AN AEROSPACE STOCK POISED TO JUMP AND KEEP GROWING

Cabot TURNAROUND LETTER
Out-of-Favor Stocks with Real Value
Kaman Corporation (KAMN) is a small-cap defense and aerospace company (2022 sales: $688 million) that produces engineered products (64% of sales), precision products (19%) and structural aircraft components (17%). Founded in 1945 by aviation pioneer Charles Kaman, the Connecticut-based company was originally an innovative and successful maker of military helicopters. Over time, it leveraged its in-house technology along with an array of acquisitions to produce a broad assortment of products and components for defense (39% of its sales), commercial aviation (35%), medical (14%) and industrial (12%) customers. About 81% of total sales are to Boeing and Airbus.

Kaman’s shares, down 70% from their early 2018 peak, trade unchanged from their 2005 price and are 25% below their pandemic low. The company has struggled with declining revenues in its military Joint Programmable Fuzes (JPF) business and other products, along with its inefficient and poorly managed collection of products. The reliance on Boeing and Airbus production, particularly Boeing’s 737 MAX, previously weighed heavily on results and are only now starting to recover.

Investors see Kaman as little more than a low-margin aerospace contractor with a fading JPF program. With this perception, it is little wonder why investors have limited interest in Kaman shares.

Changes for the Better
We see significant changes underway at Kaman that should make it a much more valuable company. First, the company has overhauled its board of directors, reducing the nine-person board to the current seven, four of whom are new. In September 2020, the company hired a capable outsider as CEO, Ian Walsh. Walsh previously was chief operating officer at REV Group, held senior executive roles at Textron, and is a former Marine Corps officer and aviator.

The new leadership, backed by a mandate from the board of directors, is reinvigorating the company. To facilitate the necessary changes, including directly addressing the company’s many sacred cows, Walsh has replaced nearly the entire executive team.

A key component of any successful turnaround is to rebuild around a successful core business. For Kaman, that business is its Engineered Products segment. Kaman previously operated under a single reportable segment, which obscured its high margin proprietary and custom-designed products for aircraft, industrial and medical markets.

These valuable products, which include super precision bearings, flexible drive systems, engine aftermarket components and others, have now been unified under the Engineered Products group. Representing nearly two-thirds of total revenues, with 2022 organic growth of 12% and EBITDA margins of 24%, this segment provides a strong foundation for the new Kaman. The strategy for this segment is to win new business, improve execution and improve efficiency. An important aspect of this strategy is to implement strategic price increases to more fully reflect the value of its products and to offset rising costs.

Growth Through Acquisition
Helping boost Engineered Products, Kaman acquired Parker Hannifin’s Aircraft Wheel & Brake division last year. The $440 million deal brings into Kaman a healthy, high (40%) margin business with strong positions in key components and attractive growth prospects.
A second segment, Precision Products, includes the fuzes business, a mix of avionics products, and aftermarket parts and service for its quirky K-MAX helicopters. Kaman’s strategy is to improve revenue growth by upgrading and modernizing the product roster. An intriguing investment in a private company that is developing autonomous flight technologies offers new capabilities while isolating the related capital and operating costs.

The third segment, Structures, produces structural components including the cockpit array for the Black Hawk helicopter, blade skins for the AH-1Z helicopter and advanced medical imaging tables. The emphasis for these operations is on greater efficiency, higher margins and tighter execution.

**Divest Underperformers**

As part of the turnaround, Kaman has also improved its capital and operating efficiency by selling its underperforming Mexico operations, consolidating production facilities and discontinuing production of its K-MAX helicopters. The company will likely selectively divest or wind down other low-margin product lines. Over time, we see Kaman becoming a more profitable, faster-growth and more focused company. And, in a world that is re-arming its militaries, the company could be a beneficiary of higher defense spending by the United States and its allies.

Kaman is profitable and will likely return to positive free cash flow this year. The balance sheet carries an elevated debt balance at 5.5x EBITDA, but with the company’s emphasis on free cash flow, this balance should move steadily lower. The company’s turnaround won’t happen overnight. However, now in its third year, the recovery process is underway – we see progress continuing gradually over a multi-year period. We see Kaman earning $150 million in EBITDA in three years, compared to about $100 million in 2023, with an improved balance sheet, strong free cash flow and a tighter mix of businesses.

Trading at only 7x our out-year EBITDA estimate, with a 3.6% dividend yield that pays investors while they wait, Kaman shares look attractive for patient investors. We have a $57 price target on the shares.
About Bruce Kaser

Bruce Kaser has more than 25 years of value investing experience in managing institutional portfolios, mutual funds, and private client accounts. He has led two successful investment platform turnarounds, co-founded an investment management firm, and was principal of a $3 billion (AUM) employee-owned investment management company, New Generation Research. Prior, he led the event-driven small/midcap strategy for Ironwood Investment Management and was Senior Portfolio Manager with RBC Global Asset Management where he co-managed the $1 billion value/core equity platform for over a decade. He earned his MBA degree, in finance and international business, from the University of Chicago and did his undergraduate studies in finance, with honors from Miami University (Ohio).