RBC Bearings Incorporated

Highlights From William Blair’s 39th Annual Growth Stock Conference

- RBC Chairman, President, and Chief Executive Officer Dr. Michael J. Hartnett spoke to investors on June 6 at William Blair’s 39th Annual Growth Stock Conference. Highlights included: 1) with new aerospace capacity now in place, incremental production will help to drive sales well into 2020, 2) almost all of RBC’s Industrial end-markets remain healthy, led by growth in the global rail market, commercial space and satellites, mining, and material handling end-markets, 3) expanded production into industrial adjacencies remains a prominent growth opportunity in the mid-to longer term, 4) RBC continues to evaluate bolt-on acquisitions with revenues in the range of $50 million to $700 million, and 6) highly skilled labor remains a key issue for RBC and its ability to drive expansion into adjacent product lines.

- Fiscal 2020 (March 2020) is likely to be a very exciting year. RBC has completed 4 plant expansions and is starting up one new plant in Mexico that should collectively increase the company’s Aerospace capacity by ~15% or 200,000 square feet. RBC is sold out in calendar 2019 for its Aerospace business and has limited capacity for its Industrial business, where it is considering potentially expanding another plant in 2020.

- With the new capacity now in place, sales should begin to ramp as soon as aerospace OEMs approve of exacting production standards for several new manufacturing processes previously provided by third-party suppliers. However, the company has limited availability in its production schedule to take on additional orders through 2019.

- To facilitate its production capacity output, RBC expects to have certified and entered full production for processes it is bringing in-house, including metal plating, metal heat-treating, and its HVOF (high velocity oxygen fuel) coating capabilities to apply ceramic coatings on key components to reduce corrosion resistance and extend performance life.

- By the second half of fiscal 2020, RBC expects its Aerospace sales to have finished working through recent supply chain bottlenecks that have been a major impediment to sales and that its recently expanded capacity should be operating at targeted capacity levels.

- Almost all RBC's Industrial end-markets remain healthy; though after two years of very robust recovery, oil and gas, semiconductor, agricultural, and construction equipment growth have now plateaued. However, RBC is experiencing strong growth in the global rail market, commercial space and satellites, mining, and material handling end-markets.

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• RBC’s core strategy is to expand content on its existing platforms, capture positions on new platforms, and develop new retrofit products that offer as much as four times the functional service life for approximately twice the price of inferior products with shorter lives. As retrofit product sales continue to grow, RBC’s dependence on ISM and capital spending is expected to gradually diminish. RBC focuses on the 20% of its products that generate 80% of sales.

• RBC typically operates under a 3- to 10-year product development cycle, however long-term contractual agreements (~5 to 7 years in length) ensure stable revenues and allow management to focus on margin improvement over that contract. Approximately 60% of RBC’s revenues are generated through contracts where RBC operates as the sole source provider.

• RBC never wants to ship its products to customers off the factory floor but rather always from inventory. That way it ensures it can continue its exceptional 15-year record for 100% on-time delivery and 100% quality. RBC once a year runs a manufacturing symposium at its headquarters in Oxford, Connecticut, to present the best ideas for automation and quality. This has been the force multiplier for RBC’s accelerated rollout of automation across the company since 2016. By the end of fiscal 2020, RBC expects to have automated ~150 manufacturing cells and reduced its direct labor force by ~750 employees.

• Historically, RBC’s source of positive variance has come from better-than-expected gross margin rather than stronger than guided sales. However, with significant new aerospace capacity coming on line and customer demand extremely elevated, we sense future quarterly upside is likely to come from both gross margin and incrementally stronger sales.

• Normally, RBC targets about 100 basis points of gross margin improvement. However, given costs in the first half of fiscal 2020 from in-sourcing new critical production processes and ramping up new capacity, the company anticipates that gross margin year-over-year improvement in fiscal 2020 is likely to be nearer 50 basis points.

• RBC believes Aerospace sales should rise perhaps 10% in the first half and low-midteens during the second half of fiscal 2020, while Industrial sales should increase perhaps 4%-6%, skewed to the second half as submarine assembly for Block 5 production steadily rises (assuming the US PMI remains above 50).

• RBC is expanding production of bearing integrated structural components, fasteners, engine seals and hydraulic actuators. The company’s CEO is particularly optimistic about the potential for new products for the commercial space sector, including rocket and satellite manufacturers, for products such as guidance components and actuators, rocket engine turbo pumps and communication satellites. He noted an explosion in demand for disposable communication satellites is very close at hand.

• As fiscal 2020 progresses, new production processes are expected to secure approval and steadily ramp up throughout fiscal 2020. RBC has expanded its capacity for several new critical processing facilities to help alleviate supply chain constraints.

• When brought in-house, the cost of the new material treatment and production processes is expected to fall by 50% and be able to be completed much more quickly (a few days rather than several weeks) at RBC’s newly expanded production facilities as cross-country shipment for interim production processes will now be able to be eliminated.

• Orders have been building at an accelerating rate, reflecting the launch of new RBC products, higher military and commercial aerospace production, positive reception to newly redesigned retrofit products for existing industrial installed base that use bearings, and supply chain constraints that generate rising requests for assistance from smaller suppliers. A growing portion of RBC’s orders never make it into backlog but are now coming through an internet portal from customers directly from major OEM customers. 9.1%

• Previously delayed but now approved production and procurement authorization for the previously anticipated second Virginia-class submarine in the U.S. fiscal 2019 budget (beginning October 1, 2018) will delay a step up to two Virginia-class submarines until the U.S. fiscal 2020 year begins (October 1, 2019).

• RBC’s content on the current Virginia-class submarine being built is about $11 million annually, though increased content should lift this to ~$13 million per submarine (or about $26 million annually) beginning with RBC’s third quarter (December 2019) in fiscal 2020.
RBC anticipates its industrial core sales growth (which include Navy sales) is still likely to expand about 4%-6% in fiscal 2020, reflecting the ramp up of Virginia Class submarines as Block 5 production accelerates. This should add about $7 million-$8 million of additional submarine sales during the second half of fiscal 2020, when production of two Virginia-class submarines starts October 1, 2019. RBC’s Defense sales remain on track to sequentially accelerate beginning in late fiscal 2019, principally driven by a 30% increase in F-35 production for the U.S. government’s fiscal 2020 year beginning October 1, 2019.

RBC continues to evaluate possible acquisitions and appears to be close to finalizing some small product line additions while continuing to assess potentially larger ($0.5 billion-$0.75 billion) transformational acquisitions similar to Sargent Aerospace. Furthermore, the company has announced a $100 million share repurchase program and we estimate, has current financial flexibility in excess of $0.8 billion, without jeopardizing the company’s investment grade debt rating.

RBC’s CEO noted he does not feel constrained by the lack of managerial resources to consider additional acquisitions despite rapidly rising production rates. We believe that management’s willingness to consider additional acquisitions indicates it remains confident it can meet accelerating aerospace sales growth in fiscal 2020.

The company also continues to steadily expand deployment of its internally designed collaborative robots, which is now beginning to materially benefit its gross margins while ensuring it can fully leverage its workforce to efficiently achieve higher output. RBC expects to double the number of manufacturing cells shifted to collaborative robotic manufacturing in fiscal 2020 to approximately 250 cells from about 130 cells at the end of fiscal 2019.

RBC Bearings conservatively believes it will achieve 10% organic sales growth in fiscal 2020, though we increasingly sense this could now prove conservative, depending on the timing of securing OEM certification for new manufacturing processes now brought in house. RBC’s very strong outlook now appears likely to extend well into the next decade to its fiscal 2022 year.

We expect RBC will benefit from several positive growth drivers over its next three fiscal years: steadily rising new commercial aircraft as well as defense production in fiscal 2020 and fiscal 2021, more moderate midsingle-digit industrial end-market growth (still aided from market share outgrowth from newly designed new OEM and retrofit products), improving cost and sales synergies from bringing in-house previously outsourced production processes, accelerated deployment of low-cost in-house designed collaborative robots across all its production facilities, and steadily declining cash interest expense from rapidly declining net debt.

We reiterate our Outperform rating and believe shares are currently undervalued, assuming the company trades at its two-year average FY1 absolute P/E of 30.5 times our fiscal 2020 adjusted EPS estimate of $5.45. Once RBC’s reported and organic sales growth return to double-digit levels in the second half of its fiscal 2020 year, we anticipate shares are likely to trade modestly above the stock’s two-year average FY2 absolute P/E of 26.6 times our preliminary fiscal 2021 adjusted EPS estimate of $6.30.

These potential valuations could prove conservative if the company were to announce a large strategic acquisition. For instance, we estimate a $0.5 billion acquisition could add as much as $1.00 per share to RBC’s EPS within three years after being completed, roughly equal to 15%-20% of our current fiscal 2020 EPS forecast of $5.45.

RBC Bearings’ gross margin should continue to improve over the next couple quarters (with the first quarter of fiscal 2020 likely stronger than the second) and then begin to materially expand beginning in the second half of fiscal 2020 as its reported sales growth returns to moderate to solid double-digit year-over-year growth.

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<th>RBC Bearings Absolute Average PE Ratios</th>
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<td>FY1</td>
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<td>FY2</td>
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Source: Factset
This will be driven by accelerating absolute and organic sales volume, positive sales mix, increasing market outgrowth from new products as well as rapidly expanding automation of prime and secondary finishing operations. In short, RBC continues to offer the an exceptional array of potential sources for fundamental upside while being optimally-positioned to benefit from moderate capital spending expansion and steadily rising strong growth in commercial aircraft production and defense spending.

Estimates, Valuation, and Risks

We reiterate our Outperform rating and believe shares are currently undervalued, assuming the company trades at its two-year average FY1 absolute P/E of 30.5 times our fiscal 2020 adjusted EPS estimate of $5.45. Once RBC’s reported and organic sales growth returns to double-digit levels in the second half of its fiscal 2020 year, we anticipate shares are likely to trade modestly above the stock’s two-year average FY2 absolute P/E of 26.6 times our preliminary fiscal 2021 adjusted EPS estimate of $6.30. We believe the slightly higher valuation is warranted based on the exceptional potential for the company to inorganically enhance its robust organic outlook. For instance, we estimate a $0.5 billion acquisition could add as much as $1.00 per share to RBC’s EPS within three years after being completed, roughly equal to 15%-20% of our current fiscal 2020 EPS forecast of $5.85.

While the vast majority of the adjustments to RBC’s near-term sales outlook essentially defer the pace of the majority of its previously expected sales increase by 2-3 quarters until the second half of the company’s fiscal 2020, RBC’s very strong outlook now appears likely to extend well into the next decade to fiscal 2022. We still expect RBC to benefit from several positive growth drivers: steadily rising new commercial aircraft as well as defense production in fiscal 2020 and fiscal 2021, more moderate midterm-digit industrial end-market growth (still aided from market share outgrowth from newly designed new OEM and retrofit products), improving cost and sales synergies from bringing in-house previously outsourced production processes, accelerated deployment of low-cost in-house designed collaborative robots across all its production facilities and steadily declining cash interest expense from rapidly declining net debt. We believe a higher valuation for RBC Bearings is warranted following its transition over the next 2-3 quarters to return to strong double-digit reported and organic growth (now likely to extend well into next decade) as well as the company’s increasingly exceptional financial flexibility to consider additional likely highly cash flow and earnings accretive acquisitions. We also strongly believe RBC Bearings’ gross margins are likely to meaningfully improve starting in the second half of fiscal 2020 and continue throughout 2021 from favorable sales volume, positive sales mix, increasing market outgrowth from new products, as well as rapidly expanding automation of prime and secondary finishing operations. In short, RBC continues to offer the widest array of potential sources for fundamental upside while being optimally positioned to benefit from rising capital spending and higher commercial aircraft production and defense spending. Furthermore, RBC is very well positioned to supplement its growth with another potentially transformational acquisition, given that we estimate a net debt of approximately $0 at year-end fiscal 2019. If RBC was able to secure another transformational acquisition similar to that of Sargent aerospace, we estimate that if could add another $1 per share to its adjusted EPS over subsequent three years after closing.

While the sharp recovery in RBC’s industrial end-markets underway over the past 24 months is now beginning to moderate, we expect they will continue to grow at midsingle-digit rates for the next few years. Beginning in the second half of fiscal 2020, RBC’s commercial aerospace sales are expected to materially accelerate following completion of several facility expansions and the ramp up of production processes now being brought in-house that were previously outsourced. Commercial aerospace production and defense procurement sales are all expected to steadily expand beginning in the second half of fiscal 2020. RBC will begin delivering components for the B777X starting in early fiscal 2020, reflecting increases currently expected in B777X production 2019 with new model deliveries starting in early 2020. Commercial aerospace is expected to remain a strong source of positive future growth over the rest of the decade and into the first part of the 2020s due to higher planned new commercial aircraft built rates for narrow body aircraft as well as the introduction of new wide body platforms and major wins on new narrow-body platforms expected to enter production over the next several quarters. End-market demand is expected to be steadily supplemented by market share gains on new products. Expanded defense production for new fighter aircraft such as the F-35, new missile systems, and military transport and trucks should also be a source of expanded defense OEM sales. Higher production of existing and new military submarines is expected to be a source of growth early next decade for RBC’s industrial OEM sales. RBC Bearings remains optimistic that it can expand its market share on key new and existing commercial aircraft platforms, which should thus enable moderate continued growth for its commercial aerospace business while its aftermarket commercial aerospace and defense business steadily expands due to larger number of existing aircraft entering overhaul and modernization.
Near-term the largest risk to the company's outlook is the ability to overcome supply chain disruptions and constraints as it seeks to increase its aerospace production output by 15%-20% throughout the first half of fiscal 2020. Another potential risk over the next few years is the impact of continuing consolidation within the commercial aerospace sector the rising influence of customer such as Airbus and Boeing. This has resulted in structural changes in commercial aftermarket aerospace parts distribution, requests for more aggressive price reductions, as well as shorter order to delivery lead-times by commercial aerospace manufacturers. Amazingly, RBC has not been impacted by any of these factors so far because of the myriad number of ways it is able to help its largest customers in very unique ways. RBC's senior management also believes this more challenging environment for the commercial aerospace industry should begin to normalize over the next few quarters and finally beginning in the second half of its fiscal 2020, should provide RBC the opportunity to expand its market share and secure incremental business. While oil and gas and mining capital spending have begun to moderate after the earlier recovery in energy prices has corrected since mid-2018, if commodity prices were to reverse and begin to rise, these end-markets could potentially return to stronger growth. For now, the primary driver of RBC's growth beginning in the second half of its fiscal 2020 year is expected to be led by a return to double-digit expansion in its commercial aerospace and defense business, which accounts for approximately 62% of its sales.
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<thead>
<tr>
<th>Period</th>
<th>FY11</th>
<th>FY12</th>
<th>FY13</th>
<th>FY14</th>
<th>FY15</th>
<th>FY16</th>
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<th>FY18</th>
<th>FY19</th>
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<th>3Q20E</th>
<th>4Q20E</th>
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<td>115,021</td>
<td>115,806</td>
<td>128,702</td>
<td>112,039</td>
<td>109,483</td>
<td>31,413</td>
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<td><strong>Y/Y Change</strong></td>
<td>30.2%</td>
<td>25.1%</td>
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<td>0.7%</td>
<td>11.1%</td>
<td>12.6%</td>
<td>2.3%</td>
<td>9.4%</td>
<td>14.5%</td>
<td>7.9%</td>
<td>9.0%</td>
<td>8.9%</td>
<td>9.0%</td>
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<td>233,099</td>
<td>230,168</td>
<td>270,524</td>
<td>277,000</td>
<td>67,653</td>
<td>72,792</td>
<td>69,764</td>
<td>81,899</td>
<td>296,708</td>
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<td><strong>Y/Y Change</strong></td>
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<td>18.6%</td>
<td>7.9%</td>
<td>3.3%</td>
<td>3.2%</td>
<td>17.5%</td>
<td>2.6%</td>
<td>3.1%</td>
<td>5.2%</td>
<td>6.0%</td>
<td>12.8%</td>
<td>6.8%</td>
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<td><strong>Ball Bearings</strong></td>
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<td>41,366</td>
<td>49,555</td>
<td>56,464</td>
<td>53,650</td>
<td>56,448</td>
<td>15,780</td>
<td>16,480</td>
<td>16,496</td>
<td>19,050</td>
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<td>13.8%</td>
<td>6.0%</td>
<td>8.9%</td>
<td>15.1%</td>
<td>13.1%</td>
<td>20.4%</td>
<td>16.7%</td>
<td>16.0%</td>
<td>14.5%</td>
<td>8.5%</td>
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<td>29,944</td>
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<td><strong>Y/Y Change</strong></td>
<td>25.1%</td>
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<td>1.7%</td>
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<td>4.5%</td>
<td>8.5%</td>
<td>3.4%</td>
<td>14.0%</td>
<td>17.4%</td>
<td>1.6%</td>
<td>5.1%</td>
<td>1.2%</td>
<td>6.5%</td>
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<td><strong>Total Revenue</strong></td>
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<td>397,511</td>
<td>420,051</td>
<td>418,866</td>
<td>454,278</td>
<td>397,472</td>
<td>615,388</td>
<td>163,897</td>
<td>164,317</td>
<td>166,858</td>
<td>179,877</td>
<td>674,949</td>
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<td><strong>FY16</strong></td>
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<td>275,138</td>
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<td>385,792</td>
<td>101,968</td>
<td>102,399</td>
<td>102,086</td>
<td>110,046</td>
<td>416,519</td>
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<td>20,840</td>
<td>38,676</td>
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<td>12,064</td>
<td>37,324</td>
<td>52,946</td>
<td>31,902</td>
<td>32,178</td>
<td>32,485</td>
<td>33,868</td>
<td>38,345</td>
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<td>32,284</td>
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<td>37,388</td>
<td>57,945</td>
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<td>FY2010</td>
<td>75,104</td>
<td>34,200</td>
<td>71,512</td>
<td>31,686</td>
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<td>30,684</td>
<td>67,762</td>
<td>29,393</td>
<td>65,992</td>
<td>31,192</td>
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**Notes:**
- All figures are in millions of dollars, except per-share data.
- Fiscal Year End: March 31st.
- FY2010—2020E includes estimates for fiscal years 2020 and beyond.

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**RBC Bearings, Inc. Summary Financial Statements Fiscal 2010—2020E**

**(Dollars in 000s, except per share data, March Fiscal Year End)**

**CASH FLOW**

**Sources**
- Net Income: 24,385
- Depreciation: 10,497
- Excess tax benefits from deferred comp: 87
- Deferred income taxes: 1,082
- Amortization of intangible assets: 1,333
- Amortization of deferred financing costs: 203
- Stock-based compensation: 5,162
- Gain on disposition or sale of assets: 200
- Loss on early extinguishment of debt: 31
- Other: (203)
- Total Sources: 11,501

**Uses**
- Net Capital Spending: 175,941
- Dividends: 30,500
- Acquisitions: 1,943
- Net Equity: 550
- Other: (7,059)
- Total Uses: 202,215

**Change in Cash**
- (5,166)

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**CAPITALIZATION**

**Short-Term Debt**
- 3,453

**Long-Term Debt**
- 37,000

**Equity**
- 330,567

**Total Capitalization**
- 322,000

**Cash & Equivalents**
- 21,389

**3 Yr Avg Cash Return to Shareholders**
- 2.3%

**Net Debt**
- 31,192

**Net Debt/EBITDA**
- 3.8

**Total ROE**
- 7.5%

**Average ROC**
- 8.2%

**Free Cash Flow**
- 31,347

**EBITDA**
- 55,952

**EBITDA Margin**
- 18.4%

**EBITDA/share**
- 53,734
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DOW JONES: 25539.60
S&P 500: 2826.15
NASDAQ: 7575.48

Additional information is available upon request.

Current Rating Distribution (as of June 6, 2019):

<table>
<thead>
<tr>
<th>Coverage Universe</th>
<th>Percent</th>
<th>Inv. Banking Relationships *</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outperform (Buy)</td>
<td>66</td>
<td>Outperform (Buy)</td>
<td>16</td>
</tr>
<tr>
<td>Market Perform (Hold)</td>
<td>32</td>
<td>Market Perform (Hold)</td>
<td>8</td>
</tr>
<tr>
<td>Underperform (Sell)</td>
<td>1</td>
<td>Underperform (Sell)</td>
<td>0</td>
</tr>
</tbody>
</table>

*Percentage of companies in each rating category that are investment banking clients, defined as companies for which William Blair has received compensation for investment banking services within the past 12 months.

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