Terry Ledbetter
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Heico Corp. (NYSE: HEI)

Buy

September 19, 2001 | **Industrial Sector** | **Aerospace**

MARKET DATA

Price	$13.10
52 Week Range	$20.90 - $10.56
Price Target	$16.00
Book Value	$9.55
Raw Beta	0.86
Shares Outstanding	22.5 million
Market Capitalization	$294.8 million
Revenue FY2000	$200.9 MM
Net Income FY2000	$26.3 MM
Earnings 5 Yr. CAGR	21.6%
Fiscal Year End	October

COMPANY OVERVIEW

Through its subsidiaries, HEICO Corp. participates in niche segments of the aerospace, defense, and electronics industries. Its customers include a majority of the world's major airlines and airmotives, defense contractors and military agencies worldwide, including the U.S. Air Force and Navy, and electronics manufacturers.

Approximately 80% of HEICO's sales come from its Flight Support Group (FSG) which manufactures FAA-approved aircraft engine replacement parts and repairs and overhauls other aircraft equipment. Due to its ability to manufacture and secure FAA approval for its parts, HEICO has challenged monopolies previously held by original equipment manufacturers (OEM's) and offers its parts to airlines at substantial discounts. Because OEM's had previously sold these parts at exorbitant prices, however, HEICO has been able to underprice the them and still maintain outstanding gross margins (around 38%).

The balance of HEICO's sales come from its Electronic Technologies Group (ETG) which develops, manufactures and repairs cutting-edge electrical and electro-optical components for applications ranging from circuit-board shielding to infra-red targeting calibration equipment used by the military.

WINDOW OF OPPORTUNITY

- Current uncertainty about the near-term outlook of the airline industry has created a window of opportunity for patient investors to acquire shares of a company that before traded at a premium relative to its earnings. While a decline in the airline industry will affect HEICO, we believe a number of positive factors offset these risks and it remains an attractive investment.

SUMMARY

- While airlines are reducing flight schedules by as much as 20% and this will adversely affect HEICO's sales, its revenue growth is primarily driven by the introduction of new FAA-approved replacement parts. New sales coming from parts previously not offered will partially off-set the decline in demand for existing parts.
- Although the public is currently reluctant to fly and the makeshift tightened security apparatus has raised the total cost of air travel (i.e. the risk of delayed flights, emotional frustration, etc.), we believe that air travel will prevail as the preferred means of traveling long distances. Demand will decrease in the short-term, but since most of us didn't fly for fun before, we believe it will gradually return to prior levels.
- Despite our confidence in HEICO's long-term prospects, further deterioration in the air travel market could negatively impact HEICO's stock performance in the short-term future. The company's financial performance over the next two years will depend on the final balance of several off-setting variables. The uncertainty of this outcome, however, has provided an opportunity for price-conscious investors to acquire stakes in this offering.

Sources: HEICO Financial Reports (10K's and 10Q's), *The Wall Street Journal, The Airline Monitor*, Bloomberg, BigCharts.com, Morningstar Principa Pro

Window of Opportunity

Competitive Advantage

An understanding of HEICO's niche within the aerospace industry begins with the regulatory process governing the manufacture of replacement parts. The FAA requires all non-OEM firms wishing to manufacture replacement parts for aircraft engines to first obtain Parts Manufacturing Authority (PMA) for every part that they desire to produce. Producing these parts thus not only involves perfectly replicating the original equipment, but also successfully passing through the FAA's verification and certification process. Thanks to this, OEM's such as G.E. and Pratt & Whitney have enjoyed monopoly like status, being the sole provider of many replacement parts for their engines. In addition, part of the OEMs' pricing model has been to supply engines to Boeing at low prices, and then make up the difference through the replacement parts they sell to airlines. Knowing that a $200 million airplane can easily be kept out of the service for lack of a single part, they have been able to sell replacements at phenomenal margins (i.e. $170 for a part that cost $25 to make).

Over the years, HEICO has successfully obtained PMA for numerous parts, demonstrating their manufacturing abilities and establishing a favorable track record with the FAA. This seems to enable them to receive their PMA's relatively quickly. Furthermore, the PMA process itself seems to create formidable barriers to entry since it requires substantial technical abilities and limits the rate at which new products can be introduced to the market.

Because OEM's have traditionally priced replacement parts so high, HEICO has been able to underprice them while still maintaining strong gross margins. Airlines have benefited from HEICO's business so much that two of them have sponsored HEICO's R&D efforts in order to accelerate its introduction of new parts. In 1997, Lufthansa began reimbursing a portion of HEICO's research and development costs and though the last of these payments came during the last quarter, HEICO entered into a similar agreement with American Airlines in February of 2001.

Financial Results

Nearing FY 2001 Year End

In FY2000, HEICO sold Trilectron, a major subsidiary of its Electronic Technologies group, which has lead to substantial decreases in sales and earnings in FY2001. As reported, operating income dropped 19% on a 19% decrease in sales during the first nine months of FY2001. Excluding the sales and income generated by Trilectron in FY2000, however, operating income dropped 9% on a 13% increase in sales during this same period. Operating margin declined primarily during the second and third quarters on FY2001, driven largely by decreased sales of circuit-board shielding to telecommunications and electronics manufacturers. This was partially offset by increased sales and earnings on FAA-approved replacement parts in the Flight Support Group.

Until the third quarter earnings release in late August, management had estimated FY2001 earnings growth to be in line with their long-term estimates of 15% to 20%. In the third quarter release, they revised their estimates, expecting annual earnings in FY2001 to be "at least flat" when compared to FY2000, excluding Trilectron. They maintained, however, that 15% to 20% sales and earnings growth was still attainable over the long-term. Because HEICO was already half-way through its fourth quarter at the time of the September 11 terrorist attacks, it could achieve earnings close to FY2000, excluding Trilectron. This is difficult to determine, however, since HEICO's sales are somewhat seasonal, rising significantly in the fourth quarter. The days that aircraft spent idle immediately after the attacks along with dramatically curtailed flight schedules have both reduced the amount of time placed on these engines and thus extended the useful lives of their parts by some amount. The degree to which this will impact their maintenance schedules and purchases of replacement parts, however, is very difficult to gauge.

Investment Risks

Estimating HEICO's operating performance for the next year is complicated by a number of variables, along with the uncertainty underlying the overall airline industry. First, HEICO's sales *growth* is primarily based on the rate at which it introduces new FAA-approved replacement parts. Airlines are currently cutting approximately 20% of their capacity as they reduce their flight schedules. As they fly their planes less, the related engine parts receive less use and the required maintenance or replacement is delayed. While we know this will reduce demand for HEICO's parts, we are uncertain as to how much the introduction of new offerings will off-set this reduction in the original sales base.

Additionally, though the specter of terrorism reduces demand for aircraft parts, it should increase demand for HEICO's defense related products. Since the attacks, it has already received requests to expedite existing defense related orders. Only approximately 20% of HEICO's business is defense related, however, so an increase in demand for these products may only partially off-set reduced demand for aircraft replacement parts.

We had before been concerned that HEICO might be adversely affected by decreased use of aircraft using JT8D engines. In FY1999 and FY2000, JT8D parts made up approximately 30% and 20% of sales respectively, but for a variety of reasons, airlines have gradually used planes with these engines less frequently. HEICO seems to have successfully continued to reduce its reliance on JT8D-related sales, but reduced demand for these parts has become insignificant relative to the overall decline in the airline industry.

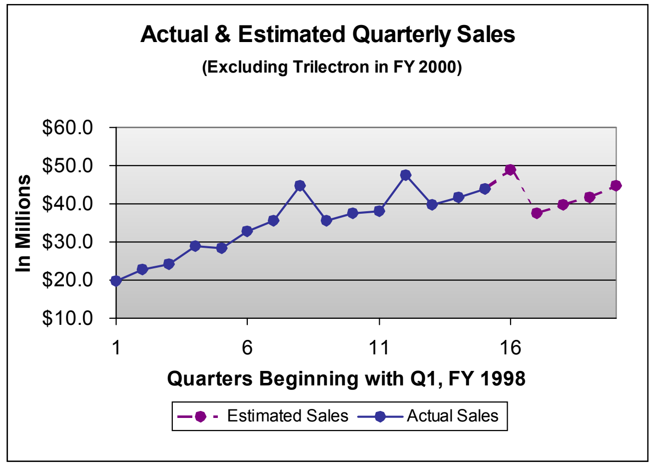
As noted before, we believe that over time, demand for air travel will return to its previous level and steady-state growth rate. The timing of this recovery, however, is uncertain and we expect HEICO to face significantly reduced demand for its parts over the next year or two. Nevertheless, it still occupies an outstanding, defendable niche and offers strong growth potential when the industry recovers. This seems to be recognized within the investment community as HEICO's stock has fallen much less than the airlines and its indirect competitors such as AAR in the last two days. (AAR is a parts redistributor, selling used parts still having significant useful lives.)

2 Day Price History (Sept. 17 & 18, 2001)

Financial Outlook

Earnings Estimates

Excluding results from Trilectron, we expect a sales increase of 14% in FY2001 followed by a sales decrease of 6% in FY2002. We expect air travel to decline sharply during the first quarter of FY2002, to rise slower than usual through the year, and to be almost back to its level before the terrorist attacks by the end of FY2002. We expect a decline in earnings of 10% FY2001 EPS (excluding results from Trilectron in FY2000) followed by a 8% decline in FY2002 EPS. This drop in FY2001 EPS would primarily represent the result of a 10% stock dividend issued during the fourth quarter and would represent only a 2.6% drop in earnings. Annual and quarterly earnings models are located on pages 6 and 7 respectively.



Valuation

Using a Discounted Cash Flow model, we estimate HEICO's fair share value to be approximately $15.93. This DCF model along with the related assumptions is located on page 10.

At $13.10 HEICO is trading at 16.7x FY2001 earnings, and while this does seem somewhat expensive given its outlook over the next couple of years, we believe it is reasonable given the premiums it had previously traded at. After a disappointing earnings release for the third quarter, the stock dropped to the $18 range where it then traded at approximately 22.2x the revised estimates of FY2001 earnings (level with FY2000 excluding the results of Trilectron).

Both Phil Fisher and Warren Buffett have noted that it is better to buy an outstanding company at a fair price than a average company at a deep discount. HEICO's stock price has fluctuated over the last two years, but we think it'd be better to establish a position in it at a good price now rather than wait for a wider margin of safety and risk the chance to buy it at all.

Recommendation

We recommend buying 300 shares of HEICO stock at the market price, but no higher than $14.50 a share. At its current price of $13.10, this would represent a $3,930 investment.

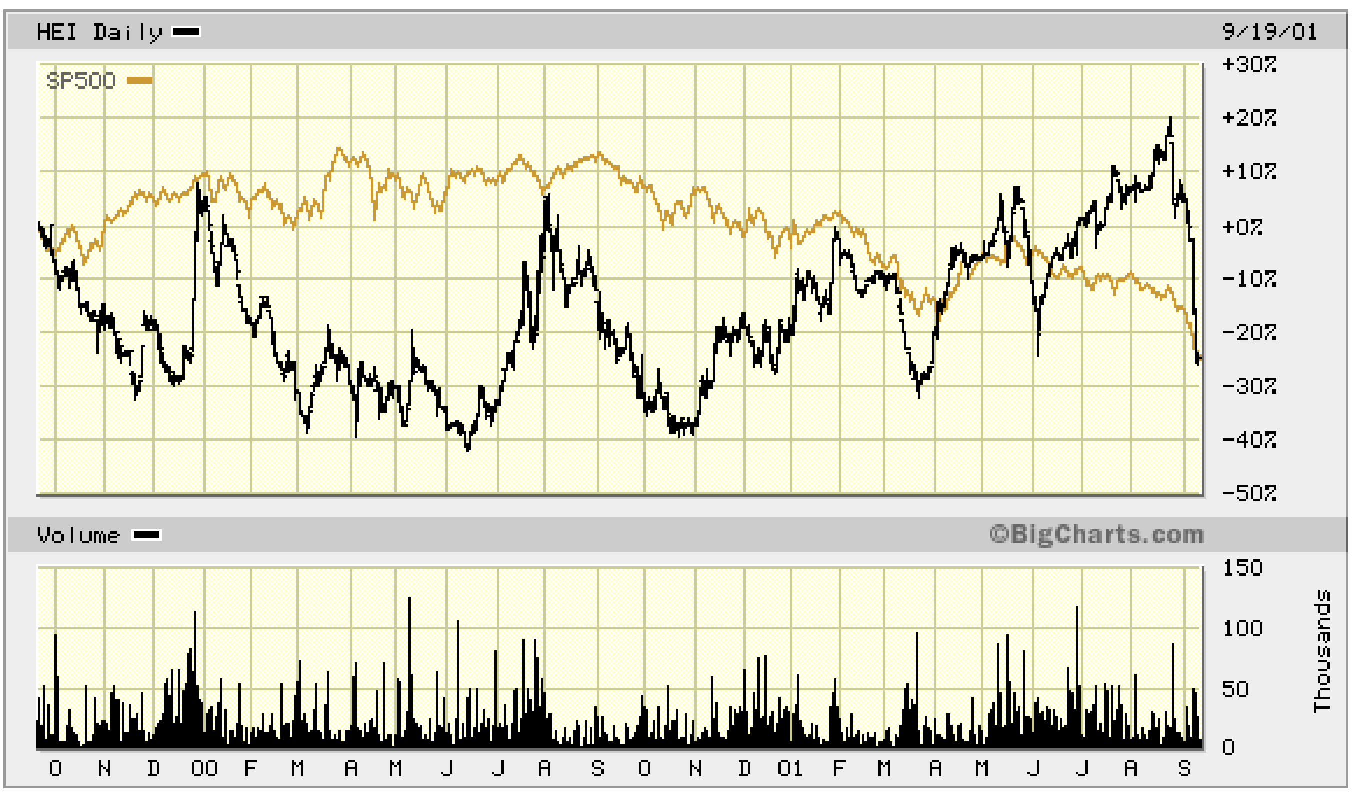
Over the past five years, HEICO's monthly returns have had low correlations with the returns of other M.A. Wright holdings in the Industrial Sector (0.13 to 0.24)

Investment Summary

Decision	Buy
Number of Shares	300
Maximum Purchase Price	$14.50
Target Price	$16.00
Stop Price	$8.00

One Year Price History

Two Year Price History
vs. S& P 5000



Heico Corporation
Annual Earnings Model
Fiscal Year Ended: October

(In millions except for percentages and per share data)

	FY 1996	FY1997	FY1998	FY1999	FY2000	FY2001E	FY2002E
Revenue	$34.6	$63.7	$95.4	$141.3	$202.9	$174.1	$163.8
% Change Yr/Yr		84.2%	49.7%	48.2%	43.6%	-14.2%	-5.9%
Total Cost of Goods Sold	22.4	43.0	59.2	83.7	127.1	99.7	96.0
Gross Profit	**12.2**	**20.6**	**36.1**	**57.5**	**75.8**	**74.4**	**67.8**
% Sales	35.2%	32.4%	37.9%	40.7%	37.4%	42.7%	41.4%
SG&A	7.7	11.5	17.1	24.7	36.6	39.7	34.9
% sales	22.2%	18.1%	18.0%	17.5%	18.0%	22.8%	21.3%
Other					1.3		
Operating Income	**4.5**	**9.1**	**19.0**	**32.8**	**37.9**	**34.7**	**32.9**
% Sales	13.1%	14.3%	19.9%	23.2%	18.7%	19.9%	20.1%
Interest Expense (Income) & Other	(0.9)	(1.2)	(1.1)	1.3	4.7	0.5	0.9
Gain on Sale of Product Line					17.3		
Pretax Income	**5.4**	**10.4**	**20.0**	**31.5**	**50.5**	**34.2**	**32.0**
% Sales	15.6%	16.3%	21.0%	22.3%	24.9%	19.6%	19.5%
Taxes	1.7	3.3	6.9	11.6	19.5	13.0	12.3
Rate	31.9%	32.2%	34.5%	36.8%	38.6%	38.1%	38.5%
Minority Interest & Other	(6.2)		2.6	3.6	4.7	3.0	3.0
Net Income	**9.9**	**7.0**	**10.5**	**16.3**	**26.3**	**18.1**	**16.7**
EPS	**$0.74**	**$0.49**	**$0.61**	**$0.84**	**$1.32**	**$0.81**	**$0.74**
Shares	13.3	14.4	17.1	19.4	19.9	22.5	22.5

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M.A. Wright Fund, Rice University
September 19, 2001

Note: In the fourth quarter of FY 2000, HEICO sold Trilectron, a subsidiary of its Electronic Technologies Group. Excluding results from Trilectron, sales were approximately $104.7 MM and $152.8 MM in FY 1999 and FY 2000 respectively. Also excluding results from Trilectron, net income was approximately $15.7 MM and $17.7 MM in FY 1999 and FY 2000 respectively.

Heico Corporation
Quarterly Earnings Model
Fiscal Year Ended: October

(In millions except for percentages and per share data)

	FY 2000				FY 2001E				FY 2002E			
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4E**	**Q1E**	**Q2E**	**Q3E**	**Q4E**
Revenue	$47.9	$53.5	$53.9	$47.5	$39.7	$41.7	$43.8	$48.8	$37.60	$39.70	$41.70	$44.80
% Change Yr/Yr	69.9%	63.6%	51.5%	6.2%	-17.3%	-22.0%	-18.7%	2.8%	-5.2%	-4.9%	-4.9%	-8.3%
% Change Sequential	7.2%	11.7%	0.7%	-11.9%	-16.5%	5.3%	5.0%	11.4%	-23.0%	5.6%	5.0%	7.4%
Cost of Goods Sold	30.1	33.9	34.2	28.9	22.6	23.4	25.8	27.9	21.8	23.3	24.6	26.3
Gross Profit	**17.9**	**19.7**	**19.7**	**18.6**	**17.0**	**18.4**	**18.0**	**20.9**	**15.8**	**16.4**	**17.1**	**18.5**
% Sales	37.3%	36.8%	36.5%	39.1%	43.0%	44.0%	41.2%	42.9%	41.9%	41.3%	41.1%	41.3%
SG&A	8.8	9.1	9.3	n.a.	9.2	10.0	10.0	10.6	8.0	8.4	9.0	9.4
% sales	18.3%	17.0%	17.3%	n.a.	23.1%	23.9%	22.7%	21.7%	21.4%	21.1%	21.6%	21.1%
Operating Income	**9.1**	**10.6**	**10.3**	**n.a.**	**7.9**	**8.4**	**8.1**	**10.3**	**7.7**	**8.0**	**8.1**	**9.1**
% Sales	19.0%	19.7%	19.2%	n.a.	19.8%	20.1%	18.4%	21.2%	20.5%	20.2%	19.5%	20.2%
Interest Expense (Income) & Other	1.0	1.3	1.4	n.a	0.2	(0.6)	0.5	0.3	0.3	0.2	0.1	0.3
Pretax Income	**8.1**	**9.3**	**8.9**	**14.2**	**7.6**	**9.0**	**7.6**	**10.0**	**7.4**	**7.8**	**8.0**	**8.8**
% Sales	16.9%	17.4%	16.6%	29.9%	19.2%	21.4%	17.3%	20.6%	19.7%	19.7%	19.3%	19.6%
Taxes	3.2	3.6	3.4	9.4	3.0	3.5	2.8	3.8	2.8	3.0	3.1	3.4
Rate	39.0%	38.6%	37.9%	66.0%	38.7%	38.9%	37.0%	37.7%	37.9%	38.4%	38.7%	38.9%
Minority Interest & Other	0.9	0.9	0.8	0.7	0.8	0.7	0.8	0.8	0.7	0.7	0.8	0.8
Net Income	**4.0**	**4.8**	**4.7**	**12.8**	**3.9**	**4.8**	**4.0**	**5.5**	**3.9**	**4.1**	**4.1**	**4.6**
ex-Sale of Product Line				2.2								
EPS	**$0.20**	**$0.27**	**$0.24**	**$0.71**	**$0.20**	**$0.24**	**$0.18**	**$0.24**	**$0.17**	**$0.18**	**$0.18**	**$0.20**
ex-Sale EPS				$0.12								
Shares	20.0	18.1	19.8	18.0	19.9	20.1	22.5	22.5	22.5	22.5	22.5	22.5

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Heico Corporation
Annual Balance Sheet Model
Fiscal Year Ended: October

(In millions except for percentages and per share data)

	FY1997	FY1998	FY1999	FY2000	FY2001E	FY2002E
Cash	24.2	8.6	6.0	4.8	5.2	9.7
Accounts Receivable	12.6	19.4	35.3	29.6	30.6	32.1
Inventories	18.4	24.3	45.2	34.4	43.5	42.7
Other	2.6	5.8	4.1	17.9	8.1	8.7
Current Assets	**57.7**	**58.2**	**90.6**	**86.7**	**87.4**	**93.2**
Property, Plant, & Equipment	8.5	14.8	28.3	26.9	29.3	33.5
Net Intangible Assets	13.3	54.0	143.6	152.8	167.0	170.1
Long-Term Investments			3.2	5.8		
Other	8.7	6.1	7.4	9.6	7.1	7.3
Total Assets	**88.2**	**133.1**	**273.2**	**281.7**	**290.9**	**304.1**
Accounts Payable	4.2	6.2	11.1	5.0	6.1	5.2
Accrued Expenses	6.7	10.4	15.3	17.9	14.5	13.4
Other	1.7	1.0	0.9	8.3	0.6	0.4
Total Current Liabilities	**12.6**	**17.6**	**27.3**	**31.2**	**21.1**	**19.0**
Long-Term Debt	10.5	30.1	73.0	40.0	38.0	36.0
Other	2.4	2.8	3.6	7.3	7.6	7.2
Minority Interest	3.3	14.9	30.0	33.4	36.2	37.2
Shareholders' Equity	59.4	67.6	139.3	169.8	188.0	204.7
Total Liabilities and Equity	**88.2**	**133.1**	**273.2**	**281.7**	**290.9**	**304.1**
Book Value	$4.48	$4.69	$8.15	$8.75	$9.69	$10.28

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Heico Corporation
Annual Cash Flow Model
Fiscal Year Ended: October

(In millions except for percentages and per share data)

	FY1996	FY1997	FY1998	FY1999	FY2000	FY2001E	FY2002E
Net Income	$9.9	$7.0	$10.5	$16.3	$26.3	$18.1	$16.7
Depreciation & Ammortizat	2.1	1.6	2.8	6.3	9.8	10.2	10.5
Minority Interest			2.6	3.6	3.3	3.0	3.0
Other	(5.3)				(17.3)		
Cash Flow	**6.7**	**8.6**	**15.9**	**26.2**	**22.1**	**31.4**	**30.2**
Captial Expenditures	3.2	3.6	6.2	14.2	8.7	7.0	8.0
Free Cash Flow	**3.5**	**5.1**	**9.7**	**12.0**	**13.4**	**24.4**	**22.2**
Interest	(0.9)	(1.2)	(1.1)	1.3	4.7	0.5	0.9
Tax	1.7	3.3	6.9	11.6	19.5	13.0	12.3
EBITDA	**7.6**	**10.7**	**21.7**	**39.1**	**46.3**	**44.9**	**43.4**
CF / Share	$0.51	$0.60	$0.93	$1.35	$1.11	$1.39	$1.34
FCF / Share	$0.26	$0.35	$0.57	$0.62	$0.67	$1.08	$0.99
EBITDA / Share	$0.57	$0.74	$1.27	$2.01	$2.32	$1.99	$1.93

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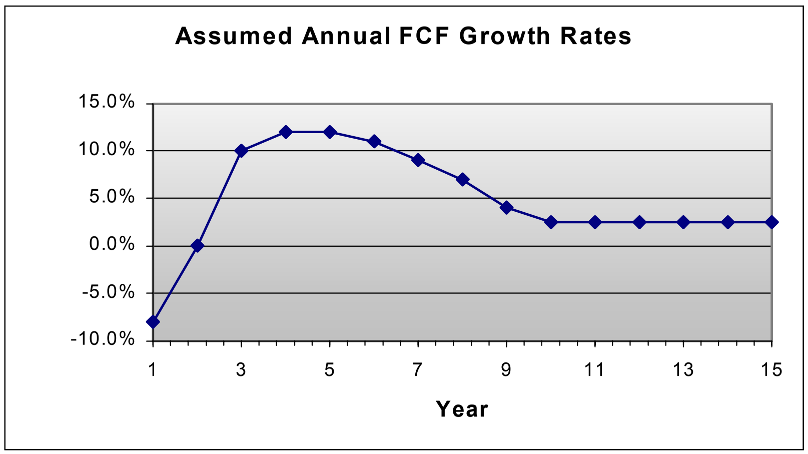
Heico Corporation
Discounted Cash Flow Model[1]
Fiscal Year Ended: October

Discount Rate	11.0%															
																Terminal Year
Year	0	1	2	3	4	**5**	6	7	8	9	**10**	11	12	13	14	**15**
Growth Rate	n.a.	-8.0%	0.0%	10.0%	12.0%	**12.0%**	11.0%	9.0%	7.0%	4.0%	**2.5%**	2.5%	2.5%	2.5%	2.5%	2.5%
FCF per Share	$1.08	0.99	0.99	1.09	1.22	**1.37**	1.52	1.66	1.77	1.85	**1.89**	1.94	1.99	2.04	2.09	**2.14**
PV of FCF	n.a.	$0.90	0.81	0.80	0.81	**0.81**	0.81	0.80	0.77	0.72	**0.67**	0.62	0.57	0.52	0.48	5.84
															Sum of PV's of CF's:	$15.93

Est. Fair Share Value $15.93



[1]Note: Yellow cells contain assumptions (inputs), green cells contian outputs.

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