

Aerospace & Defense

Spring 2009

Shifting Industry Landscape

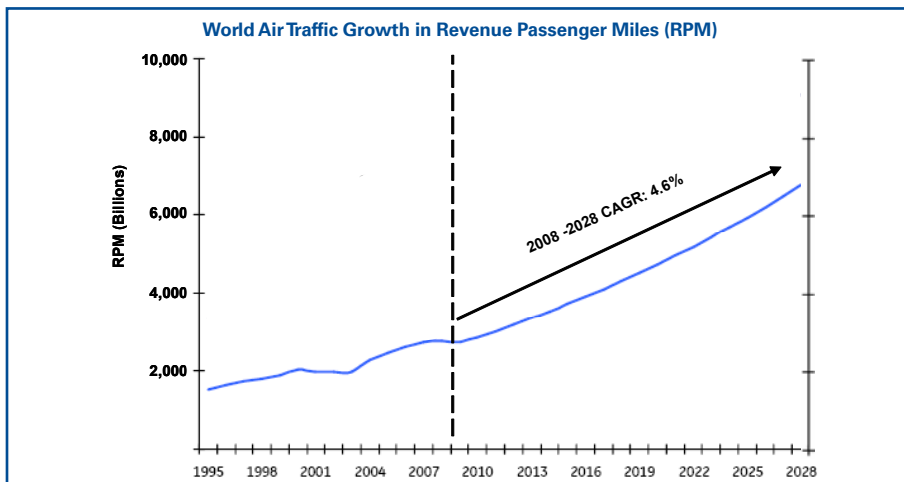
Market Dynamics

The year 2009 will present a period of changes and adaptation for the Aerospace & Defense (A&D) Industry. The global economy continues to slow, consumer confidence is at a record low, and the financing environment has shown little sign of improvement. The commercial aerospace market has been impacted by a decrease in global air traffic, and the U.S. Department of Defense (DoD) is poised to make sweeping changes. Amid these shifts, prudent steps can help companies preserve continued viability while the long-term dynamics for aerospace and defense companies remain attractive with growth opportunities in a number of submarkets, emerging technologies, and continued potential for a strong backlog.

Commercial Aerospace

In 2008, U.S. aerospace industry sales grew 2 percent to a record high. During this period, Boeing's backlog grew 6.9 percent to US\$295.1 million and Airbus gained 13.5 percent to US\$275.2 million. While new orders fell 14 percent, they exceeded shipments by approximately 20 percent.¹ Despite the cautious investment environment in 2009, the Aerospace Industries Association (AIA) expects commercial sales to increase 7 percent in 2009. While commercial air traffic experienced a severe decrease between November 2008 and January 2009 on a global basis, over the long term, Global Insight forecasts revenue passenger miles (RPM) will grow at a compound annual growth rate of 4.6 percent from 2008 to

2028. Similarly, Boeing projects a continued annual growth rate of 5 percent in air travel² and Airbus remains confident that air traffic will double in the next 15 years.³ The compelling dynamics of the aerospace industry are supported by a strong backlog (Boeing and Airbus had a combined backlog of over US\$570 billion at the end of 2008); new and more efficient planes, adoption of composites; growth in maintenance, repair, and overhaul (MRO) services; and simplification of the supply chain. Grounding older, less efficient aircrafts and purchasing new airplanes offers airlines higher profitability achieved from lower fuel burn and longer maintenance intervals.³ Composites have seen rapid adoption by the aerospace industry and account for up to 50 percent of content in new-generation planes.⁴ This has spurred M&A activity in the sector with aerospace and component manufacturers and private equity firms actively seeking acquisitions. The MRO sector saw over 50 M&A transactions in the last three years as companies look to add service capabilities. Component manufacturers also have recently seen M&A activity as suppliers look to consolidate supply chains and increase product offerings.



Source: Global Insight

¹ Aerospace Industries Association.

² Boeing's current market outlook 2008-2027.

³ Airbus Product Development Update, March 10, 2009.

⁴ Composites World, May 1, 2005.

Department of Defense Spending

The U.S. DoD is proposing a drastic shift in defense programs. Robert Gates, the secretary of Defense, has proposed a 2010 DoD budget of US\$534 billion, an increase of 4 percent from 2009. The new budget calls for a watershed shift from ambitious high-tech weapons to programs for today's warfare needs such as unmanned drones and heavy armored vehicles. Some of the key points of the proposal are highlighted in the table below.

Positioning for the Future

Given the precarious nature of the economy, many industry analysts view it as crucial that aerospace and defense companies take strategic steps to protect their businesses and take advantage of growth opportunities existing today and in the future.

Working capital management, cost optimization, as well as management

of supply chain and manufacturing facilities are critical to conserving cash, which is a priority for many companies. The lack of available debt to finance short-term cash needs and a drop in demand, creating excess supply and low capacity utilization, will force companies to maintain cash to weather the storm. Just in time inventory, alliances for partnering in product design with other suppliers, sharing product development costs, and human resource management are some of the steps companies can take to generate or preserve cash.

For example, in April 2009, Sikorsky Aerospace, a subsidiary of United Technologies Corp., announced a joint venture with MilSOFT CT to develop fleet management software tools. National Defense Business Institute at the University of Tennessee was established to research innovative solutions in acquisition and business

management programs.

With regard to human resource management, many of the major A&D companies have announced production cuts, personnel reductions, outsourcing plans, and reductions in compensation to conserve cash. Boeing and United Technologies announced 10,000 and 11,600 layoffs, respectively, in 2009. The European Aeronautic Defence and Space Company (EADS) announced plans to outsource US\$5 billion of aerospace components, systems, and software to India over the next 10 years.⁵

Securing long-term agreements can also provide the necessary pipeline to operate a business with a longer-term perspective. In February 2009, Pratt & Whitney signed a long-term agreement with Air Methods for helicopter engines. In January 2009, CIRCOR signed a long-term agreement with Cessna for check and release valves.

Restructuring can also allow companies to maintain focus on core businesses and reduce cash burn. Teleflex announced the sale of its ownership in Airfoil to GE aviation to reduce outstanding debt. Northrop Grumman announced a reorganization to reduce business sectors from seven to five.

Despite the current challenging environment, technology developments continue to offer robust growth opportunities, which have prompted a number of M&A transactions. Cyber-security is a key focus for the U.S. government, which will likely form a new cyber defense department and allocate US\$15 to US\$30 billion in the next five years.⁶ In anticipation of this new revenue stream, defense companies are quickly growing their competency in cyber-security via acquisitions. Raytheon acquired Oakley Networks and SI Government Solutions to boost its cyber capabilities. Similarly, BAE Systems

U.S. DoD 2010 Proposed Budget	
Losers	Winners
<ul style="list-style-type: none"> • Halt F-22 Raptor Fighter purchases from Lockheed Martin Corp. after delivery of 187 aircrafts • No additional orders of Boeing Co. C-17 transport planes beyond the existing 205 planned purchases • Cancel the US\$87 billion high-tech ground vehicle program, part of the Boeing and SAIC Inc.'s US\$200 billion Future Combat Systems program • Halt Lockheed-led program to build a new fleet of Presidential Marine One helicopters • Eliminate US\$26 billion Transformational Satellite program • Terminate Air-Force Combat Search and Rescue X helicopter program • Halt Navy's futuristic cruiser program and replace it with an existing destroyer design • Reduce the Missile Defense Agency budget by US\$1.4 billion 	<ul style="list-style-type: none"> • Increase spending on Lockheed Martin Corp.'s F-35 Lightning Fighter Jet from US\$6.8 billion in 2009 to US\$11.2 billion in 2010 • Appropriate approximately US\$2 billion in additional funding for intelligence, surveillance, and reconnaissance (ISR) programs, including fielding and sustaining 50 Predator-class unmanned aerial vehicle orbits by 2011, increasing manned ISR capabilities (e.g. turbo-prop aircraft), and additional R&D spend • Improve cyberspace capabilities including increasing the number of cyber experts trained annually from currently 80 per year to 250 per year by 2011 • An increase of 5 percent, or 2,800, special operations forces

Source: *The Wall Street Journal*, "Gates Unveils Overhaul of Weapons Priorities," April 6, 2009.

⁵ Wharton Aerospace & Defense report, November 20, 2008.

⁶ *The Wall Street Journal*, "Defense Firms Pursue Cyber-Security Work," March 18, 2009.

PLC bought Detica Group PLC, an information security firm, for US\$1.06 billion. Other technology sectors have also seen recent M&A activity. SAFRAN purchased Motorola's biometric business unit and CardBASE Technologies to bolster its portfolio of identification systems.

Conclusion

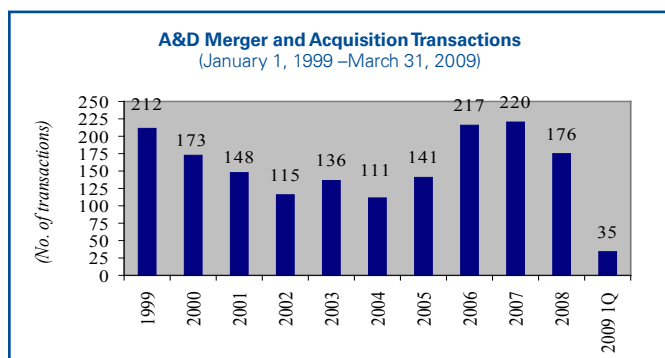
Amid the precarious economic environment, slowdown in air travel, and the new defense landscape, aerospace and defense companies need to adapt their strategy to weather the downturn and take advantage of new growth sectors. Managing cash by optimizing assets and growing core business lines while restructuring

noncore businesses will be important to helping ensure long-term viability. The ambiguity around the DoD priorities has mostly been lifted and new growth areas appear to be cyber-security and unmanned aerial vehicles. M&A activity will allow defense contractors to quickly add new capabilities to their arsenal. In addition to expanding product offerings, buyers can continue to utilize M&A as a tool to gain scale and offer increasingly integrated systems.

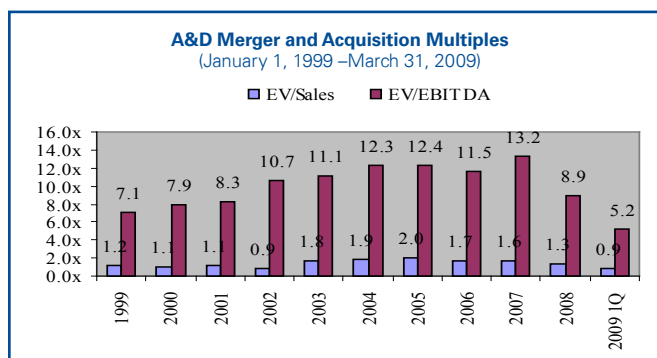
KPMG Corporate Finance

KPMG Corporate Finance is a full service, independent, middle-market investment bank with extensive experience in the A&D Industry. In the current economic climate and credit crisis, our Special

Situations Advisory Group (SSAG) is working closely with our A&D professionals to assist companies to evaluate a wide range of liquidity options. We understand the pros and cons of various financial and operational techniques for preserving and maximizing value as well as creating liquidity. We can customize an approach to best meet a business owner's needs. In these challenging times, business owners should seek objective advice from qualified professionals employed by a reputable firm. Our A&D and SSAG bankers would welcome the opportunity to meet with you on a confidential basis to learn more about your firm's strategic objectives, and help you explore all liquidity options available in the market today.



Source: Thomson Financial, company filings



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Market Snapshot												
Company	Market Cap ¹	Share Price ²	52-Week Low	52-Week High	Price % Change 1 Mo	Price % Change 1 Yr	Debt to TC	Price to BV	EV ³ /Sales	EV ³ /EBITDA ⁴		
NORTH AMERICA												
BARNES GROUP INC.	741.0	14.2	7.7	32.3	32.5%	-45.7%	45.8%	1.3x	0.9x	5.6x		
CURTISS-WRIGHT CORP.	1,445.6	32.0	22.6	56.1	14.0%	-32.7%	37.3%	1.7	1.0	7.0		
ESTERLINE TECHNOLOGIES CORP.	782.3	26.4	18.9	62.9	30.5%	-52.7%	33.0%	0.8	0.8	5.5		
GOODRICH CORP.	5,484.3	44.3	25.1	70.4	16.9%	-35.0%	44.9%	2.5	1.0	5.0		
HONEYWELL INTERNATIONAL INC.	23,215.5	31.2	23.1	63.0	12.0%	-47.5%	53.8%	3.2	0.8	6.6		
MAGELLAN AEROSPACE CORP.	16.7	0.9	0.2	5.8	187.5%	-80.5%	49.9%	0.1	0.4	4.6		
MOOG INC.	1,139.4	26.8	17.9	71.9	17.1%	-37.9%	44.2%	1.1	1.0	7.2		
PARKER HANNIFIN CORPORATION	7,286.2	45.4	27.7	86.9	33.5%	-43.2%	36.8%	1.6	0.8	5.5		
TRANSDIGM GROUP INCORPORATED	1,693.5	35.1	23.0	44.5	7.0%	-7.5%	66.8%	2.5	4.0	8.5		
TRIUMPH GROUP INC.	685.1	41.3	26.9	73.8	8.2%	-29.8%	33.2%	0.9	0.8	5.2		
WOODWARD GOVERNOR CO.	1,353.9	20.0	8.0	48.6	78.5%	-43.2%	39.8%	2.1	1.2	7.1		
North America Mean					39.8%	-41.4%	44.1%	1.6x	1.2x	6.1x		
North America Median					17.1%	-43.2%	44.2%	1.6x	0.9x	5.6x		
INTERNATIONAL												
BBA AVIATION PLC	648.7	1.6	0.6	2.4	32.7%	-49.6%	59.8%	1.0x	0.9x	6.8x		
MEGGITT PLC	1,779.4	2.7	1.6	4.6	45.2%	-54.6%	46.4%	0.9	1.9	8.1		
MTU AERO ENGINES HOLDING AG	1,649.1	33.8	17.1	41.7	44.2%	-26.4%	35.3%	2.0	0.6	3.7		
ROLLS ROYCE GROUP PLC	9,285.1	5.0	3.6	6.7	18.8%	-42.5%	34.8%	2.5	0.5	4.6		
SAFRAN SA	4,808.2	12.0	8.7	20.2	29.3%	-42.8%	36.8%	1.0	0.5	5.0		
SINGAPORE TECHNOLOGIES ENGINEERING	5,224.9	1.7	1.2	2.3	7.6%	-26.6%	34.5%	4.9	1.5	11.0		
International Mean					29.6%	-40.4%	41.3%	2.0x	1.0x	6.5x		
International Median					31.0%	-42.6%	36.0%	1.5x	0.7x	5.9x		
North America and International Mean					36.2%	-41.1%	43.1%	1.8x	1.1x	6.3x		
North America and International Median					29.3%	-42.8%	39.8%	1.6x	0.9x	5.6x		

Source: Capital IQ and company filings

- Market Capitalization amounts are in US\$ millions, based on closing Share Prices as of April 30, 2009.
- Market Capitalization and Share Prices are based on foreign exchange listed securities and converted to US\$
- Enterprise Value (EV) equals Market Capitalization plus Debt, Preferred Equity, and Minority Interest, minus Cash and Cash Equivalents.
- EBITDA equals Earnings Before Interest, Taxes, Depreciation, and Amortization.

Select Aerospace & Defense Transactions

- March 13, 2009 – U.S.-based **Triumph Group Inc.** acquired **Saygrove Defence & Aerospace Group, Ltd.** Based in the United Kingdom, Saygrove manufactures actuation and motor control solutions.
- March 7, 2009 – UK-based **BAE Systems PLC** signed a definitive agreement to acquire **Advanced Ceramics Research, Inc.** for US\$14.7 million. Based in Tucson, AZ, Advanced Ceramics Research manufactures small Unmanned Aircraft Systems and advanced ceramic materials.
- March 3, 2009 – U.S.-based private equity firm **Nogales Investors Management, LLC** acquired **DR Technologies, Inc.** for US\$28.6 million. Based in San Diego, CA, DR Technologies manufactures advanced composite structural products.
- January 30, 2009 – U.S.-based **Astronics Corp.** acquired **DME Corporation** for US\$50.6 million or 1.1x revenue. Based in Fort Lauderdale, FL, DME manufactures aviation and defense safety and test products.

Source: Capital IQ



Deal Announcement

KPMG Corporate Finance (UK and US), working with Steen Associates, Ltd. under a joint sales mandate, marketed Gardner Group Limited, a manufacturer and supplier of metallic aerospace details and subassemblies, through a controlled and competitive process. KPMG's role involved identifying suitable strategic and financial acquirers, negotiating the key terms of the transaction, and project managing the transaction to its successful conclusion. The sale process generated significant interest from a variety of buyers. The acquisition by the ultimate

buyer, Carlyle Europe Technology Partners, with the incumbent management team, reflects their interest in the opportunities to create value through the consolidation of a highly fragmented supply chain within the aerospace and defense industry, where medium- to long-term prospects remain strong for the key industry players.

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