

## Triumph Group

## Investor Day: Operational runway clearing, leverage crosswinds ahead

Maintain Rating: UNDERPERFORM | PO: 8.00 USD | Price: 8.59 USD

## Strong pricing &amp; aero recovery, but high leverage

We walked away from Triumph Group's (NYSE: TGI) investor day positively surprised about the renewed approach to healthy pricing and contract structure. TGI's refreshed portfolio seemingly has a strong position in both commercial and defense markets across OE and aftermarket. However, we still see risks surrounding TGI's high interest expense, and leverage given uncertainty around rates. We maintain our Underperform and PO of \$8.

## Pricing tailwinds inbound, 2/3rds of contracts repriced

Post-COVID, the industry has shifted perspectives from seeking the lowest price, to best value with emphasis on de-risking quality issues, channel control, and on-time deliveries. TGI embraced the customer's increased willingness to discuss pricing in an inflationary environment renegotiating about two thirds of existing contracts. The improved pricing agreements take about two years to fully flow through, with many early-stage programs just starting to ramp up. In the near term, we expect TGI to maintain pricing control if further escalations are necessary. We view the renewed contracts & pricing focus as potentially positive, with significant upside in the long term. Currently ~80% of contracts are renegotiated every six years, with the remaining ~20% every four. Additionally, every ~6 months the contracts team tests new prices to better gauge what the market is willing to accept.

## OEM volumes tailwinds in both Commercial &amp; Defense

We see potential upside for TGI to increase content on existing programs through technologies refreshes as OEMs are looking to de-risk and dual source components. TGI remains well positioned to benefit from OEM production ramps at Boeing and Airbus, with ~2x exposure to widebodies vs. narrowbodies. In defense, TGI's positions on CH-53K & AH-64 are expected to benefit from increase production volumes, while F-15EX, B-21, CH-47 remain stable. On the F-35, although production rates may be lower due to the recent snag on the [Tech Refresh-3](#), both international and long term demand remain strong. These defense tailwinds will be partially offset by sunseting V-22.

## 6x Leverage remains greatest investor concern

TGI expects to end FY2024 at 6.2x and gradually delever to <2.0x by FY2028. Interest expense will continue to weigh on free cash flow (we estimate ~\$145mn in interest payments in FY2024) which limits TGI's ability to invest in the business or return cash to shareholders. TGI owes \$485mn on 7.75% senior notes due in 2025, exceeding the \$146mn of cash on hand, and \$106mn in total proceeds from the warrants issued. Management maintains an improved credit rating and balance sheet should insulate from a higher rate at the time of refinancing. We do see risks to the wait and see approach given the uncertainty around the Fed's rate decision.

18 September 2023

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## Stock Data

Price	8.59 USD
Price Objective	8.00 USD
Date Established	11-Aug-2023
Investment Opinion	C-3-9
52-Week Range	7.84 USD - 13.33 USD
Mkt Val (mn) / Shares Out (mn)	659 USD / 76.7
Average Daily Value (mn)	12.85 USD
BofA Ticker / Exchange	TGI / NYS
Bloomberg / Reuters	TGI US / TGI.N
ROE (2024E)	NA
Net Dbt to Eqty (Mar-2023A)	NA
ESGMeter™	High

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Timestamp: 18 September 2023 10:19AM EDT

## Post restructuring - the path to improved margins and FCF

Management provided outlook for FY2024-28 anticipating annual growth in net sales at 9%, EBITDAP at 19%, and FCF at 48%. Key enablers beyond the increases in volumes and pricing is TGI's refreshed operating strategy. The strategy leverages TGI's improved corporate structure, efficiencies gains, and more focused capital deployment.

## Efficiency gains from the shop floor to the Corp office

Management focused on the significant efforts exerted on pushing forward the *One Triumph* operating strategy through the entire organization. We view the changes positively, given TGI's limited capital resources can be deployed more effectively towards better performing lines. At the corporate level, TGI restructured businesses to realize greater internal synergies, while creating central points for cross selling, customers, and contracts. At the business unit level, management focused on instituting the same lean standards across each business and a full product line review to identify underperformers. P&L owners of the bottom quartile of underperforming products were then tasked with implementing a turnaround strategy or having the product line sold/transferred.

## Modest aftermarket growth in the near term

In the commercial aftermarket, TGI expected 4-6% growth in the near term on Part Repairs, Spares, and TGI IP-based MRO. In defense, military MRO spending remains well supported while fleet readiness continues to be a top DoD priority, management expects 3%-5% growth in line with defense spending.

## Price objective basis & risk

### Triumph Group (TGI)

We derive our PO of \$8 using an 9.0x EV/EBITDA multiple on CY24e earnings. We think a multiple four turns below investment grade peers fairly reflects the risk profile of high yield commercial aerospace suppliers.

Better-than-expected execution could provide upside risk to our PO. TGI's ability to recover cash from customers could improve liquidity. Higher-than-expected cash generation could increase capital returned to shareholders. Acquisitions could provide upside risk.

Downside risks: Higher oil prices could derail air traffic growth and therefore aircraft demand, resulting in a downturn in commercial aviation. A downturn in commercial aviation, due to an exogenous factor such as a terrorist attack or natural business cyclically, could adversely affect financial results. TGI could be materially affected if serious complications should arise from new platforms. Given that aircraft are priced in dollars, an unexpected rapid devaluation in the dollar could significantly affect order activity. Revenues are heavily dependent on Boeing. Any material change in a relationship with Boeing could affect the company's financials. Balance sheet constraints could negatively impact operations.

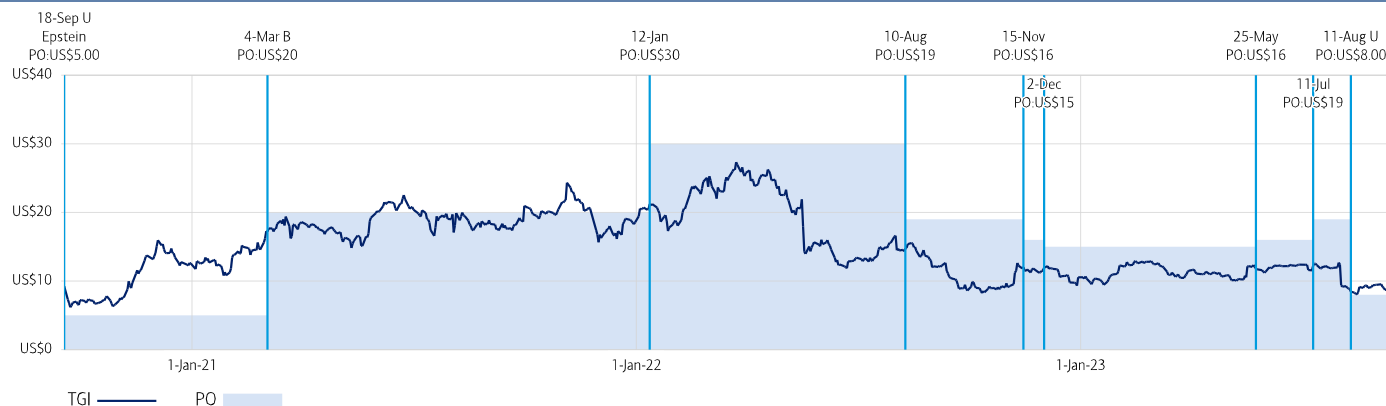
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Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	25	50.00%	Buy	17	68.00%
Hold	14	28.00%	Hold	13	92.86%
Sell	11	22.00%	Sell	4	36.36%

### Equity Investment Rating Distribution: Global Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1877	53.28%	Buy	1040	55.41%
Hold	815	23.13%	Hold	464	56.93%
Sell	831	23.59%	Sell	385	46.33%

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