M.A. WRIGHT FUND EQUITY RESEARCH

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Heico Corp. (NYSE: HEI)

Sell

September 27, 2001 **Industrial Sector** **Aerospace**

MARKET DATA

Price	$15.72
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	$353.7 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 participates in niche segments of the aerospace, defense, and electronics industries. Its customers include a majority of the world's major airliners 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 replacement parts, HEICO has challenged monopolies for these parts previously held by original equipment manufacturers (OEM's), offering them to airlines at substantial discounts. Because OEM's had previously sold these parts at exorbitant prices, however, HEICO has been able to underprice the OEM's 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.

REVISED OUTLOOK

- ❑ While HEICO remains an outstanding long-term opportunity, a clearer understanding of the airline industry's outlook for the coming 12 months along with a 20% increase in its share price have lead us to revise our position.

SUMMARY

- ❑ Since our first report, we have come across information that suggests the airline industry's decline will be worse than we had originally anticipated. One sign of this has come as numerous carriers such as Northwest and American have invoked "force majeure" provisions in their labor contracts, allowing them to eliminate jobs without providing the required notice, severance packages, or early-retirement incentives usually required to eliminate jobs. Our view has also been heavily influenced by a report released earlier this week which contains detailed estimates of demand for new aircraft and spare parts during next two years.
- ❑ We before thought that the introduction of additional products would partially offset the decrease in demand for existing products. We now believe that the drop in demand for all parts will overwhelm any increase in sales coming from the introduction of new replacement parts. We had also believed that increases in defense related sales would partially offset reduced engine replacement part sales. We believe increased sales from these products will also be insignificant compared to the drop in demand for aircraft replacement parts. Even if defense related sales increase substantially, they will probably not impact the income statement for a couple of quarters.

Sources: HEICO Financial Reports (10K's and 10Q's), *The Wall Street Journal, The Airline Monitor*, Bloomberg, BigCharts.com, Morningstar Principa Pro, *Market Musings* (A research publication by CL King & Associates)

REVISED OUTLOOK (CONT.)

- Our original report recommended HEICO when it was trading for approximately 14.7x FY2000 earnings (excluding the sale and operations of Trilectron) and we acquired it for 14.0x earnings. Since then, this multiple has increased to 17.6x. Coupled with our clearer understanding of the challenges HEICO will face in the coming year, this increase in its price has deteriorated its risk / reward profile.
- Despite HEICO's outstanding long-term prospects, we feel that a very difficult operating environment over the next 12 to 24 months will reduce net income significantly and this will in turn be reflected in its stock price. At $15.72, HEICO offers little margin of safety, especially when we think it could be re-acquired at a better price in the next 6 months.