

## **PENN Points to Aerospace**

June 7, 2011

*Philadelphia, PA* – There aren't enough planes! Let's take one step back here. As it stands, there are few key particulars within this sector that we just cannot ignore.

For one, there is a significant amount of backlog. The large Original Equipment Manufacturers (OEMs), Boeing and Airbus, have multiple years of current production as backlogs. Additionally, airlines have been delaying the replacement of their older fleets for a number of years. The backlog for "narrow-body planes" is 5 years and the backlog for "wide-body planes" is 10 years. These newer and more fuel efficient planes are proving to drive the rise in demand as fuel costs continue to increase. What is the bottom line? Investors can buy future sales at a discount today because this backlog has yet to be realized.

Furthermore, we are seeing a rise in production volume. With strong orders globally, the OEMs have been increasing their plane production targets. Specifically, Boeing announced a number of production increases during its Investor Day last month. Some of the notable increases included its 737 moving from 31.5 per month to 38.0 per month, its 777 moving from 5.0 per month to 8.3 per month and lastly, its 787 increasing to a 2.5 per month run-rate by the end of 2011 and ramping up to 10 per month over next 2 to 3 years. What does this all mean? This is a sector that is still increasing production volumes in the midst of economic uncertainty.

Another notable point regarding Aerospace is that the discipline of the supply chain has been realized. OEMs have learned their lesson with regards to supply chain optimization and will allow component suppliers to better manage their working capital. PENN believes that the sector has found discipline with regards to managing the supply chain, which will benefit the cash flow generation of suppliers. Better inventory management lowers working capital and boosts capital generation. A more disciplined supply chain management by Boeing and Airbus will allow component part investors to better manage the working capital requirements and generate better cash flow profiles.

Finally, the positive production announcements above have set the stage for EBITDA multiples expansion. Multiples will rise as the new aircraft build cycle, particularly the 787, gains momentum and rising multiples provides downside protection.

As a result, we have established positions in aerospace component suppliers across all of our investment strategies. PENN's Investment Team believes that it has positioned itself to take advantage of the cycle as investors gain more clarity on the "big guy's" execution. The team anticipates opportunistically increasing its positions in aerospace to participate in ramping commercial build cycle.

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