

## Hawker Beechcraft (HBAC) — Special Situation BizJet Tailspin

Figure 1. Hawker Beechcraft — Debt Structure

Description	Coupon	Maturity	Outstanding	Price/ Yield	Rating	Recommendation
<b>Loans:</b>						
Term Loan B	L+200	3/14	\$1280	\$46.75/ 34.8%	Ba3/BB	Buy
<b>Bonds:</b>						
Senior Notes	8.5%	4/15	\$400	\$25.5/45.68%	B3/B-	Hold
Senior Pay-in-Kind Notes	8.875-9.625%	4/15	\$400	\$12.5/71%	B3/B-	Hold
Senior Subordinated Notes	9.75%	4/17	\$300	\$18.75/56.63%	Caa1/B-	Hold

Source: Beach Research and Company reports.

Figure 2. Hawker Beechcraft — Financial Ratio Highlight Estimates

	6/30/08	6/30/08 LTM	12/31/08
Pro Forma Adjusted EBITDA	\$180.1	\$509.5 <sup>a</sup>	\$338.6
EBITDA/ Interest	1.91x	2.70x	1.72x
EBITDA-Capital Expenditures/ Interest Expense	1.45x	2.05x <sup>b</sup>	1.26x
<b>Total Debt/EBITDA</b>		<b>4.69x</b>	<b>6.98x</b>

<sup>a</sup> Six-month interest annualized. <sup>b</sup> Six-month capital expenditures annualized. Cap Exp Capital expenditures. EBITDA Earnings before interest, taxes, depreciation and amortization. LTM Latest 12 months.

Source: Beach Research and Company reports.

### Investment Summary and Recommendation

#### Investment Summary:

In March 2007, Goldman Sachs Capital Partners and Onex Partners formed Hawker Beechcraft Acquisition, LLC (HBAC) to finance the purchase of Raytheon Corporation's general aviation operations. Total consideration was \$3,218 million, or approximately 10.1 times **\$318.6 million** 2007 *pro forma* EBITDA. (Utilizing June 30 LTM **adjusted pro forma** EBITDA of **\$509.5** million, the acquisition multiple would be **6.3 times**). Under the Hawker and Beech brands, HBAC is a leading manufacturer of business jets, turboprop and piston aircraft. Due to the general global prosperity of the last several years, general aviation had experienced consistent growth in worldwide demand. Since the March 2007 acquisition, HBAC's backlog has grown from \$3,937 million to \$7,600 million at year-end, in part due to the introduction of the Hawker 4000, a wholly new composite corporate jet. Recently, because of the significant economic downturn, as well as negative statements from the Congress regarding corporate jets — particularly related to the auto Industry and Citigroup bailouts — all of Hawker debt has been in a tailspin. The once impressive backlog is in question, although holding together as of the Company's March 3 conference call.

#### Investment Recommendation:

On March 23, the Company announced that Mr. Worth Boisture would be taking over as Chairman and President, effective immediately. Mr. Boisture served as the President of NetJets from 2003 to 2006. Prior to that, he served as President of Gulfstream Aerospace from 1999 to 2003, and acted as an Executive Vice President of Gulfstream for many years when it was a private company.

NetJets, the world's largest fractional corporate jet operator (a wholly owned subsidiary of Berkshire Hathaway) is Hawker's biggest customer, representing 34% of the Company's **\$7.4 million** backlog and 6% of second-quarter sales. The last detailed information regarding specific customers in the backlog was as of the second quarter. The Company did not provide detail in Hawker's more recent disclosures. As a slowdown in business aviation activity accelerates, NetJets **and others** may postpone or cancel some of their orders, placing pressure on production.

We expect further deterioration in the order book, and therefore would recommend purchase of the Senior Secured Term Loan now. At \$46.75, the L+200 Term Loan B has a yield to maturity of 34.8%, and as of year-end, with a market value of \$597 million, is covered by cash and inventories by 3.6 times, with the market value approximating 2.2 times our \$275 million conservative EBITDA estimated run rate. Some type of exchange offer is no doubt being considered, with unsecured debt trading as an option. Today, Hawker announced that it will elect the non-cash PIK option for interest payment on the 8.875-9.625% Senior Notes. The banks amended the bank agreement so that the Company can repurchase the Term Loan in the open market under certain conditions. We believe that the Company's excellent product line will see it through, although with a much lower production rate for the foreseeable future, as business aviation flight activity is slowing. A major out-of-court restructuring, or straight debt repurchase by the sponsors, should be considered.

### Recent Financial Performance and Announcements

On March 3, the Company hosted a conference call to review the 12-months ended December 31, 2008, reporting EBITDA of \$296.8 million, compared to \$316.8 million for the 12-months ended December 31, 2007. Adjusted EBITDA for 2008 was \$338.6 million, when acquisition add-backs were included.

During 2008, production was disrupted in August due to a four-week strike, which reduced deliveries of both business and military trainer aircraft. Also included in 2008 was a \$91.1 million charge associated with increased costs to confirm the new early production of Hawker 4000 units to final type design. Production that is more normal has been established and six units were delivered in 2008.

Because of the slowdown in business aviation, the Company announced a reduction of 500 workers in November, with an additional reduction of 2,300 workers by the end of 2009, for a 20% overall workforce reduction.

Hawker currently has adequate liquidity, with \$377.6 million in cash and \$347.9 million in revolving credit availability at year-end. The Company has a mere \$13 million in annual debt amortization through 2012. As mentioned earlier, Hawker amended its loan agreement, allowing it to purchase the Term Loan at a discount in the open market under certain conditions. The Company must announce the election of the 8.875% Senior Note PIK option by April 1, which would achieve a \$35.5 million current interest in cost savings.

### Risk Factors

#### *Positives:*

- **Market Position** — With more than 75 years of experience, the Company is one of the most respected manufacturers in general aviation. The Hawker and Beech product lines have a reputation for innovation, performance, quality and value. The Hawker 900XP and King Air product families and platforms are the best selling business jet and turboprop lines **in their categories**, respectively, in the history of general aviation.

- **Recurring Revenue from a Diverse Customer Base** — The Company sells aircraft to a diverse customer base comprised of corporations, fractional and charter operations, governments and individuals throughout the world. HBAC provides parts, maintenance and flight support services through an extensive network of service centers in 25 countries to an estimated fleet of 36,000 aircraft. In addition, the Company is the sole source provider of primary trainer aircraft to the US Air Force and Navy. Collectively, the customer support and trainer aircraft segments contributed 37% of first-quarter 2008 sales.
- **Moody's Ratings** — On February 5, 2009, Moody's downgrade the rating on the Company's Term Loan from Ba3 to B1, but retained the same recovery rating (LGD-2, 28%). The corporate family rating was moved to B3 from B2, with the Senior Notes moving from B3 to Caa1, and recovery (LGD-5, 74%) to (LGD-5, 77%0). "Moody's anticipates Hawker could generate positive free cash flow, and after modest capital expenditures and have material free cash flow, albeit at less robust levels." Moody's revised liquidity rating of SGL-2 designates good liquidity.
- **Technologically Advanced Product Line** — With the planned derivative upgrades to the Company's existing models, and its entry into the mid-sized jet segment with the Hawker 4000, HBAC is strongly positioned across all segments of general aviation. The Hawker 4000 is the Company's second carbon composite construction jet, after introducing the first smaller carbon composite jet, the Premier. The Company just announced the development of the Premier II. Carbon composite construction allows for greater interior space than other jets in the same class. As the aircraft is lighter than a standard aluminum structure, both maximum range and service ceiling are increased.

**Negatives:**

- **Cyclical Industry and Recent Negative Press** — The auto industry and major banks have encountered negative press and congressional criticism regarding their business jets and expenditures on luxury items while being recipients of Government assistance. General aviation has always been a cyclical industry, affected by the condition of the US and global economies. Aircraft are discretionary purchases, and general aviation's sales have historically been tied to corporate and consumer spending levels, which are cyclical in nature. During the past three years, general aviation has recorded consistent growth due to increasing fractional and charter demand, and increasing international demand for general aviation products. In the current economic environment, customers may delay delivery or cancel orders.
- **NetJets Backlog Concentration** — Currently, fractional and aircraft charter demand is softening in the US and Europe. NetJets, the largest global provider of these services, is HBAC's largest customer, contributing 6% of sales and 34% of the overall backlog at the end of the second quarter. Should NetJets experience a decline in demand, it may delay or cancel orders.
- **US Air Force and Navy Fixed-Rate Contracts** — For the three-months ended March 30, approximately 15% of sales came from fixed-rate US Government contracts. These contracts are only partially funded at the outset, and potentially can be terminated at the US Government's convenience, due to lack of funding, delays and so forth. Upon such a termination, HBAC would only be entitled to payment for work done to date, which would have an immediate impact upon financial performance, and make it difficult to obtain future contracts.
- **Major Competitors' Financial Strength** — HBAC currently competes with five major global aircraft producers: Cessna Aircraft, Bombardier Aerospace, Gulfstream Aerospace, Dassault Falcon Aerospace and Embraer Aircraft, most of which are part of larger, more diversified companies. The bigger size of these competitors, with potentially lower cost funding, will allow them to withstand a prolonged industry downturn more easily.

## Company Overview

Hawker Beechcraft Inc. is a leading designer and manufacturer of business jets, turboprops and piston aircraft, with \$3.4 billion in 2007 *pro forma* sales. The Company operates in the global general aviation industry, which has experienced strong growth since 2003, and reached sales of \$21.9 billion in 2007. The Company operates in three segments: 1) Business and General Aviation, which contributes approximately 65% of sales, and is engaged in the sale of new business and general aviation aircraft, 2) Trainer Aircraft, primarily producing trainers for the US Government, and 3) Customer Support, which services the 36,000 existing aircraft with parts and services, and contributes the remainder of sales.

## Capital Structure

In March 2007, Goldman Sacs Capital Partners and Onex Partners formed Hawker Beechcraft Acquisition, LLC (HBAC) to finance the purchase of Raytheon Corporation's general aviation operations. Total consideration was \$3,218 million or approximately 10.1x 2007 *pro forma* EBITDA. **The updated capitalization is shown in Figure 3 below.**

**Figure 3. Hawker Beechcraft — Capitalization, at 6/29/08 and 12/31/08**

	6/29/08	LTM \$509.5 MM <i>Pro Forma</i> Adjusted EBITDA	12/31/08	LTM \$338.6 MM <i>Pro Forma</i> Adjusted EBITDA
Revolving Credit Agreement (\$400 MM Available)	\$0		\$0	--
Synthetic LC (\$75 MM)	\$0		\$52.1	--
Term Loan B	\$1,287		\$1,277	--
<b>Total Senior Secured Debt</b>	<b>\$1,287</b>	<b>2.53x</b>	<b>\$1,329.1</b>	<b>3.93x</b>
Unsecured Supplier Credit	\$100.8	--	--	--
8.5% Senior Notes due 4/15	\$400	--	\$400	--
8.875-9.625% Senior Pay-in-Kind Notes	\$400	--	\$400	--
<b>Total Senior Notes</b>	<b>\$900.8</b>	<b>4.29x</b>	<b>--</b>	<b>6.29x</b>
9.75% Senior Subordinated Notes due 4/17	\$300	--	\$300	--
<b>Total Debt</b>	<b>\$2,487.8</b>	<b>4.88x</b>	<b>--</b>	<b>7.17x</b>
Equity	\$1009.3	--	\$449.7	--
<b>Total Capitalization</b>	<b>\$3,497.1</b>	<b>6.86x</b>	<b>\$2878.8</b>	<b>8.5x</b>

LTM Latest 12 months.

Source: Beach Research and Company reports.

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## Appendix I — UBS Aerospace Industry Publication

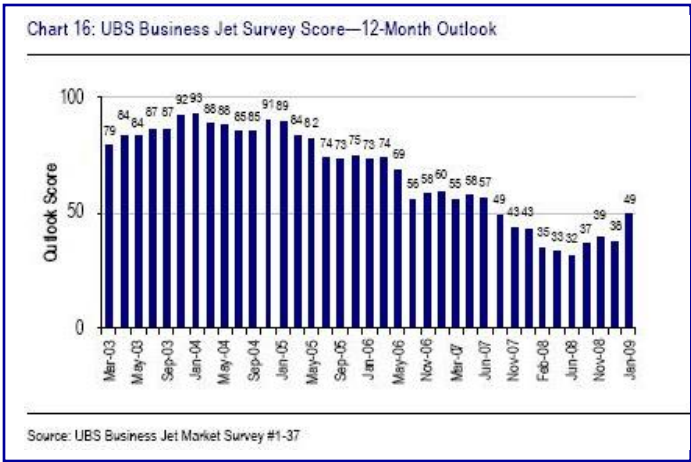
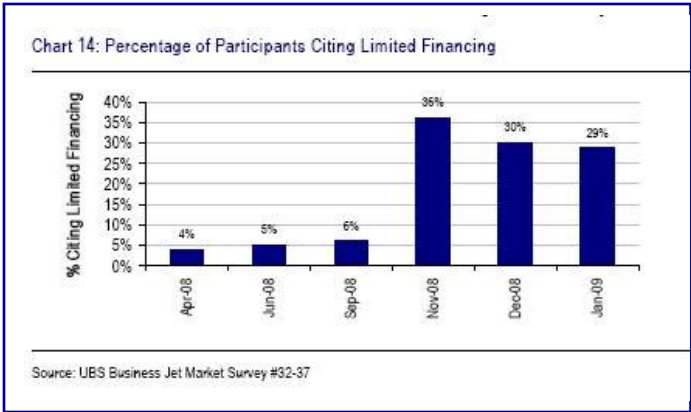
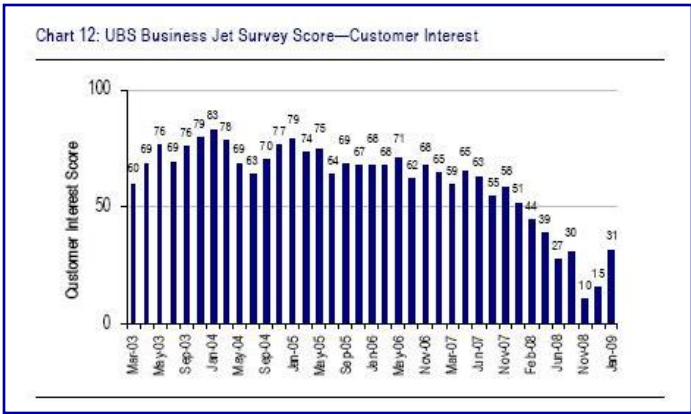
### **UBS Business Jet Monthly:**

The equity research department of UBS publishes **Business Jet Monthly**, one of the most important monitors of the industry. A summary of the March 16 edition outlines the state of the industry as follows:

- The **UBS Business Jet Index** indicates a severely depressed market, characterized by too much aircraft inventory, falling prices and tight financing.
- Used business jet inventories are climbing. Available jets for sale moved up 2% in February and are now 69% higher than last year, which was a historically active market.
- Inventories of young used jets (10 years or less) are on the rise.
- Business jet flight cycles (take offs and landings) declined 14% from the prior-12 months rolling average as of January, the last available FAA data. Short-range jets are down 17%, medium-range jets are down 11% and long-range jets down are 12 percent.
- UBS has lowered its 2009-12 business jet delivery forecast to account for continued weakness, which is still increasing due to used aircraft for sale and lower flight activity. The UBS forecast now reflects deliveries dropping to 550-600 aircraft in 2010, 44% lower than the previous 2008 peak.
- Still, the January **Business Jet Monthly** indicates a change in the market's outlook regarding customer Interest, financing availability and the overall 12-month outlook.

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**Appendix II — UBS Business Jet Index, as of 3/16/09**



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