$220, high-end of range on aero upcycle

We maintain our PO, unchanged at \$220. We are rolling our valuation one year forward to reflect CY25 estimates. Our PO is based on a 2.4x relative P/FCF multiple to the S&P 500 on CY25 estimates. Historically, HEI has traded between 0.9x and 2.6x (excluding some 2013 exceptions). Starting in 2018, HEI has traded above average on strong commercial aero growth expectations. We think the 2.4x multiple (vs. last 5 year average of 1.92x) fairly values the upside from both Wencor and commercial aftermarket.

Estimates (Oct) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	2.21	2.55	2.91	3.45	4.10
EPS Change (YoY)	-3.5%	15.4%	14.1%	18.6%	18.8%
Consensus EPS (Bloomberg)			2.85	3.48	4.12
DPS	0.17	0.18	0.20	0.21	0.24
Valuation (Oct)					
P/E	81.1x	70.3x	61.6x	51.9x	43.7x
Dividend Yield	0.1%	0.1%	0.1%	0.1%	0.1%
EV / EBITDA*	57.7x	47.2x	37.1x	28.0x	25.0x
Free Cash Flow Yield*	1.6%	1.8%	1.6%	2.0%	2.5%

* For full definitions of *IQmethod*SM measures, see page 6.

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Refer to important disclosures on page 7 to 9. Analyst Certification on page 5. Price Objective Basis/Risk on page 5.

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Timestamp: 25 January 2024 06:00AM EST

25 January 2024

Equity

Key Changes

(US\$)	Previous	Current
Inv. Opinion	B-2-7	B-1-7
Inv. Rating	NEUTRAL	BUY
2023E Rev (m)	2,723.8	2,968.1
2024E Rev (m)	2,967.3	3,936.2
2025E Rev (m)	3,154.9	4,291.0
2023E EPS	2.85	2.91
2024E EPS	3.30	3.45
2025E EPS	3.75	4.10

Ronald J. Epstein
Research Analyst
BoFA
+1 646 855 5695
r.epstein@bofa.com

Mariana Perez Mora
Research Analyst
BoFA
mariana.perez mora@bofa.com

Jordan Lyon nais
Research Analyst
BoFA
jordan.lyonnais@bofa.com

Andre Madrid
Research Analyst
BoFA
andre.madrid@bofa.com

Samantha Stiroh
Research Analyst
BoFA
samantha.stiroh@bofa.com

Stock Data

Price	179.20 USD
Price Objective	220.00 USD
Date Established	13-Jun-2023
Investment Opinion	B-1-7
52-Week Range	153.63 USD - 191.00 USD
Mrkt Val (mn) / Shares Out (mn)	24,833 USD / 138.6
Free Float	77.1%
Average Daily Value (mn)	70.61 USD
BoFA Ticker / Exchange	HEI / NYS
Bloomberg / Reuters	HEI US / HEI.N
ROE (2023E)	13.8%
Net Dbt to Eqty (Oct-2022A)	5.1%
ESGMeter TM	Medium

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BoFA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BoFA ESGMeter Methodology".

MRO – Maintenance, Repair and Overhaul
OEM– Original equipment manufacturer
PMA - Parts Manufacturer Approval

iQprofileSM HEICO Corporation

iQmethodSM – Bus Performance*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	10.3%	11.5%	9.8%	9.8%	10.3%
Return on Equity	14.1%	14.2%	13.8%	14.0%	14.3%
Operating Margin	21.1%	22.5%	21.1%	21.0%	21.7%
Free Cash Flow	408	436	399	485	613

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	1.5x	1.3x	1.1x	1.2x	1.2x
Asset Replacement Ratio	0.4x	0.3x	0.4x	0.5x	0.4x
Tax Rate	14.8%	20.4%	20.0%	20.5%	20.5%
Net Debt-to-Equity Ratio	5.0%	5.1%	64.8%	45.4%	27.1%
Interest Cover	NM	NM	8.6x	5.2x	5.3x

Income Statement Data (Oct)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Sales	1,866	2,208	2,968	3,936	4,291
% Change	4.4%	18.4%	34.4%	32.6%	9.0%
Gross Profit	1,436	1,672	2,296	3,062	3,313
% Change	3.7%	16.4%	37.3%	33.4%	8.2%
EBITDA	486	593	755	1,001	1,121
% Change	4.5%	22.1%	27.3%	32.5%	12.0%
Net Interest & Other Income	(6)	(6)	(70)	(155)	(130)
Net Income (Adjusted)	304	352	404	483	577
% Change	-3.1%	15.6%	14.8%	19.7%	19.4%

Free Cash Flow Data (Oct)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Income from Cont Operations (GAAP)	330	391	444	534	637
Depreciation & Amortization	93	96	130	174	190
Change in Working Capital	2	(61)	(117)	(159)	(173)
Deferred Taxation Charge	(16)	9	(27)	0	12
Other Adjustments, Net	35	33	18	15	15
Capital Expenditure	(36)	(32)	(49)	(79)	(69)
Free Cash Flow	408	436	399	485	613
% Change	5.6%	6.9%	-8.4%	21.6%	26.3%
Share / Issue Repurchase	0	0	0	0	0
Cost of Dividends Paid	(23)	(24)	(27)	(29)	(34)
Change in Debt	(505)	50	975	(200)	0

Balance Sheet Data (Oct)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	108	140	171	427	1,007
Trade Receivables	245	295	509	568	623
Other Current Assets	584	718	1,175	1,309	1,427
Property, Plant & Equipment	194	226	322	352	344
Other Non-Current Assets	2,367	2,717	5,018	4,893	4,779
Total Assets	3,498	4,095	7,195	7,549	8,180
Short-Term Debt	2	2	18	18	18
Other Current Liabilities	293	419	648	681	682
Long-Term Debt	235	289	2,460	2,260	2,260
Other Non-Current Liabilities	419	410	511	511	523
Total Liabilities	949	1,120	3,637	3,471	3,483
Total Equity	2,550	2,976	3,558	4,078	4,697
Total Equity & Liabilities	3,498	4,095	7,195	7,549	8,180

* For full definitions of iQmethodSM measures, see page 6.

Company Sector

Aerospace

Company Description

HEICO is a leading manufacturer of FAA approved jet engine and aircraft component replacement parts. The company is organized into two reporting segments: Flight Support Group (FSG) and Electronic Technologies Group (ETG). In FY21, 39% of sales came from the commercial aviation industry, 44% from defense and space, and the remaining 17% from other industrial markets including medical, electronics and telecommunications.

Investment Rationale

HEI stands to benefit as 1) a recovery in air traffic demand fuels better than anticipated growth in aftermarket producers, 2) slower than expected OEM deliveries, and 3) recent GTF/ BA MAX-9 groundings pressuring existing aircraft supply.

Stock Data

Average Daily Volume 390,022

Quarterly Earnings Estimates

	2022	2023
Q1	0.63A	0.67E
Q2	0.62A	0.76E
Q3	0.60A	0.74E
Q4	0.70A	0.74E

Wencor closed – hands off approach for first 6-12mo

HEI reported the first quarter with Wencor included in the results following [\\$2.05bn acquisition of the Wencor Group](#). We continue to view the deal favorably as the deal will increase HEI's exposure to the commercial aftermarket (PMA, DER, MRO, and distr.) with a complimentary portfolio and minimal overlap of product offerings. HEI will effectively run Wencor as a separate business unit over the next 6-12months to fully understand the business, processes, and preserve culture before ultimately consolidating operations, facilities, and see real cost synergies. HEI expects Wencor to benefit from HEI's larger existing customer base, HEI developing specialty parts (which Wencor currently outsources) and leveraging expertise from both businesses. We anticipate Wencor revenue's growing 12% in FY2024, then low double-digit growth in FSG once combined and synergies materialize.

Sentiment of OE vs. aftermarket to be tested

The Electronic Technologies Group (ETG) revenue increased 26% Y/Y in 4QFY23, driven by the Exxelia acquisition, but only 1% Y/Y organically. In FY2024e, we expect an inflection point to the upside on defense related products supported by greater demand from high margin space products, strong demand for munitions, and stronger book-to-bill. Additionally supply chain headwinds have tempered with \$10mn in orders pushed to 1QFY24 vs. \$20mn in 3QFY23, and \$30mn in 2QFY23.

Margins to decline on acquisition costs, pricing may help

FSG's 4Q op. margins declined to 19% (down 345bps Y/Y) due to transactions costs from the Wencor acquisition. FSG's deal related margin headwinds are expected to continue with due to increased amortization expense, deal expenses, and inventory write-ups. We anticipate FSG margins recovering in FY2026, at 23% given HEI intends to let Wencor operate independent for the next 6-12months.

ETG: Exxelia growth tempering, space driving

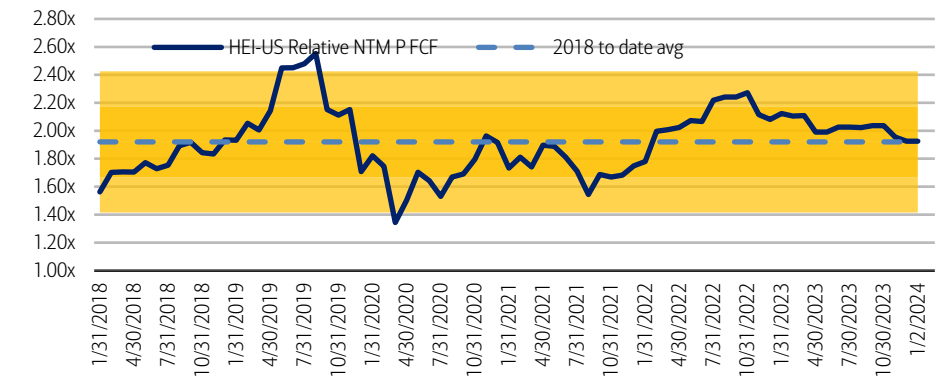
The Electronic Technologies Group (ETG) revenue increased 26% Y/Y, driven by the Exxelia acquisition, and 1% Y/Y organically. Defense & Space sales increased 11% Y/Y, driven by Space products, offset by a defense products sales decline of \$28.2mn. Margins increased 246bps sequentially, and down 445bps Y/Y, driven by increased SG&A, lower gross margins, and higher acquisition expenses. Management expects Exxelia's performance and underlying profitability to temper in FY2024, end the year ~24%, with greater lumpiness in the quarters.

Updating our model to include Wencor Acquisition

Our updated model reflects the anticipated impact of the Wencor acquisition to FSG's 4Q and FY2023 sales and margins. We continue to expect strong aftermarket performance to drive double digit sales growth for FSG in the mid-term, then high-single digits in 2026 / 2027. In ETG we anticipate mid-single digit revenue growth driven by the Exxelia acquisition, space exposure, and muted defense growth. On margins we anticipate a return to previous highs in FY2026 and maintained in outyears as synergies are realized from both Wencor and Exxelia. EPS estimates reflect the changes above and Wencor acquisitions, FY2024 EPS: \$3.45 (vs. prior \$3.30), 2024E: \$4.10 (vs. prior \$3.75), FY2025E: \$5.05 (vs. \$4.20), FY2026E: \$5.05 (vs. prior \$4.20), FY2027E: \$5.70 (vs. prior \$4.70).



Exhibit 1: HEI Relative NTM P/FCF Valuation
HEI has traded at 1.9x NTM P/FCF on average relative to the S&P500



Source: FactSet, BofA Global Research

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Price objective basis & risk

HEICO Corporation (HEI)

Our PO of \$220 is based on a 2.4x relative P/FCF multiple to the S&P 500 on CY25 estimates. Historically, HEI has traded between 0.9x and 2.6x NTM relative P/FCF multiple (excluding outlier period in 2013). In our view, a relative multiple above HEI's 5-year 1.92x average, fairly factors in HEI's unique market positioning, strong management execution and a sound balance sheet.

Downside risks are a longer-than-expected economic slowdown, which would likely lower original equipment manufacturer (OEM) production rates and demand for air travel, higher oil prices, which would likely derail air traffic growth and, therefore, aircraft demand, less acceptance of PMAs from the airline community, a change in acquisition strategy and integration.

Upside risks are increased M&A due to the company's acquisitive history, faster growth in sales, a stronger-than-expected commercial aero recovery, better-than-expected margins, a greater acceptance of parts manufacturer approval (PMA) parts by airlines and lessors.

Analyst Certification

I, Ronald J. Epstein, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Aerospace and Defense Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	AerCap Holdings N.V.	AER	AER US	Ronald J. Epstein
	Air Lease Corporation	AL	AL US	Ronald J. Epstein
	Boeing	BA	BA US	Ronald J. Epstein
	Booz Allen Hamilton	BAH	BAH US	Mariana Perez Mora
	BWX Technologies, Inc.	BWXT	BWXT US	Ronald J. Epstein
	CACI International	CACI	CACI US	Mariana Perez Mora
	Cadre Holdings Inc	CDRE	CDRE US	Ronald J. Epstein
	Crane Co.	CR	CR US	Ronald J. Epstein
	Embraer	ERJ	ERJ US	Ronald J. Epstein
	General Dynamics	GD	GD US	Ronald J. Epstein
	HEICO Corporation	HEI	HEI US	Ronald J. Epstein
	Howmet Aerospace Inc.	HWM	HWM US	Ronald J. Epstein
	KBR	KBR	KBR US	Mariana Perez Mora
	Leidos Holdings	LDOS	LDOS US	Mariana Perez Mora
	Leonardo DRS, Inc.	DRS	DRS US	Ronald J. Epstein
	Northrop Grumman	NOC	NOC US	Ronald J. Epstein
	Palantir Technologies	PLTR	PLTR US	Mariana Perez Mora
	Parsons Corporation	PSN	PSN US	Mariana Perez Mora
	RBC Bearings Inc	RBC	RBC US	Ronald J. Epstein
	Rocket Lab	RKLB	RKLB US	Ronald J. Epstein
	Teledyne Technologies Inc	TDY	TDY US	Ronald J. Epstein
	TransDigm Group Inc.	TDG	TDG US	Ronald J. Epstein
NEUTRAL				
	Albany International	AIN	AIN US	Ronald J. Epstein
	Garmin	GRMN	GRMN US	Ronald J. Epstein
	Hexcel Corporation	HXL	HXL US	Ronald J. Epstein
	L3Harris	LHX	LHX US	Ronald J. Epstein
	Lockheed Martin	LMT	LMT US	Ronald J. Epstein
	Textron	TXT	TXT US	Ronald J. Epstein



US - Aerospace and Defense Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
UNDERPERFORM				
	Bombardier	BDRBF	BDRBF US	Ronald J. Epstein
	Bombardier Inc.	YBBD B	BBD/B CN	Ronald J. Epstein
	CAE Inc.	YCAE	CAE CN	Ronald J. Epstein
	CAE Inc.	CAE	CAE US	Ronald J. Epstein
	Huntington Ingalls Industries	HII	HII US	Ronald J. Epstein
	Mercury Systems	MRCY	MRCY US	Ronald J. Epstein
	RTX Corp	RTX	RTX US	Ronald J. Epstein
	Spirit AeroSys-A	SPR	SPR US	Ronald J. Epstein
RVW				
	Triumph Group	TGI	TGI US	Ronald J. Epstein

iQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization

Shareholders' Equity

Sales

N/A

N/A

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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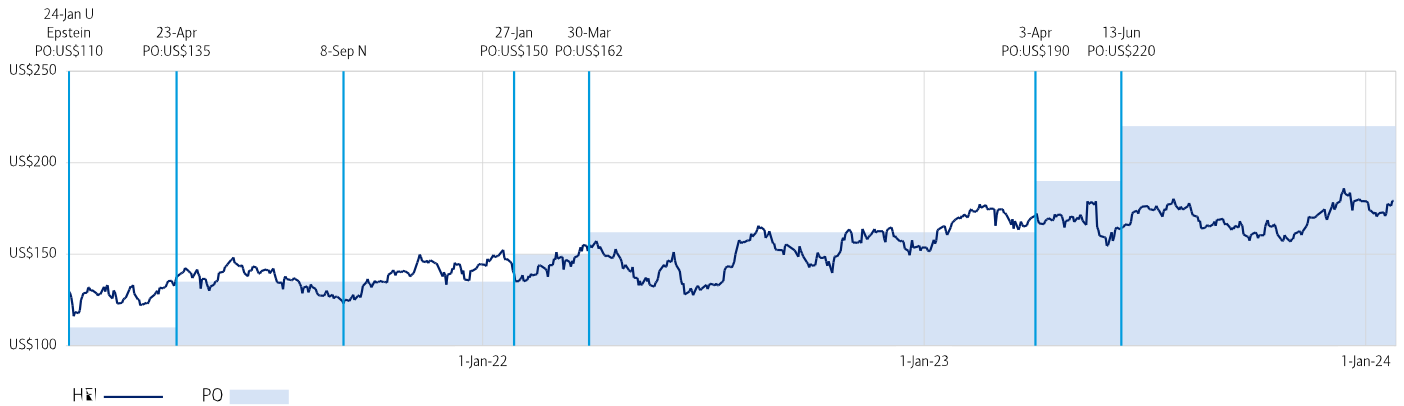
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Disclosures

Important Disclosures

HEICO (HEI) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Aerospace/Defense Electronics Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	31	62.00%	Buy	23	74.19%
Hold	11	22.00%	Hold	9	81.82%
Sell	8	16.00%	Sell	6	75.00%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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